Risk Management in Australian Manufacturing Exports: the Case of Letters of Credit to ASEAN

By
Roberto Bergami
B.Bus. (with Dist) (Victoria University, Melbourne), M.Ed. (Victoria University, Melbourne), M.Bus. (Res) (App Eco) (Victoria University, Melbourne)

This thesis is presented in fulfilment of the requirements of the degree of

DOCTOR OF PHILOSOPHY

School of Accounting and Finance
Faculty of Business and Law
Victoria University
Melbourne, Australia
March 2011

Abstract

One of the fundamental considerations for exporters in international trade transactions is the aspect of payment. In the context of financial risk management, Letters of Credit enable the exporter to substitute the credit risk of the buyer with that of his bank. The Letter of Credit is a conditional payment guarantee, relying on one hundred per cent documentary accuracy to trigger the payment. Less than one hundred per cent compliance means the loss of the payment guarantee. Non-compliance is a significant problem as, according to the International Chamber of Commerce, world-wide documentary discrepancy rates against Letter of Credit transactions have been estimated to be between sixty to seventy per cent. The mechanics of Letter of Credit transactions comprise a complex web of interactions between banks, traders and their service providers, providing a fertile ground for discrepancies and existing literature acknowledges this world-wide problem. In the UK, in 2000, losses were estimated to be AUD 305 million (£ 113) through non-compliant documents being presented under Letters of Credit – this amount did not include lost opportunities and cash flow problems. In the same year, a separate USA study of Letter of Credit transactions confirmed the high discrepancy rate, but also claimed that as long as buyers want the goods discrepancies did not translate into financial losses. The findings were refuted by others.

It is the potential loss of revenue caused by the mismanagement of risk that is foremost in this research. It is estimated that the annual value of Letter of Credit business for manufacturing exports to ASEAN is approximately AUD 3.5 billion, with losses estimated to be upwards of AUD 920 million. This research aims to assist in greater understanding of the usage of Letters of Credit and the dynamics that underpin these transactions leading to a greater understanding of the interactions between Australian exporters and ASEAN importers.

The thesis provides a literature review in three parts: historical developments of risk management approaches over the past two decades; Letters of credit in general; and an internal audit approach to internal controls relevant to Letter of Credit transactions to develop a risk theoretical management model.

Whilst there is abundant literature on Letters of Credit and error rates, there is a dearth of literature that focuses on the reasons for discrepancies and their effects,

particularly when viewed from the lens of exporters. The risks most relevant to this research are behavioural and process risks, as identified by McNamee (2000), as they give rise to a number of elements that are closely linked to the problems suspected to exist, viz: errors, omissions, delays, frauds, productivity losses and a dysfunctional work place.

The objectives of this qualitative research are to:

a. Investigate why the Letter of Credit is chosen and discover whether in this process enterprise risk management principles are adopted,
b. Investigate the level of Letter of Credit documentary discrepancy rates for Australian manufacturing exports to ASEAN countries, and compare these rates with existing literature,
c. Determine the factors contributing to this discrepancy and estimate their financial impact,
d. Suggest improvements for the future.

Ethics approval was obtained for data to be collected through voluntary written surveys administered to Australian exporters, banks and service providers. Furthermore, additional data were obtained through voluntary semi-structured interviews.

In relation to the objectives above it was found that

a. There is some evidence that ERM approaches are being pursued through the use of Letter of Credit templates;
b. Discrepancy rates appear to be about 26 %, and these are much lower than earlier ICC estimates;
c. The highest number of new exporters has been micro enterprises with little experience and expertise in Letter of Credit transactions and this lack of knowledge leaves these organisations exposed to financial losses through documentary discrepancies;
d. There is a requirement for training programs specifically related to risks involved in Letter of Credit transactions and the means available to reduce documentary risks following the suggestions of the Export Letter of Credit Business Risk Model.

Consequently, in the conclusion, one suggestion is for changes to specific government export assistance schemes to incorporate education on Letter of Credit transactions as a means to reduce financial losses.

Student Declaration

I, Roberto Bergami, declare that the PhD thesis entitled Risk Management in Australian Manufacturing Exports: the Case of Letters of Credit to ASEAN is no more than 100,000 words in length including quotes and exclusive of tables, figures, appendices, bibliography, references and footnotes. This thesis contains no material that has been submitted previously, in whole or in part, for the award of any other academic degree or diploma. Except where otherwise indicated, this thesis is my own work.

Signature

Date
22 March 2011

Acknowledgements

I dedicate my thesis to my family and thank them for all their support and encouragement and their gentle coaxing.

There are a number of people that I ought to thank but, in particular, two individuals stand out as they contributed significantly to the completion of this thesis.

Professor Robert Clift, my Principal Supervisor. Robert, or Bob, as he prefers to be called, is a tower of strength. Bob is a warm, wonderful human being who is very dedicated and passionate about his candidates. He provided me with guidance and support, and displayed a lot of patience when, due to work circumstances and ill health my progress, at times, slowed. He was always willing to listen, encouraged discussion and debate and was always very constructive with his feedback. Bob made himself available on a regular basis even after hours. He never put pressure on me as a candidate, rather he found a way to keep me focused and progress as best I could. Bob has been a wonderful mentor and I remember him saying that if a person was not changed through their PhD research, then the research was not worth it. The quest for my PhD has certainly taught me many things and I believe it has also instilled many positive changes, so thankyou to Bob.

Segu Zuhair, my Co-Supervisor. Segu was instrumental in assisting me with the data analysis and its interpretation and discussion. Segu is committed to helping his candidates and is very generous with his time. Segu's ability to listen to arguments and interpretation of data, and challenge where needed, was of great assistance. Segu was a excellent mentor for me, as I was trying to address the research questions through the data gathered via the surveys and the semi-structured interviews. Segu's clarity on data analysis and the suggestions he made ultimately resulted in my thesis being enhanced by his contribution, and for this I am grateful to Segu.

I also express my gratitude to the individual respondents that made this research possible by providing answers to the surveys and participating at the personal semi-structured interviews

Last, but not least, I thank the individuals from the banking, customs brokerage and freight forwarding sectors who provided me with valuable information about international trade activities.

List of Publications

Bergami, R 2010, 'A risk management approach for export letter of credit transactions', *The Vindobona Journal of International Commercial Law and Arbitration*, vol. 14, no. 2, pp. 165-174.

Bergami, R 2003, 'Discrepant documents and Letters of Credit - the bank's obligation under UCP 500', *The Vindobona Journal of International Commercial Law and Arbitration*, vol. 7, no. 1, pp. 105-120.

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1. Introduction

International trade is an essential aspect of global economic activity. The irresistible forces of globalisation have facilitated cross border trade by opening up economies and liberalising markets, providing new opportunities for exporters and importers alike. This has assisted in the formation of new industry clusters and niche markets in response to demands in different areas around the globe.

The liberalisation of economies and the whittling down of tariff barriers has also impacted production and business flows, resulting in greater demand for transport services as final products are often the results of components sourced from different areas of the world. Indeed, there has been a general trend to move production to lower labour-cost countries, especially in Asia, resulting in an increase in trade and also risk, particularly where marginalised economies are concerned. The expanding middle class in Asia, resulting from increased economic activity, is likely to cause increased demand for imported products, providing additional opportunities for Australian exporters. Against this background of opportunities there is also a number of risks, particularly as they relate to payment for goods supplied to a foreign buyer.

1.1 Background

International trade transactions are risky and complex and one of the fundamental considerations for exporters is the aspect of payment. It is generally accepted that there are four traditional methods of payment for exports. These methods are, in preference of security from the exporter’s point of view: Prepayment; Letter of Credit, Bills of Exchange and Open Account. Prepayment is only typically used where there is no trading history between traders and it is typically for small value consignments, as it simply poses too much risk on the importer. Open Account is typically used in long-established relationships, as the exporter has a risk exposure to payment delays and/or payment defaults. Bills of Exchange, although channelled through the banking system (without any payment undertaking from the banks), essentially in the form of a request for payment, do not provide payment security, as the exporter relies on the goodwill of the importer to agree to accept and pay the debt as due. Although Bills of Exchange offer greater security than Open Account, because the document are only released to the importer against payment or a promise to pay, the exporter has a risk exposure against importer default simply because there is no guarantee the importer will accept and pay. Bills of Exchange, from approximately the Middle Ages to World War I, enjoyed good popularity because, although not perfect, they did place a considerable amount of pressure on buyers to settle debts, to avoid having their reputations tarnished. It should be remembered that, by comparison, international trade was conducted by wealthy merchants, that comprised a relatively small proportion of the population and all knew each other, so reputation was highly important for business continuity. Early attempts to make buyers accountable for their debts through the use of Bill of Exchange were made by the maxim '*chi accetta paghi*' (the acceptor must pay), a principle that remains today. As international trade grew, the increasing difficulty for the exporter was ensuring payment would be forthcoming in a timely manner from foreign buyers, often total strangers, residing in physically distant different jurisdictions. Under these circumstances, payment enforceability may become problematic and resolution may prove to be expensive with no guarantee of beneficial outcomes. Not content with the Bill of Exchange as a secure form of payment, the Letter of Credit evolved as a payment option offering better foreign buyer credit options.

Letters of Credit, first codified after World War I, have been described "as the lifeblood of international commerce" (D'Arcy, Murray and Cleave 2000, p. 166) and they are considered to be the most popular financial instrument in international trade insofar as payment 'guarantee' is concerned. Indeed, recent estimates place Letter of Credit transactions in excess of USD 1 trillion per annum (Klein 2006), making this method of payment significant indeed.

