

## Garment Exporter View on Letter of Credit



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### Abstract

Letter of credit is as 'documentary credit'. This can offer a guarantee to the seller that they will be paid, and the buyer can be sure that no payment will be made until they receive the goods. The main advantage of using a letter of credit is that it can give security to both the seller and the buyer. A letter of Credit is the Buyer's Banker's promise to the Bank of the Seller / Exporter that the bank will honor the Invoice presented by the Exporter on due date and make payment, provided that the Seller/Exporter has complied with all the requirements and conditions set by the Importer mentioned in letter of credit or the Buyer's Purchase Order and produced documentary evidence to prove compliance, along with the necessary shipment related documentation.

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## 1. Introduction

Angbazo *et al.*, (1998), Letter of Credit has been a cornerstone of international trade dating back to the early 1900s. They continue to play a critical role in world trade today. For any company entering the international market, Duffee & Zhou (2001), Letter of Credit is an important payment mechanism which helps eliminate certain risks. International trade between an Exporter and Importer would entail multiple transactions in terms of documentation exchange, physical cargo movement, as well as settlement of payment which have to be clearly defined and setup in order to ensure smooth business transaction.

### Statement of the Problem

In international trade letter of credit plays an important role since the importer and exporter is unknown. It is necessary to know the behavior of exporters with regard to letter of credit. Hence this study aims to identify the exporters' view on letter of credit.

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### *Objective of the Study*

- 1) To study the garment exporter's view on letter of credit.
- 2) To know the importance of the letter of credit used in export and import trade
- 3) To analyze the reasons for preferring letter of credit

### *Scope of the Study*

Koppenhaver & Stover (1991), (1994), international trade refers to export and import of goods and services in exchange of foreign currency. Payments for exports are open risk faced by the exporter due to changes in political and economic policies. This risk can be overcome by the documentary credit. Among other methods of payment, letter of credit is mostly preferred by the exporter, since it is the most secured instrument available and it is less risky. The present study reveals to avoid the payment problem and to know the different types of L/C and the things under to bank for presentation.

### *Review of Literature*

Harfield & Ward (1974), stated that the L/C constitutes a contract between the issuing bank as promisor and the seller as promise, supported by consideration moving from the buyer in the form of an "indemnity" agreement to reimburse the issuer for drafts accepted or paid under the credit and to pay the issuer a commission for his services.

Luhar (2014), Letter of Credit have been a cornerstone of international trade dating back to the early 1900s. They continue to play a critical role in world trade today. For any company entering the international market, Letters of Credit are an important payment mechanism which helps eliminate certain risks.

## **2. Materials and Methods**

### *Tools for Analysis*

The following satisfaction tools are used in the study for the purpose of analysis.

### *Chi Square Test*

Kothari (2004), Chi-square test enables the researcher to find out whether the divergence between expected and actual frequencies is significant or not.

$$\text{Chi-square test} = \sum (O_{ij} - E_{ij})^2 / E_{ij}$$

### *Ranking Method*

Exporters' views are differing from one another. So the researcher has applied weighted score analysis for measuring the level of satisfaction. Here weights "score" given by individual respondents.

- 1<sup>st</sup> rank – 4<sup>th</sup> scores
- 2<sup>nd</sup> rank – 3<sup>rd</sup> scores
- 3<sup>rd</sup> rank – 2<sup>nd</sup> scores
- 4<sup>th</sup> rank – 1<sup>st</sup> score

### *Limitations of the Study*

- a) The busy schedule of the exporters also makes the collection of information a difficult one.
- b) Time available for the study is not sufficient and it permits to collect data for a short period.
- c) The study is limited with Theni city

### 3. Results and Discussions

Table 1  
Chi – Square

YEAR OF EXPERIENCE \ PERSONS RESPONSIBLE	1-5 years	6 – 10 years	11-15 years	above 26 years	TOTAL
Exporter	8	19	1	15	43
Customs House Agent	1	0	12	3	16
Importer	3	10	14	5	32
Co-Exporter	5	3	1	0	9

Degrees of freedom = 9

Level of significance = 0.05

Table Chi- square Value = 16.9

Calculated Chi- square value= 50.135

Result = Rejected

The calculated value (50.135) is greater than the table value (16.9), hence the hypothesis is rejected and there is a significant association between year of experience and person responsible for preparing L/C.

Table 2  
Reason for Preferring Letter of Credit-Rank

S. No	Reason for Preferring l/c	I	II	III	IV	Weighted score	Rank
1	Minimize risk	148	75	40	18	281	IV
2	International trade	320	30	12	4	366	II
3	Availing bank finance	360	9	12	1	382	I
4	Secure form of payment	228	75	30	3	336	III

#### Findings of the Study

- Majority of the respondents have above 46 years of age.
- 48% of the respondents are professionals.
- Most of the respondents have an experience of 6 – 10 years
- The majority of the respondents (44%) belong to a partnership nature of concern
- 37% of the respondents earn on annual turnover above 5crores.

#### Suggestion of the Study

- Bank may scrutinize the documents properly to avoid the discrepancy made in letter of credit.
- The banks may reduce the charges of L/C, since it is high.
- Banks may lead to their customer (importer or exporter) in a better way to minimize the risk.
- The method of payment which is through letter of credit is lengthy and time consuming one. So RBI may take an initiative to overcome this problem.
- There is no prescribed format for letter of credit by RBI. So RBI may provide a common prescribed format of letter of credit and pay more attention in electronic bank service to their users.

#### 4. Conclusion

Letter of credit is very important instrument in the field of national and international trade. They provide security for the Importer, which he can ensure to get the goods and for the exporter, which he can ensure, he sends the goods and for the importer. Letter of credit also makes the transactions very smoothly. It gives the mechanism stability; especially from the Importer and the Exporter's perspective. For instance, there is little or no previous trading relationship among the parties; the letter of credit provides them to work with confidence and security. The exporters also concentrate more on that.

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##### *Statement of authorship*

The authors have a responsibility for the conception and design of the study. The authors have approved the final article.



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