Letters of Credit are subject to a specific set of rules devised by the International Chamber of Commerce (ICC). At the time the research was conducted, these rules were the Uniform Customs and Practice for Documentary Credits, 1993 Revision, ICC publication 500, commonly abbreviated to UCP 500. On 1 July 2007, a revised set of rules became effective – the Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC publication 600, commonly abbreviated to UCP 600. Although the thesis is based on the UCP 500 rules because these were the applicable rules in force at the time of designing the research, the new UCP 600 rules do not invalidate the thesis. The UCP 600 rules have not altered the implications for risk management. If the study were to be repeated today the conceptual framework, the list of variables and the questionnaire would still be relevant and able to be used without any modification.

It should be noted that a new set of delivery terms (Incoterms 2010) is to be introduced effective 1 January 2011, the text for which was only released by the International Chamber of Commerce in mid-October 2010. There will be an inevitable period of transition with current contracts due for delivery beyond 1 January 2011 using the existing Incoterms 2000 rules and new contracts formed post 1 January 2011 progressively incorporating the new Incoterms 2010 rules. The general risk profile of the new Incoterms 2010 does not substantively alter the risk position of traders, although in the transition period there is likely to be confusion and, therefore, added risk.

Letters of Credit are typically established by a bank (Issuing Bank) and provide an undertaking to pay the exporter (beneficiary), thereby substituting the credit risk of the buyer with that of the Issuing Bank. However, Letters of Credit are a conditional "payment guarantee" (AusIndustry 1996, p. 18), as the condition for payment assurance is one hundred percent documentary compliance with the terms and conditions appearing on the Letter of Credit. In essence, the Issuing Bank undertakes to buy the documents (representing the title to the goods) specified on the Letter of Credit from the beneficiary, provided they comply completely with the Letter of Credit requirements. Less than one hundred percent compliance means the loss of the 'payment guarantee'.

The mechanics of Letter of Credit transactions give rise to a complex web of interactions between banks and traders providing a fertile ground for discrepancies. Indeed, non-compliance is a significant risk as, according to the ICC, world-wide documentary discrepancy rates against Letter of Credit are between 60% to 70% (ICC Thailand 2002). These figures appear to be consistent with studies in the USA citing discrepancy rates of 73% (Mann 2000) and the UK, with 50% to 60% (SITPRO Ltd. 2003). The cost of discrepancies is not well researched and, therefore, difficult to establish, but in a study by SITPRO Ltd it was estimated "that in 2000 the UK lost £ 113 million through non-compliant documents being presented under Letters of Credit" (SITPRO Ltd. 2003, p. 2).

Where discrepancies cannot be resolved, the result may be financial losses to the exporter as a result of the Issuing Bank rejecting the documents. Financial losses incurred through documentary discrepancies is another area that lacks publicly available information. Earlier estimates suggest that in 1985, in the UK, the total of Letter of Credit business ‘gone wrong’ was five billion pounds annually (Moses 2003). From a risk management point of view these are significant issues.

It is known that exporters in Australia use Letters of Credit as a payment mechanism with foreign buyers. Official figures for the value of Letter of Credit business do not appear to be available in the public domain but industry sources estimate that approximately thirty percent of Australia’s international trade is subject to Letter of Credit payment arrangements.

In the context of Australia’s international trade flows, Asia has become increasingly important. The realisation of closer bilateral trade flows is evidenced by a number of Free Trade Agreements (FTA), especially in South East Asia, including ones with Singapore and Thailand, and scoping studies for future FTAs with China, as an example. The importance of ASEAN to Australia is underscored by the Australia New Zealand ASEAN Free Trade Agreement that became effective on 1 January 2010. Because of the increasing economic importance of the Asian region to Australia, this thesis focuses on manufacturing exports to the Association of South East Asian Nations (ASEAN). ASEAN comprises ten nations, viz: Brunei, Burma (Myanmar), Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand and Vietnam. Services exports are not included in the research as, typically, this type of export does not utilise Letter of Credit in the same context as trade in goods and, additionally, its risk profile is different to that of trade in goods.

Merchandise exports to ASEAN for 2006-07 were Australian dollars 184.8 billion, representing 11% of total export trade (Department of Foreign Affairs and Trade 2007). If the industry estimates on Letter of Credit value hold true for ASEAN merchandise export trade, then the estimated value is Australian dollars 55.44 billion and this is considered a value worthy of investigation from a risk management perspective.

It is the potential loss of revenue caused by the mismanagement of risk that is foremost in this research. It is intended that this research will assist in greater understanding of the usage of Letters of Credit as a method of payment and the choice of such payment method for export transactions from the Australian perspective. This research will contribute knowledge by expanding the understanding of the dynamics that underpin Letter of Credit transactions leading to a greater understanding of the interactions between Australian exporters and ASEAN importers and the risk cycle applicable to Letter of Credit business.

This area is worth researching because Letters of Credit account for a large proportion of trade in monetary terms and there is no evidence that a study like the one in this thesis has been conducted in Australia before.

ASEAN is highly relevant to this research because of the nature of L/C as an instrument of payment guarantee. The economies of ASEAN countries are less developed than Australia and it is generally accepted that there is an increased financial risk when dealing with less developed economies. The knowledge derived from this thesis enables a categorisation of the security of Letter of Credit business in the export cycle. Core to this research is the notion of the 'guarantee' of payment offered by the Letter of Credit mechanism and the consequential risk of financial losses as a result of bad business processes. According to McNamee (2000) errors, omission and delays are the result of incorrect processes, whereas behavioural risks are a result of dysfunctional work places. The exporter's risk is considered in accordance with a framework proposed by McNamee (2000) and a new framework of risk, specific to Letter of Credit business is proposed, based on an adaptation of McNamee's (2000) framework, with a view to providing possible solutions for existing problems. The identification, analysis, evaluation and treatment of risk are part of any risk management overview (Joint Technical Committee OB/7 - Risk Management, 1999).

Risk may be avoided by being shifted to another party or by implementing changes. The possible solutions for risk management encompass cost benefit analysis. The cost of reducing risk may be deemed uneconomic, may be a matter of judgement or the subject of risk reduction implementation measures. Because of the widespread use of Letters of Credit there is an opportunity to identify optimal business processes to avoid risk.

The aim of this research is to investigate the following questions:

- Why is the Letter of Credit used as a method of payment?
- Why do documentary discrepancies occur?
- What measures are put in place to prevent documentary discrepancies?
- What arrangements are put in place when problems arise?

These research questions will be addressed using the objectives outlined in the following section.

1.2 Objectives

Following from the research questions, the following objectives were formulated:

1. Determine the attributes of the firm that are associated with the error rate in Letter of Credit business;
2. Measure the magnitude of trade between Australian manufacturing exporters and ASEAN that is conducted by Letter of Credit and also the percentage of this trade in proportion to total trade to the same geographical area;
3. Establish the reasons for using Letter of Credit as the payment method of choice. This may link to the proposition that Letters of Credit are used as a risk management tool;
4. Measure the usage of different types of Letter of Credit;
5. Measure the magnitude and frequency of discrepancies, the amounts involved and the corrective measures to resolve any disputes:
   - why are these discrepancies allowed to occur?
   - what arrangements are put in place when problems arise?;
6. Estimate the level of bad debts incurred as a result of L/C discrepancies;
7. Determine the priority of attributes for export documentation employees;
8. Determine the level of training received internally/externally by employees;
9. Determine whether the exporting firm is exposed to foreign exchange currencies and how this risk is managed; and
10. Establish the frequency of discounting proceeds in order to generate cash flow in deferred payment arrangements.

The research aims to fill a gap in the current literature relevant to business processes under Letter of Credit transactions resulting in high discrepancy rates and potential financial loss. It appears that this area has not been well researched generally, and in particular, as stated before, this investigation has not been previously undertaken in Australia.

This research will be of benefit to some sectors of the business community. Being able to understand the reasons for the discrepancies and their risk effect will allow international trade facilitation agencies, such as government departments (for example, Austrade and Business Victoria), to clear problem areas as part of their strategy to foster successful export business. Academic institutions will also benefit from this research as it will provide a greater understanding of aspects of the export cycle and identify the reasons for the documentary discrepancies, resulting in appropriate education on these issues.

Credit insurance companies will benefit from this information and will be able to formulate strategies that may lead to lesser discrepancies and therefore a lessening of the financial risk they carry.

The banking industry will be able to focus more on exporters at risk that may be identified through the analysis of the data in this thesis.

Although this study specifically investigates Australian manufactured exports to ASEAN, the Letter of Credit is an international trade facilitation tool, governed by one set of uniform rules, and used in all continents around the globe for the sale of any type of good. Therefore, the findings from this research have a wider in-principle application to any type of international sale regardless of the type of good or the nation of residence of the trading parties.

1.3 Methodology

The methodology used for this research was to distribute written questionnaire surveys to exporters, banks and service providers in Australia, after approval was received from the Victoria University Human Research Ethics Committee. As there is little secondary data available in the public domain on the matters considered in this thesis, the primary approach is based on the survey questionnaires, distributed by mail-out during 2005-2006. The surveys incorporated the option for respondents to volunteer to participate at a semi-structured interview that was conducted personally at the respondent's premises in Melbourne and in other cities via telephone, during 2007.

1.4 Structure of the thesis

Chapter 2 provides a brief history of the development of trade finance instruments from the earliest days on record to the evolvement of Letters of Credit and their codification in 1933, the rules in existence at the time of the research in this thesis (UCP 500) and the introduction of new rules (UCP 600) in 2007 (that did not, however, substantially change the risk profile of this method of payment).

Chapter 3 provides a literature review in three parts. Part I provides a historical perspective on the development of risk management and considers literature that may be relevant to Letter of Credit transaction processes. Part II focuses on literature about Letter of Credit in general, and more specifically research on discrepancies – what are the contributing factors and mitigation processes. Part III considers an internal audit risk management approach framework (McNamee 2000) and proposes an adaptation of this framework more specific to Letter of Credit transactions.

Chapter 4 outlines the mechanics and operations of Letter of Credit transactions, highlighting the risk implications for exporters, focusing on the choice of delivery terms (Incoterms 2000) and the documentary discrepancies.

Chapter 5 lists the objectives of the research, as outlined above and describes the methodology for the selection and administration of the questionnaire surveys, as well as the semi-structured interviews.

Chapter 6 provides the analysis and discussion of the data gathered through the questionnaire surveys, supplemented with data from the semi-structured interviews and data from secondary sources. The analysis and discussion aims to address the objectives of the research as outlined in Chapter 5.

Chapter 7 provides the conclusions, including a statement on the limitations of this research, and makes a number of recommendations in relation to the findings of each of the objectives listed in Chapter 5. Finally, Chapter 7 discusses a number of theoretical implications through the lens of the new proposed framework of risk for Letter of Credit transactions and suggests areas of possible future research in this area of risk.

2. A Brief History of Trade Finance Instruments

This chapter contains a brief history of early financing instruments from their genesis to the Letter of Credit in order to provide the background and context leading to modern day usage of this instrument of trade finance.

2.1 Early Developments of Letters of Credit and Trade Facilitation

"A Letter of Credit is a complex, practical instrument whose governing principles have developed over time as a result of customary banking practice" (Kingman-Brundage and Schulz 1986 p. 66).

It is not clear as to when the Letter of Credit was first devised and its usage began (Ellinger 1970 p. 24). The first evidence of a financial instrument is in the form of "a clay tablet constituting an instrument payable to the bearer and promising repayment in produce of a loan in money" (Trimble 1948 p. 82) apparently dating to about 2100 B.C. (Pruessner 1928).

Ancient Egypt developed institutions that performed banking functions, including the issuance of documents similar to modern day usage (Mugasha 2003) and it is likely that this is where the Letter of Credit originated, although there is some argument on this point. The arguments put forward by Trimble have been refuted on the grounds that they "… do not appear to be conclusive. Moreover, none of them includes documentary evidence" (Ellinger 1970 p. 24). In a later publication, Ellinger's assertions are challenged:

> the basics of the system – financial accounts, drafts, contracts, letters of credit, credit money and other commercial practices involving international trade and finance – were mentioned by writings on clay tablets dating back to 3000 B.C. (Ferguson 1983 p. 381).

Furthermore, around 575 B.C. there is evidence that the Igibi Bank in Babylon was performing a role synonymous with that of modern day "buying agent" (Bruce 1998,p 2-1). Whilst the finer points of the argument about when, and where, the Letter of Credit was born may continue to be debated for some time yet, in the context of this thesis one of the important considerations is why they where devised and used. "It is likely that letters of credit were principally used to reduce the risk and weight of carrying money *in specie*" (Mugasha 2003 p. 38). The early use of letters of credit suggests that these instruments were issued by merchants for either own benefit or for the benefit of another and referred to as “open” or “uncovered” letters of credit. The “open” L/C has no documentary requirements for its operation, whereas the commercial L/C has documentary requirements making this type of L/C more akin to the modern day instrument (Ellinger 1970; Mugasha 2003).

The major risks involved in the transfer of cash from one place to another were the likelihood of physical loss in transit, through disaster, theft or other reasons. Although the true origin of coinage is unknown (Cameron 1993), coins were readily accepted as an alternative to the barter system that existed beforehand. The ancient Greek *trapezitai* (money changers) were among the first to issue letters of credit as means for people to avoid the risk of carrying cash during travel. The *trapezitai* thus transformed into nascent bankers. They would issue a letter to their correspondent with instructions for them to pay a specified sum, that sum having already been paid by the customer to the *trapezitai*. These letters therefore provided travellers with the flexibility of raising money in different places with minimum transit risk between the travelling destinations. Usage of these letters became more popular and their application diversified to such an extent that they were also used as a means of payment and by the fifth century B.C. these instruments were being used as L/C (Toutain 1968).

Quite apart from the risks involved in moving cash from one place to another, the transport risks of a consignment were of considerable importance in the early days of trade, in principle as much as they are now. The earliest form of transport was man himself, carrying whatever chattels he wanted on his back; this was followed by the use of pack animals; subsequently the two-wheeled cart, typically drawn by one or two asses or mules, came into existence (camels were not used until early Egyptian times); horses were largely used for military applications and their use in the carriage of goods did not take place until much later (Weber 1961). In ancient times there were no roads serving as commercial routes, making the journey more perilous, as one had to rely on navigational skills to get from one place to the other. Road journeys were slow and with little cargo security, the risks were high.

The transport of goods over water evolved from primitive efforts across rivers. “Not only in the Assyrian and Babylonian times were inflated goat skins used for the diagonal crossing of rivers, but even in the Mohammedian period, skin-bag boats dominated the river traffic" (Weber 1961 p. 153). Sea transportation evolved around coastal routes, but the boat structure, although small, remained clumsy with the requirements for ropes to hold the plank boats together to prevent their breaking apart (Weber 1961). The use of oars as a means of propulsion was common place and the early use of sails supplemented rather than replaced rowing. By about 3000 B.C., though, the Phoenicians had established themselves as the first specialised sailors and merchants, operating in the eastern end of the Mediterranean, serving as pharoahs' agents or contract merchants, virtually monopolising the commerce of Egypt, as there was no privately owned shipping in Egypt (Cameron 1993; Weber 1961). By contrast, privately owned shipping was common under the Phoenicians and Homeric Greeks (Weber 1961).

Much of the information about the legal requirements for trade in the early period has been lost. The *lex Rhodia de iactu*, which is the origin of the modern law of general average, "shows that a number of merchants were usually carried on a ship[1]. If goods had to be thrown overboard in a time of distress, the loss was born equally by the participants" (Weber 1961 p. 157). That trade by sea was affected by extraordinary risks can be seen in the institution of the sea loan, the *foenus nauticum*.

> The sea loan is mentioned in the Hammurabi Code in 2250BC. The sea loan represented an exchange of risk. This contract allowed an entrepreneur to purchase and equip a ship and the loan was repaid with interest only if the ship returned safe; otherwise the loan was forgiven. The sea loan is an example of a debt instrument used to finance maritime commerce. Such a loan is an example of a package of contracts including a debt contract and an insurance contract (McMinn, 1999).

The creditor to such a loan usually charged high interest rates – suggested to be as high as 30% and it was typical for a number of lenders to participate in the loan. The lenders were able to stipulate the course and duration of the ship's voyage and where the cargo

[1] It is not entirely clear why the merchants were on board the ships, as Weber does not provide any details. It is presumed that the merchants travelled with their cargo, so they could sell it at the various ports of call, but their presence may have served two other main purposes:
a. the witnessing and verification of the type and quantity of cargo jettisoned overboard, to maintain the safety of the ship and thereby allow the journey to continue. The law of general average demands that the loss of jettisoned cargo be made good by the others whose cargo was not sacrificed. It would therefore seem reasonable that a degree of accounting for the value of the sacrifice had to exist, otherwise dubious practices may have ensued; and
b. to overcome black market activities. For example, by claiming the goods had to be jettisoned when, in fact, they might be sold on the black market at any port of call during the voyage.

could be sold. The exercise of such financial power leads to the conclusion that the ship owners lacked capital (Weber 1961). Nevertheless, Greek shipping continued to grow with the expansion of the empire and merchant vessels had capacities of 250 tonnes and means of propulsion by sails, with oars used only in exceptional circumstances (Toutain 1968). The increased size of ships demanded infrastructure such as well equipped ports. The practice of beaching the boats high and dry was no longer an option with these new vessels. The expansion of this trade caused an expansion in the banking services as trade was being conducted in new and different places and values needed to be transferred between buyers and sellers. The banking system became well established during the Roman Empire, carried on by the *argentarri* (or *mensarii*).

> One of the functions of the *argentarri* was the *receptum argentarri*. The *receptum* was an informal guarantee where the *argentarri* as a banker committed himself to ensure that the person to whom the commitment was made would receive payment from the *argentarri* or a third party. The *receptum argentarri* was similar to the modern day Letter of Credit due to the abstraction from the underlying relationship in both instruments – the *receptum* was independent of the actual existence of the debt which the banker was undertaking to pay (Mugasha 2003 pp. 39-40).

It can therefore be observed that even in ancient trade, the risks associated with modern day trade share some common concerns. For example, the risks of carrying money and sea transport may be classified as hazards, however, such hazards are external to the organisation. From the financial risk point of view, the *receptum argentarri* of early trade provided for some 'guarantee' of payment and thus attempted to overcome aspects of process risks, such as delays and/or frauds. These risks form part of more recent risk management frameworks, such as the one devised by McNamee (2000), discussed in greater detail in Chapter 3, as part of the literature review. In this stage of early trade, though, the documentary Letter of Credit, as we know it today, was not yet in existence.

It seems that there is an historical gap in the reporting of usage of the Letter of Credit between the end of the Roman Empire and the Middle Ages (Trimble 1948) and this may be in part explained by events that occurred during this period.

> Coinage, bills of exchange and new modes of public finance were broadly transmitted through the expansion of the empires of Alexander and the Caesars. These ideas, carefully preserved by ecclesiastics during the barbarian invasions of the seventh through ninth centuries A. D.,

> again influenced Western thinking with the economic revival of the later Middle Ages. Economic recovery together with the formation of international trading linkages between Northern and Southern Europe gave rise to and was, in turn, facilitated by an expanding financial sector. A leading center for this development was the Italian city-states … Many of the practices emergent there were basic to what we know as modern international trade finance, including foreign exchange conversion, bills of exchange, specialised project financing, portfolio diversification and deposit acceptance (Baskin and Miranti 1997 p. 29).

Demand for credit was driven in part by the confusion of coinages that existed in western Europe at the time. Although the monetary denominations used the Carolingian system: the *libra* (pound), *solidus* (shilling) and *denarius* (pence), the actual values of these denominations varied widely. For example, the lira in Genova, Italy, had a different value to the Pisan or Milanese lira and a different value again to the French livre. These coins were money of account, as

> no actual coins of those values were struck until very late in the Middle Ages. … The most common coins of the eleventh and twelfth centuries were pennies: not only were these inconvenient for large payments, but were minted by different authorities – kings, dukes, counts, even abbeys – different sizes weights and silver contents" (Cameron 1993, p. 67).

Campsores, or money changers, therefore performed an important function, as they had to know the relative value of the different coins used in commerce and fairs and in the commercial cities. Many bankers had their early origins as money changers. We can observe that the *campsores* were exposed to risks in dealing with unstable currencies and their intimate knowledge of the different and relative values of each denomination was a unique skill developed in time through practice. In the McNamee model the *campsores* would have been exposed to errors, caused by applying the incorrect value to any particular denomination, as well as potential frauds, through the mixing of contents of precious metals. Currency stability was introduced into Europe in 1252 when the gold florin was issued in Florence. Genoa had issued its own coin just before the gold florin was released, but the Florentine currency proved more popular at that time. Genoa subsequently successfully minted ducats in 1284 and this currency proved popular particularly in the eastern Mediterranean. Although the florin and the ducat became accepted as stable currencies, demand for credit had already established itself as indispensable in commercial dealings. To satisfy demand for credit facilities, early primitive deposit banks were set up in Venice and Genoa. These establishments were intended as safe deposits but soon began to transfer money between accounts (under oral instructions) and also began to grant overdrafts to preferred customers, thus creating a new means of payment (Cameron 1993). The transfer of money under verbal instruction required a high degree of trust between bankers and depositors. These types of transaction carried inherent problems, such as errors, omissions and delays. It would appear that in the nascent stages of this type of banking records were certainly kept by the banker but not necessarily by the trader. This raises the questions of transparency and dispute settlement, where a discrepancy between what was owed, and claimed to be owed, arose.

As trade grew, the trading structures became more sophisticated and the early *commenda*, a sort of partnership, was supplanted by a new organisation, the *vera società* (true company). One of the advantages of this structure is that it comprised many partners and operated in many European cities, an early model of the modern day transnational company, perhaps. The Italians were very prolific in these sorts of arrangement and "from headquarters in Florence, Siena, Venice or Milan they could operate branches in places such as Bruges, London, Paris, Geneva and several other cities" (Cameron 1993, p. 66). The *vera società* engaged not only in commercial trade, often owning ships, wagons, mule trains or leased mineral concerns but frequently these organisations were heavily involved in banking matters as private bankers. Banking was largely a private market in those days and the *cambium*, or exchange letter - a device invented by the Arabs - was relied on to facilitate long-distance trade (Weber 1961). The proceeds on most trading fairs were on credit and any unsettled balances were carried to the next fair through a "letter of fair" or a sort of a bill of exchange (Cameron 1993).

Initially bills of exchange were devised for the commodity trade but their use was widened to be used purely as a financial instrument, regardless of type of trade they may cover. The bill of exchange in the Middle Ages consisted of two documents the *literae apertae* (open letters) and the *literae clausae* (closed letters). The open letters were subject to official witnessing, whereas the closed letters (also referred to as "drafts") were just ordinary letters. These early forms of bills of exchange evolved into the present bills, so much so that even in modern day trade the word "draft" is an alternative for bill of exchange (Weber 1961). Bills of exchange were used as an alternative to carrying money by handing these over to clearing houses and receiving net balances. It is apparent that the bill of exchange was predicated on the availability of external finance to keep the sell/buy cycle active. Typically the promise to pay appears to be invariably in the future, requiring the banker to take on the payment risk. For traders, the bill of exchange reduced the risk of physically carrying money between different places. As the bills were taken to a clearing house, the net balance was received without delay. The banker was required to have adequate sources of funds to discharge the presented bills and this necessitated the assumption of risk through the physical availability of money at the clearing house. In this trading environment, the bill of exchange appears to work closer to the modern day forfeiting arrangement, where the banker discounts the proceeds of the transaction by paying out a lesser sum immediately and subsequently carries the risk of recovering the funds from the paying party at a later stage, according to the rate of exchange at the time (Braudel 1981).

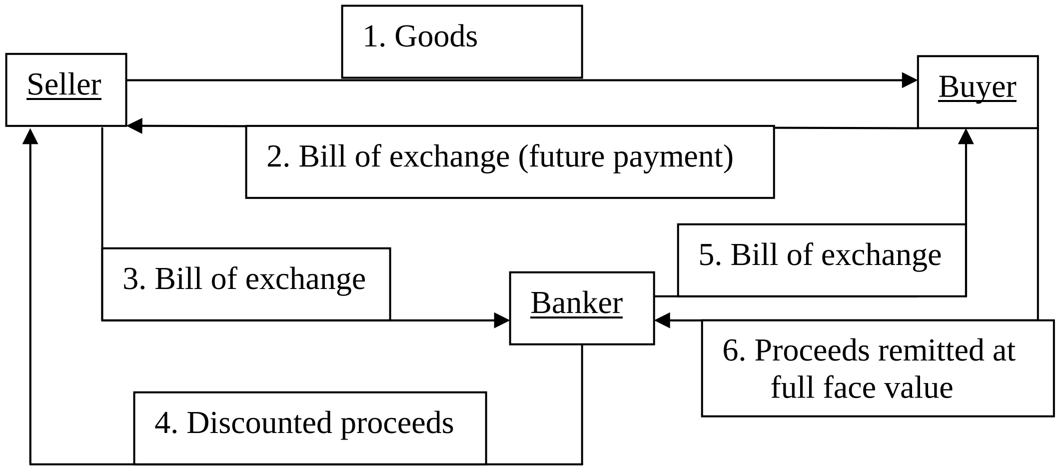
The banker in those days apparently assumed the risk on a without-recourse basis. The banker would then have been exposed to the risk of delays in payment, external hazards during times of military and civil unrest (making the task of reaching the payer difficult, if not impossible), leading to potential bad debts. The typical cycle of the Middle Ages bill of exchange for an ordinary transaction for the sale and purchase of goods at the local, but not at the international level, might have followed the path outlined in Figure 2.1.

It can be noted from Figure 2.1 that the banker's role was to advance finance to the seller and retain the risk of collecting future payables.

> The bills were only discount instruments in connection with which it was tacitly assumed that they would be liquidated through a deposit bank or a local merchant's association (Weber 1961, p. 197).

Presumably the banker was able to predict the default rate for such transactions and make adequate returns through the discounting of proceeds and fees charged for the exchange services provided. Indeed, it would not have been in the interest of the Middle Ages banker to encourage negotiability, because of the loss of exchange fees.

Figure 2.1: Possible bill of exchange cycle in the Middle Ages



It appears that Italian Renaissance bankers had, by the 1500's, developed sophisticated practices, for those days, in ensuring profitability when dealing with foreign bills of exchange. These bills were based on international trade within Europe. The exchange banker was able to realise a profit by exploiting the different rates of exchange between two places. The full impact of the bill of exchange trade is not apparent until the reverse operation or 'return' is considered.

The *res* of exchange was the object of the transaction and the *pretium* the price. These terms are the equivalent of the purchase-sale operation and may be referred to as 'certain' and 'moveable'. The exchange transactions were akin to modern day operations, where

> The city whose exchange is *res* quotes certain (for moveable in the other) and the city whose exchange money is *pretium* quotes moveable (for certain in the first) (Boyer-Xambeu, Deleplace and Gilard 1994, p. 83).

By virtue of the quotation of certain versus moveable, a quantity of *res* money (represented by *écu*) is equivalent to a variable quantity of *pretium* money (*maravedis*). This principle appears to have been well understood by the exchange banker of the time and an explanation of the cycle of the Renaissance bill of exchange from Florentine Bernardo Davanzati attests to this:

> If you (A) have money in Florence and want to transfer it to Lyons, because you can make a profitable return exchange, give me (B), who need[s] money, 64 *écus* in Florence, when the exchange rate reaches this

> level in exchange of which I promise to have a gold marc paid to Tommaso Sertini in Lyons. I give you a bill of exchange drawn on Salviati (C), you send it to Tommaso (D) to cash it and use it at its best advantage for a return exchange. The consignment letter is called 'notification' or *spaccio*. Tommaso (D) will obey your orders, he will pay your gold marc to Piero (E) in Lyons and receive from him a bill of exchange drawn on Federigo (F) in Florence, on which the latter has to pay you (A) 65 and a half *écus* in so many days. Tommaso will send you this exchange in return, and when it falls due, you will have gained 1 *écu* and a half. But you have to run the risk of three bankruptcies, mine, Tommaso's and Piero's. So you will have to search with Argus eyes to whom you can give money to exchange at the greatest advantage, to whom you can hand over your bill and through whom the return exchange will be carried out … The person who does not resort to the mediation of a banker should, once he has deducted the 1 ½ percent local charges, gain an average of 8 per cent interest a year (Boyer-Xambeu, Deleplace and Gilard 1994, p. 84).

The information above is not entirely clear. There is no specific mention of the purpose of the gold marc, so it is presumed that this is the 'discount fee' that B incurs for receiving the 64 *écus* in Florence now. The gold marc paid is not received by A, but rather paid to D who transfers this to E. Due to the timing of the events in these transactions, it would appear that each party stands to gain something from it, as follows.

- A gives to B 64 *écus* now and in return, if the transaction proceeds according to the above, will ultimately receive 65.5 *écus,* after being paid by F sometime later. Thus, A will, make a profit of 1.5 *écus*.
- B receives 64 *écus* now and agrees to pay D 1 gold marc at the appropriate time. B therefore has immediate access to funds that he would not otherwise have.
- C had an obligation to pay a bill of exchange and this is not altered by these transactions. Instead of paying A, C pays D.
- D receives a bill of exchange from A with instruction to cash this immediately in Lyons and use it to its best advantage to secure a return exchange. D also receives 1 gold marc from B that he uses to pay E to secure a (return) bill of exchange payable in Florence – this bill of exchange is drawn on F. As D has received 1 gold marc from B and paid 1 gold mark to E, his position is net. D's gain is what he can realise in the exchange of the original bill and the purchase of the new one (the return bill).

- E gains one gold marc for proving the return exchange to D – the return exchange is drawn on F and payable to A at a future predetermined date. E has advanced some money to F at a discounted rate, thereby acquiring a future promise to pay by F - this payment is realised in Florence in favour of A at a future predetermined date. E makes a profit by discounting the bill of exchange by advancing money to F.
- F gains by getting the money at an earlier time (cash flow), albeit a reduced sum due to the discounting.

Davanzati mentions the amount of interest that is to be made and calculates this to be about eight per cent per annum on the basis that "the outward gain after deducting the exchange fees amounts to about 2.2 per cent" (Boyer-Xambeu, Deleplace and Gilard 1994, p. 84). Given that these exchanges took place approximately four times a year, the interest earned equated to about eight per cent per annum. Even though Davanzati wrote about interest charges, the mechanism he describes for these bills of exchange was structured in such a way as to avoid 'interest on loans', by inventing a method enabling bankers to advance / procure money for "a small rate, which however does not look like usury" (Marx 1916, p. 611). The notion of charging interest on a loan was not an acceptable practice and regarded as *usury*. The church "prohibited usury for religious reasons" (Pirenne 1936, p. 121) and due to the influence exterted by the church during those times, "it would be wrong to assume that Medieval merchants disregarded and openly defied the canons of the church" (de Roover 1946, p. 154).

It was during the fourteenth century that the teachings of Saint Thomas Aquinas who "had condemned usury (and also foreign exchange)" (Boyer-Xambeu, Deleplace and Gilard 1994, p. 35) began to be challenged by influential people of the time, such as Henri de Gand and Alexander of Alexandria. The argument distinguished loans from bill of exchange contracts, as in a loan "the borrower returns the same thing, whereas with exchange someone else returns something else" (Boyer-Xambeu, Deleplace and Gilard 1994, p. 35), therefore, it was regarded as being "outside the prohibitions of canon law" (Usher 1934, p. 416).

Therefore, it appears that the imposition of a fee for changing money, such as at a bureau de change, was acceptable. As such, the exchange of money against a bill of exchange was tantamount to a change of money in different places with different values and so fees appeared to be acceptable, even though they may have been regarded as 'borderline' to charging interest and, therefore, *usury* (de Roover 1946). The literature points to different interpretations on the matter of what might have constituted *usury* or not at the time. As the definition or interpretation of *usury* in the 1500s is not a critical element to the thesis, no further analysis is provided.

In a diagrammatic form the bill of exchange transaction, earlier described by Davanzati, may have proceeded as shown in Figure 2.2. As these transactions were largely based on the trade fairs, that took place four times a year, it would have been possible for the return exchange to be undertaken on each occasion as, apparently, the common usance of the bill of exchange was about 25 days (Boyer-Xambeu, Deleplace and Gilard 1994). The slowness of communications meant that "even sight drafts were in effect time bills" (de Roover 1946, p. 154) with a usance of one to three months in different markets.

As can be observed there are six parties involved in this complex exchange mechanism. In the context of risk management, Davanzati is very clear about the dangers. The person starting the transaction (A), under these circumstances, runs the risk of being the victim of three bankruptcies and perhaps this underscores the importance of business relationships and the development and reliance on trust among traders and financiers alike. The issue of *bona fides (*good faith or trust) among merchants is paramount (Trakman 1980) and the spread of business relied on the "precondition of a spirit of mutual trust and a sense of honesty in business" (Cipolla 1980, p. 198) - a principle just as applicable today, as it was then.

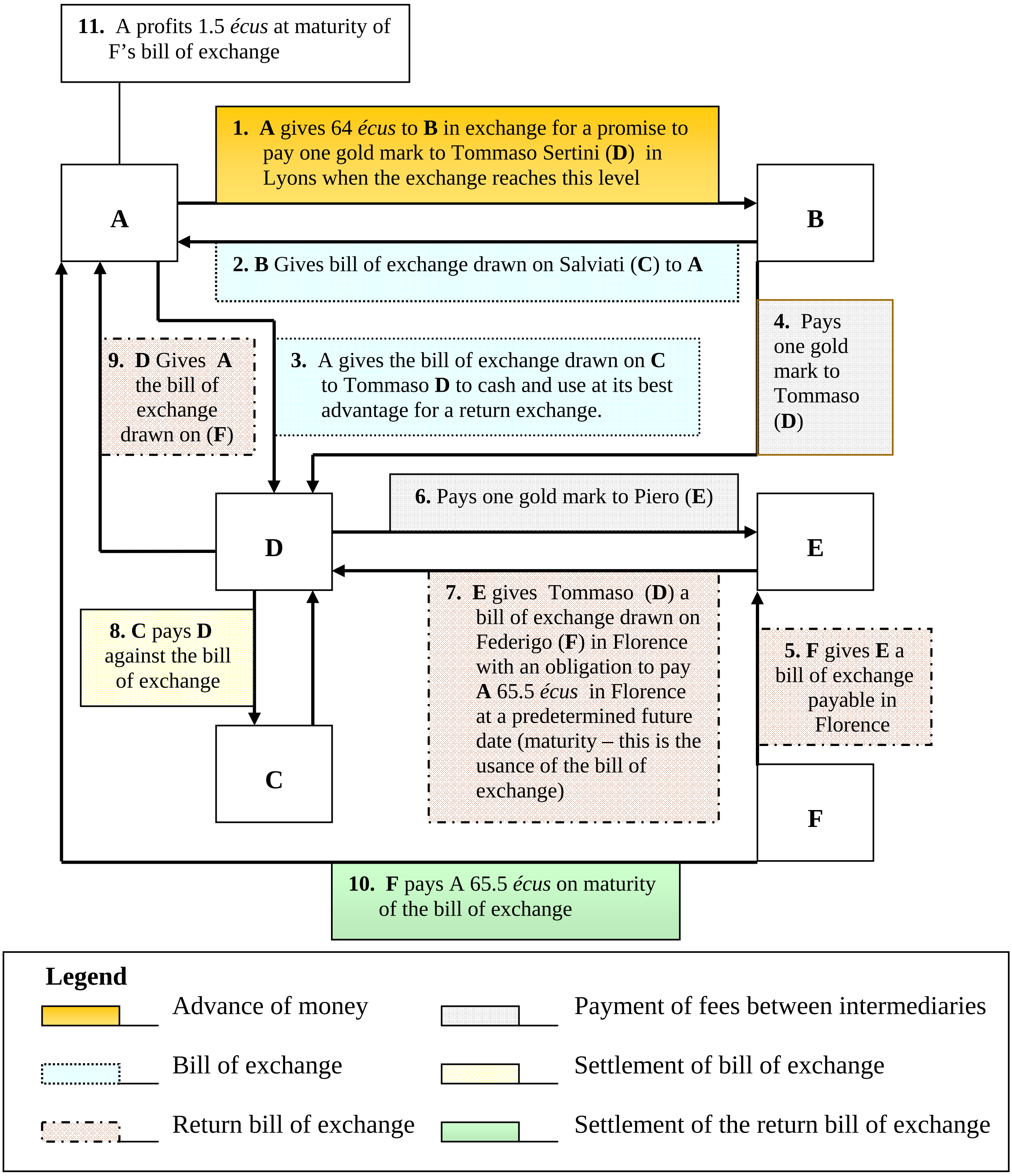
The exchange banker of those days would have been subject to potential payment delays, not once, but thrice, by parties, B, D and E, not to mention the much higher external risk represented by the possible bankruptcies by any one of B, D, and E. The bill of exchange operations under these circumstances reflect the changing nature and higher risk involved with the expansion of trade. There may be more profit to be made but apparently with a higher risk factor – a generality that is still with us today.

In practice, the bill of exchange "was usually the consequence of a loan, an advance … which carried interest charges" (Braudel 1982, p. 215), as

> the principle behind 'bill of exchange': the seller of a bill in any market whatever – at a fair at Medina del Campo in the sixteenth century, for example – received the money immediately. The taker would be repaid at another market, three months later, according to the rate of exchange

at the time. It was up to him to calculate his potential profit and work out the degree of risk (Braudel 1981, p. 471).

Figure 2.2: Possible bill of exchange return cycle in the 1500s



Credit instrument law was slow to develop and the use of the mercantile “bill of exchange with acceptance made its appearance in the first half of the fourteenth century” (Pirenne 1939, p. 382), but its use “was not substantial until the end of the fourteenth century, after the doctrine of Baldus was established” (Baldwin 1968, p. 93). The doctrine of Baldus established the liability of the maker of the bill in case of protest, a principle that is embodied in modern bill of exchange operations. “Drafts did not gain their negotiability by endorsement until the seventeenth century” (Baldwin 1968, p. 94; Usher 1914, p. 576). Notwithstanding this situation by the sixteenth century exchange law had progressed to essentially its present development and “equivocation on legal grounds was excluded by the maxim “*chi accetta paghi*” (the acceptor must pay)” (Weber 1961, p. 197).

The colonisation of foreign lands that started during the late Middle Ages, with the epic voyages of famous explorers, such as Christophorous Columbus, continued. European nations such as Spain, Portugal, France and England explored further and in the seventeenth century China was finally reached and some form of direct trade ensued. It is interesting to note that until that time the two “halves” of the world - West and East - had been living “at the same time in almost complete ignorance of each other” (Wells 1922, p. 130) and “although the Romans knew of China and the Chinese knew of the Roman Empire, there was no really direct intercourse or mutual influence” (Roebuck 1966, p. 639) and the only meaningful direct contact seemed to have been the journey that Marco Polo embarked on.

Around the first and second century B.C., the Roman Empire had extended its reach to the Euphrates, but “it was never able to get beyond that boundary. It was too remote” (Wells 1922, p. 129). China had extended its power “into western Turkestan. But there too it reached its extremes. Beyond was too far” (Wells 1922, p. 130). The means of communication by land and seas were neither sufficiently organised, nor developed, for these two powers “to come to a direct clash” (Wells 1922, p. 130). Trade between West and East was certainly conducted. “The main cargo carried from the East was silk. To the Romans the Chinese were ‘the Seres’ the people of silk” (Blainey 2000, p. 161). Silk was expensive because it had to travel a very long distance across a treacherous landscape and because there was no direct trade between the Chinese and the Romans. The price commanded by the silk was a reflection of the taxes and tributes demanded along the way and the profits taken by the various people who “acted as middlemen” (Toutain 1968, p. 160) in the supply chain. “To cut out half a dozen middlemen, European merchants would occasionally despatch a brave agent halfway to China to act as expediter and negotiator” (Blainey 2000, pp. 160-161). It was this lack of direct contact that enabled the two worlds to co-exist without interaction.

Yet, parallels developed. The Chinese invented their own monetary system, with paper money introduced in the ninth century, ahead of Europe (Braudel 1984). The relative success of the Chinese paper based monetary system was largely due to the fact that, unlike Europe, a divided continent under competing feudal rulers, China, having abolished its feudal system in the third century (Weber 1961), was by now under the control of one dynasty. Consequently, it would have been comparatively easier to introduce a monetary system under one rule.

The paper money was referred to as “flying money”, probably because it was a lot easier to handle than the equivalent value in heavy coins. Flying money was “a convenient means of exchange sparing the merchants and couriers of the provincial governments the inconvenience and risks of transporting money physically over long distances” (Buencamino and Gorbunov 2002, p. 3). The money was “completely representative. Behind each unit there was on deposit in government banks an equal value in metallic coins” (Ederer 1964, p. 92) and therefore the money was fully backed and redeemable by government banks. Paper money was good for internal trade because it provided a common denominator of exchange and overcame the problems that were plaguing Europe with different coinages of differing values. Despite the paper money, other means of exchange co-existed, notably copper coins and silver ingots. In 1189 the world’s first issue of fiat money took place under the Jin dynasty (Williams 1997).

> Fiat money refers to money that is not backed by reserves of another commodity. The money itself is given value by government fiat (Latin for "let it be done") or decree, enforcing legal tender laws, previously known as "forced tender", whereby debtors are legally relieved of the debt if they (offer to) pay it off in the government's money. By law the refusal of "legal tender" money in favour of some other form of payment is illegal (World Paper Money 2006).

The successive Mongol rulers (Yuan dynasty) saw to it that the paper money was a managed success. They began issuing paper money in 1260 and passed legal tender laws forbidding gold, silver and copper as substitutes for paper money (Angell 1929;

Williams 1997). Money was printed in excess, but because of the carefully managed and orchestrated legal tender laws, very few paper notes were actually exchanged (Williams 1997), therefore, the confidence in paper money was (artificially) maintained. The over-issue of paper money ultimately led to a loss of confidence but, notwithstanding when the Ming dynasty took over from the Yuan dynasty, they began issuing their own paper money in 1374 and forced the use of notes as legal tender by outlawing gold and silver as money and introducing a requirement that taxes and a percentage of government official's salaries be paid in notes (Mote 1999). Despite the laws, the value of the notes declined and by 1450 depreciation reached extreme levels and silver was legalised as the currency for taxes and salaries, with copper used for everyday exchanges (Mote 1999). By 1455 China had abandoned the use of paper money, after about 500 years of usage (Davies 1994; Davies 2005; Money Museum 2006).

It was during the Ming period that the capital was moved from Nanking to Peking and "most remarkable of all, the Chinese began to trade overseas" (Cameron 1993, p. 86). Whereas in the past the Chinese had relied on foreign merchants for their foreign trade, in the first quarter of the fifteenth century trade was directly conducted with Japan, the Philippines, South East Asia, the Malay peninsula and Indonesia (Cameron 1993). But this period of direct international trade activity was short lived as

> suddenly, in 1433, the emperor forbad further voyages, decreed the destruction of ocean-going ships, and prohibited his subjects from travelling abroad. The colonies were left to wither away (Cameron 1993, p. 86)

The reason for such action seems unknown.

It was during the Yuan dynasty that Marco Polo lived in China (about 1275 to 1295) and he observed the use of notes and the acceptance of such currency for every day transactions noting that

> everybody takes them readily, for wheresoever a person may go throughout the Great Kaan's dominions he shall find these pieces of paper current, and shall be able to transact all sales and purchases of goods by means of them just as well as if they were coins of pure gold (Polo 2004, p. 337)

Marco Polo apparently took the idea of paper money back to Europe, where during the thirteenth century it "was an entirely alien concept" (Haw 2006, p. 65). "Paper money in China was not the accelerator of capitalism that it was in the west"(Braudel 1982, p. 113). At the time of Marco Polo the great innovation in Europe was the penetration of the bill of exchange in trade, that started in Genoa, Florence and Venice (Braudel 1982). Paper money did not become a reality in Europe until the seventeenth century, with the first freely circulating banknote issued by Stockholm Banco in Sweden in 1656 (Williams 1997).

The history of Chinese banking practice does not appear to be as well documented, in the English language, as is the history of Western Europe and it is much more difficult and confusing to follow. Chinese banking appears not to have developed along the lines of the European model due to a number of factors and events.

The Chinese society was agrarian-based, populated by farmers who had a low income stream and were subject to regular government taxes. "Merchants were ranked lowest in social order by the Confucian physiocrats" (Wakeman 1975, p. 39) and "held in check by a watchful government" (Braudel 1993, p. 194). Merchant guilds (*hang*), that began as craft and trade associations, were organised by the government during the Tang period (about 618 to 907), thus being "denied organisational autonomy" (Wakeman 1975, p. 44). Trade was centrally controlled by the emperor through location of shops in specific quarters of towns and the control of quality and membership of the *hang*. Prices were overseen by a government appointed *hang t'ou* (guild-head), who was also responsible for the collection of taxes. Trade, therefore, was a privilege to be purchased from the emperor (Wakeman 1975).

The restrictions placed on artisans and merchants at times assumed strange characteristics, like the "Tang ban of 667 on artisans and merchants riding horses" (Holcombe 2001, p. 79). Because the Chinese economy was so reliant on agriculture, the government of the time feared that trade would lure farmers away from the land and the fear was that for "each person who would not cultivate someone would go hungry" (Holcombe 2001, p. 79). Rigorous border control restrictions were established and commerce was strictly regulated through government officials. By the mid eighth century it is estimated that there was one overseeing government official for every twenty-two households in the empire (Holcombe 2001). It is difficult to see how free market forces and entrepreneurial banking could have existed under such tight controls.

The Tang era appears to have been an unusual period of government interference after which “never again would the Chinese empire aspire to its former level of direct bureaucratic micromanagement” (Holcombe 2001, p. 217). Yet, government controls remained over merchants. Traders found it difficult to break away from government control, because

> brokers or merchants found it impossible to operate without official sponsorship. Under the pretext of controlling trade and regulating prices, bureaucrats frequently conferred monopoly rights upon individuals or guilds in exchange for a fee from the merchants (Wakeman 1975, pp. 44-45)

The conferral of this monopoly was not through the purchase of an official licence issued at law, but rather the broker:

> paid a personal fee to an individual bureaucrat, and when that official was replaced by someone else, the contract had to be renegotiated. The advantages clearly rested with the bureaucracy (Wakeman 1975, p. 45)

The temporary character of these licences created opportunities for bureaucrats to profit from their sale and resale, whereas permanent licences transferred by sale from one broker to another would have generated and kept profits in the private sector. Under such circumstances through successive dynasties, it is, therefore, not surprising that the banking industry in China did not develop in the way the European system did.

Whilst Europe was embroiled in feudal disputes, in China

> the commercial growth of Tang and Sung times [approximately from 618 to 1279] took place within a highly organised bureaucratic empire … however much commerce grew, the merchants never became strong enough to challenge the monolithic state but always remained at its mercy (Reischauer and Fairbank 1960, p. 220).

Unlike Europe, the unified empire also denied the opportunity to fund war activities through banking finance (Weber 1961). It appears then, that to the degree that the rulers allowed it, a banking industry was present, although it seems this was largely confined to depositary practices and money lending activities carried on by private individuals (Braudel 1993). Apparently China’s first banks can be traced back to the Tang dynasty and

> these were of two varieties: the deposit shops (kuei-fang) and the gold and silver shops (chin-yin p'u). The deposit shops charged a fee for safeguarding funds, and honored checks drawn against deposits. They

> also issued certificates of deposit which circulated like currency (Cassidy 1990).

As prosperity grew in the Chinese economy, particularly in the Sung era, much of the legal constraints earlier placed on merchants were relaxed, so they could marry into the ranks of the officials and have their sons educated, although the "anti-merchant bias of an earlier social era still lingered" (Mote 1999, p. 391).

The Chinese economy continued its steady expansion after the 1400's and the demand for "transfer of funds, papers of credit and other banking services needed by the growing commercial sector" (Mote 1982, p. 222) were eventually satisfied by the guilds of Shansi merchants who specialised in money shops offering such services. During the Ching dynasty the Shansi organised the safe transport of "official and unofficial funds between the capital and the provinces" (Reischauer and Fairbank 1960, p. 98). Through a courier system they devised and soon realised that they could operate more efficiently by developing a network of branches where they conducted regular business and issued drafts as a means of transferring funds, "thus were the Chinese remittance banks born" (Cassidy 1990).

The Shansi bankers' success was their national network and the reputation they gained for being good transporters of money, so much so that even the government engaged them to perform these tasks. The drafts the Shansi bankers issued were sold for a fee and can be considered akin to the modern day traveller's cheque. From a risk perspective, therefore, banking in China, prior to the arrival of the Europeans, was of a different nature to that of Europe. This was mainly as a result of the high degree of government control over its population. The agrarian-based economy did not promote an individual's accumulation of wealth, rather it ensured a small elite segment of the ruling society that could live in comparative opulence. The highly interventionist approach of rulers over the centuries did little to foster an environment of entrepreneurship. The circulation of money, precious metal and coins was also highly controlled by the officials and this appeared to have stymied the growth of banking practices that flourished in Europe. Consequently, the bill of exchange (and eventually the Letter of Credit) had to wait for the Europeans to arrive to China post the 1500's.

Meanwhile the power in Europe began to shift to the Hapsburgs in the late fifteenth century and this became the basis for the wealth of the Fuggers (a German dynasty), who made their money firstly in textiles and subsequently as lenders to the aristocracy and the papacy (Gascoigne 2005). The mix and location of trade centres in Europe also began to change as a result of the influence of the Spanish, Portuguese, Dutch, French and British empires. Many new countries were ‘discovered’ and conquered as part of a nation’s desire to increase its wealth during the period from 1500 to 1800. The philosophy that drove this expansion was underpinned by a school of economic thought referred to as ‘mercantilism’ (Appleyard, Field and Cobb 2006; Pugel 2007). A central aspect of mercantilist theory was

> the view that national wealth was reflected in a country’s holdings of precious metal. In addition one of the most important pillars of Mercantilinist thought was the static view of world resources. Economic activity in this setting can be viewed as a zero-sum game. In which one country’s economic gain was at the expense of another. Acquisition of precious metals thus became the means for increasing wealth and well-being and the focus of the emerging European nation-states. In a hostile world, the enhancement of state power was critical to the growth process, and this was another important Mercantilist doctrine. A strong army, strong navy and merchant marine, and productive economy were critical to maintaining and increasing the power of a nation-state (Appleyard, Field and Cobb 2006, p. 18).

Europe during this early period was certainly not unified and therefore the race to power was achieved through the exploitation of non-European conquered lands. The expansion of trade and

> Reformation Europe as a whole overtook the Mediterranean economy, brilliant as it was and long experienced in the ways of capitalism. (I am thinking of Italy in particular) (Braudel 1982, p. 569).

Powers such as Holland, France and Britain took on a more dominant role. Logistically trade to ports such as Venice and Genoa was less attractive because of the comparatively longer sailing times (there was no Suez Canal in those days to shortcut through to India, instead circumnavigation of Africa and entry through the Strait of Gibraltar was the only maritime access). For the French, British and Dutch there were no such impediments. As trade developed out of these new centres, finance followed, and Italy began to lose its status as the monopoly financier of Europe, although the Northern European nations had made no discoveries (America, East Indies, China and Japan were discovered by the Portuguese and the Spaniards) and in terms of finance

> nor did the North invent any of the instruments of capitalism: these all came from the South. Even the Bank of Amsterdam was modelled on the Venetian Bank of the Rialto. And it was by competing with the state monopolies of the southern countries - Spain and Portugal -that the great merchant companies of the north were formed (Braudel 1982, p. 569).

In establishing these organisations, governments

> gave exclusive rights for certain routes or areas to specific companies. Trade monopolies fostered generation of higher profits… profits contributed both directly and indirectly to a positive trade balance and to the wealth of the rulers who shared the profits of this activity. The Hudson Bay Company and the Dutch East India Trading Company are familiar examples of trade monopolies (Appleyard, Field and Cobb 2006, p. 19).

During this period of unprecedented European expansion, the mix of trade flows and market participants was also changing. Whereas previously much of the trade was intra-European and banking was largely a private affair, Reformation Europe saw the emergence of public banks and new relationships forged between buyers and sellers in distant lands, who were unknown to each other. The bill of exchange, though, continued to be used for some time and, at least in London, by the

> second half of the seventeenth century the bill of exchange payable to order was freely transferred from one person to another by indorsement and delivery, and that the practice of repeated indorsements had become customary (Richards 1927, p. 368).

The apparent ease by which a bill of exchange could be transferred to others increased the popularity of this method of payment and there is incontestable “evidence for the constant use of bills of exchange in the Anglo-Irish, Anglo-American, Franco-Canadian and Dutch-West Indies trades” (Sperling 1962, p. 462), such as, for example, “the drawing of bills of exchange from London against funds to be delivered in India” (Chaudhuri 1968, p. 491; Sperling 1962, p. 462). Perhaps less commonly known, but certainly widely used, was “the use of bills of exchange in payment of slaves” (Sheridan 1958, p. 251).

From the middle of the eighteenth century the population in Europe began to grow at a “rate unprecedented in previous periods” (Heaton 1948, p. 380). Medical and economic reasons contributed to this growth. There was not so much of an increase in birth rates, as much as a decrease in mortality through public and private health improvements. Vaccination began to be practised and water supplies improved.

Healthier individuals contributed to improved productivity and this was "in turn the outcome of two developments: new or improved techniques for the use of resources and new or improved organisation and conduct of enterprise" (Heaton 1948, p. 381).

The revolution in transport, coupled with changes in production, no doubt contributed to the expansion of trade. On land, the steam engine and the railways gave "power to penetrate areas inaccessible by river or canal" (Heaton 1948, p. 515), beginning the "transition to continuous buying and selling by breaking down the physical barriers" (Birnie 1964, p. 48). Improvements in ocean shipping practices, as well as ship design and shipbuilding, all eventually contributed to a greater flow of goods, although "it was not till 1880 that steam ships accounted for half of the carrying power of the chief maritime countries" (Lilley 1973, p. 211). Other inventions, especially in the communication industry, assisted further in the development of international trade. The invention of the electric telegraph by Samuel Morse, in 1832 (Cameron 1993) and that of the telephone, patented by Bell in 1876 (Hill 1961), provided new avenues to disseminate information. Even more remarkable was the invention of wireless telegraphy (or radio) by the Italian Guglielmo Marconi, in the autumn of 1894, at Pontecchio (Bologna), Italy (Kluzer 2001). The radio was to play a significant role in ocean navigation soon thereafter (Cameron 1993). This mass communication medium is still used today and its principles have been used in a wide variety of communication applications. The improvement in telecommunications led to an acceleration of information flows between markets across different countries, fostering an increase in commercial and financial activities.

Trade had become complex and governments realised they were operating in "negative *laissez-faire*" (Sperling 1962, p. 449) and not in control of international financial operations. Yet governments had a desire to be in control to ensure that the benefits from foreign trade could be channelled for the greater good of the country, in accordance with mercantilist ideologies. In England, towards the end of the seventeenth century, the "establishment of the office of Inspector General of Imports and Exports and the beginning of regular quantitative measurements of trade" (Sperling 1962, p. 449), was an example of a government attempt to regulate and gain control of trade.

The industrialisation phenomenon led to the rise of banking establishment, as "increased industrialisation created an increased demand for capital" (Gille 1973, p.

260). Credit facilities were lower on the continent than in England, where joint-stock deposit banks practised discounting of bills on a major scale, unlike their continental counterparts. Industrialisation also contributed to more localised production, with consequential separation between raw material producers and manufacturers. The separation demanded "necessary market linkages to complete the circular flow of production, trade and consumption" (Hartwell 1973, p. 380). The nineteenth century witnessed the continual expansion of facilities for trade resulting in a decline of fairs, local markets and auctions and an increase in forward trading, retail shops and wholesale warehouses (Hartwell 1973). The patterns and the mechanisms by which trade was being conducted, particularly across the globe, had therefore undergone tremendous changes by the beginning of the twentieth century.

Two significant events took place in Europe and the world during the first half of that century that had fundamental impacts on patterns of trade and global financing. The first was World War I (WWI) during 1914 - 1918, and the second was World War II (WWII) during 1939 - 1945. Between these wars there was also the Great Depression of 1929-1933.

The devastation caused by WWI cannot be understated. Quite apart from the sad loss of a large number of human lives, destruction to housing, industries and equipment, mining, livestock and farming, as well as transportation and communication were experienced. Ocean shipping did not escape disruption either, largely as a result of submarine warfare, in short, economies were left in tatters and relationships between sellers and buyers were soured as a result of the belligerence (Cameron 1993). The warring nations additionally suffered by losing foreign markets and shipping service income, as well as foreign investments and, in the case of England, the loss of clearing bank services and predominance in financial markets (Byrne 2004). After the end of the war, there was a period of prosperity but, unfortunately, that ended with the Great Depression. The Great Depression

> brought widespread unemployment as demand evaporated and businesses failed. The collapse of Wall Street and the New York stockmarket in 1929 determined the timing of the Great Depression but was not the sole - or even the main - cause of it. Economists still argue about the cause. It is commonly accepted that one factor was the growing imbalance in world trade, brought about by increased levels of primary production in more recently settled economies such as Australia and Canada, in the face of inadequate growth in demand. At the same

> time, the earlier industrialised nations faced problems selling their increased output of manufactured goods (Carew 1996, p. 97)

The Great Depression provided an avenue for governments to increase their role in economic management and a change in attitude towards economic policy but, arguably, it also spawned extremist political movements and this may have indirectly contributed to the origins of WWII (Cameron 1993). The devastation caused by WWII is well known and, in essence, replicate those of WWI but in a much greater scale, particularly in relation to the loss of human life and the development of weapons of mass destruction (nuclear bombs).

Each of these three events had the same effect on the relationships between buyers and sellers. Trust was eroded as a result of these events and with new entrepreneurs entering the market, new trading relationships needed to be forged in a relatively chaotic and unstable environment. A nation rebuilding after a war may well hunger for raw material resources and finished goods but, in the seller's mind, from a financial risk management point of view, the considered question must surely be: "Will I be paid if I supply these goods?"

The situation of the past, as depicted in Figures 2.1 and 2.2 earlier, was no longer suitable to the changed requirements of international trade. Because of the comparatively lesser known reputation of buyers abroad, exporters in distant lands were not satisfied to sell against promises to pay by "the buyers themselves on their own credit" (Thayer 1936, p. 1032). Likewise, buyers needed a commercial payment instrument that would enable them to buy products in markets where their reputation (however good at home) was unknown and the "ultimate result was the development of the banker's credit" (Thayer 1936, p. 1032), the precursor to the current irrevocable documentary credit.

Thayer's (1936) differentiations between buyer's credit and banker's credit are summarised in Table 2.1. Buyer's credit and banker's credit in those days shared one common element and that was that neither payment option provided any irrevocability as to the undertaking to pay given to the seller, however, "banking institutions were relatively few in number; and the existing banks played a meticulous solicitude in honouring their obligations" (Thayer 1936, p. 1034). Yet, again, the notion of trust is brought to the fore in business.

Table 2.1: Differences between buyer's credit and banker's credit

Buyer’s credit	Banker’s credit
Mainly domestic transactions in regional areas	Principally used for international trade
Little significance to international trade	Not limited to regional areas
Used as an inducement to sale	Bank promises to honour seller’s bills

The risks between the two types of credit are in essence differentiated by the party providing the promise. In a buyer’s credit transaction, clearly the seller’s risk rests on the honesty of the buyer to make good the debt by the timely settlement of the debt incurred. Thus, a seller entering into a transaction on this payment basis accepts the buyer’s credit risk - a matter of trust indeed. In a banker’s credit transaction, the seller arguably has a (perceived) lessened credit risk, because the bank is now offering to make the payment. However, the situation remains, even under these circumstances, that the bank is not actually making any payment guarantees but merely making a promise that may, or may not, be upheld. In an international transaction it would be nigh on impossible to conjure the right of recourse possibilities that a seller might have in the case of a bank not proceeding with a earlier (non-binding) promise to pay. The considerations that would need to be taken into account include the contractual agreement (if any) entered into between the seller and the banker in relation to the promise of payment, the applicable laws to that contract, the enforceability of such a contract in a foreign jurisdiction and the forum for resolution of any disputes. Therefore, even with banker’s credit, the possibility of revocation remained a matter of concern to the seller.

From a risk element point of view, the seller’s preferred position must surely be one of confidence of payment and either buyer’s credit or banker’s credit, under the circumstances described above, provide such comfort. This means that the seller is likely to run into higher risks by engaging in trade, yet the seller needs to sell to survive.

What the seller really needed was an instrument of finance that provided a definite undertaking, by way of a promise to pay, and that such an instrument would be equally treated by all banks regardless of the country of operation. True, such an instrument would be subject to local laws and regulations that would not be able to be departed from but the seller was looking for some financial comfort, with the provision that payment would be assured. The buyer equally would require some protection against funds being transferred to an unscrupulous seller that did not perform against the agreed contractual terms. Bankers, as facilitators of international trade finance, were regarded as the 'neutral' third party by both the seller and the buyer. However, the seller, in particular, remained concerned about the varying treatments that different banks in the same or different countries might give to a payment instrument. The seller's preferred position was to manage the buyer's credit risk by substituting it with that of the buyer's bank. In other words, a certainty of payment that would work regardless of what the buyer's financial position might be at the time of payment.

The situation surrounding certainty of payment was not resolved, in reality, until the 1993 version of the rules governing L/C that provided an irrevocability option for this payment instrument.

> The origins of the UCP lie in the displacement of the London clearing banks as the world's financial arbiters during World War I. Until that time, London practice predominated and that practice was set by each of the clearing banks with its correspondents. It was widely understood to rest on fundamental principles and not specific rules. Indeed it was a reluctance to adhere to a set of written rules that caused the British banks to decline to adhere to the UCP [Uniform Customs and Practice] until the 1963 revision (Byrne 2004, p. 19).

The Americans had formulated rules for Letter of Credit transactions that had been in existence and had been revised several times, by 1919, under the aegis of the predecessor organisation to the International Financial Services Association (Byrne 2004). The first attempt to codify internationally Letter of Credit practice can be traced back to 1929 when the ICC, following the earlier American initiative, introduced its 'Uniform Regulations for Commercial Documentary Credits' (Wheble 1971), with the aim of creating a global standard for L/C. Unfortunately, these regulations were only limited to Belgian and French banking practices and whilst these failed to gain wide acceptance, they nevertheless provided a basis for further developments. In 1933 the ICC issued the 'Uniform Customs and Practice for Commercial Documentary Credits', the first codification effort, and this set of rules "received formal acceptance in some 40 countries" (Wheble 1971, p. 98). This edition of the rules was based on the previously existing American rules and it "was promulgated … at the request and insistence of the

American banks (Byrne 2004, p. 20). Although the 1951 Revision doubled the acceptance of these rules, it was not until the issue of the Uniform Customs and Practice for Documentary Credits (UCP) in 1962 that global acceptance took place. It was during this revision that the "British representative to the ICC Banking Commission, Mr Bernard Wheble, took the lead in bridging British practice and that of the balance of the western world" (Byrne 2004, p. 29). Since then, the L/C rules have been up-dated in 1974, 1983 (UCP 400) and 1993 (UCP 500) – the rules upon which the investigation in this thesis is based. The changes introduced from previous revisions reflect developments in transport and communication, as well as changing some of the rights and responsibilities for banks and traders.

Since 1974, the UCP have received the endorsement of the United Nations Commission on International Trade Law (UNCITRAL) in an effort to make sure that these rules can enjoy true global adoption. Although internationally recognised, and endorsed by UNCITRAL, the UCP is a private set of rules and not legislative or regulatory but, nevertheless, the UCP are recognised as the source of the rules that govern commercial Letter of Credit transactions (Byrne 2004) The UCP becomes part of the Letter of Credit transaction by explicit incorporation, usually through a specific clause stating the rules apply – this has always been the case and this requirement can be traced back to the first edition of the UCP in 1933. Indeed, these days it would be unusual for a Letter of Credit not to refer to the UCP by specific incorporation.

There is no intention to reproduce the various texts from the different versions of the UCP in this Chapter but rather to provide some contextual background by highlighting some of the more significant changes that have evolved in international Letter of Credit usage and practice over the past six decades, particularly from the exporter's (beneficiary's) point of view, as this is the focus of this thesis. More in-depth discussion on the mechanics of the modern day Letter of Credit transactions is provided in Chapter 4.

The first codification of the UCP, in 1933, set the **revocable** Letters of Credit as the standard instrument of payment for this type of transaction. Revocable Letters of Credit present with significant problems, "as they are not effective in securing payment" (Mugasha 2003, p. 28). The revocable Letter of Credit presents some difficulties for the exporter, because

> neither the authority to pay nor the authority to purchase protects the seller against modification or cancellation. Either may be revoked or modified at any time without notice to the seller … Banks have customarily relieved themselves of the responsibility of giving effective notice of cancellation of a "revocable" credit by inserting in the advice a clause which permits the modification or cancellation of the credit without notice (Ward and Harfield 1958, p. 14).

The ramifications of the above statement became evident in the case of *Cape Asbestos Company, Limited v. Lloyds Bank* [1921] WN 274. The essence of that case was that a revocable Letter of Credit was issued by a Polish bank to an exporter (beneficiary) in the UK, via Lloyds Bank, who acted as the advising bank. The Letter of Credit contained a footnote: "This is an advice of the opening of a credit and is not to be taken as a confirmation of same" (Ward and Harfield 1958, pp. 14-15). A part shipment was effected, documents were presented and payment was made. The Polish bank subsequently withdrew the credit and Lloyds Bank inadvertently forgot to notify the exporter. Without knowledge that the letter of credit had been revoked (cancelled) the exporter effected another shipment and was refused payment against the documents presented under the (now cancelled) Letter of Credit. Mr Justice Bailhache in the Court of King's Bench held that whilst the failure to notify the exporter was regrettable, the fact was that this type of Letter of Credit could be revoked at any time. "The court came to the conclusion therefore that … there was no legal basis under which it could find an obligation to give it [that is, give notice]" (Ward and Harfield 1958, p. 15). It is not difficult to imagine that from an exporter's point of view, the revocable letter of credit is not the preferred option. Yet, as undesirable as the revocable Letter of Credit might be, it remained the default standard for sixty years, until the UCP 500, issued in 1993.

However, **irrevocable** Letters of Credit were also in use, alongside the revocable counterpart, during this period. Indeed, the first edition of the UCP, in 1933, provided a definition for an irrevocable Letter of Credit as a "definite undertakings by an opening [issuing] bank in favour of the beneficiary" (Taylor 2008, p. 49) and according to Article 5 of the 1933 rules, "such undertaking can neither be modified or cancelled without the agreement of all concerned" (Taylor 2008, p. 52) – this requirement remains unchanged today. The UCP 500, in 1993, introduced a "change in the presumption that a credit is revocable to a presumption that a credit is irrevocable" (Taylor 2008, p. 143). In 2007, the revocable Letter of Credit, issued by a bank, ceased to exist by virtue of

Article 2 of the UCP 600 that defines a Letter of Credit as “any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation” (International Chamber of Commerce 2006, p. 18). The net effect of these changes was to increase the attraction of the Letter of Credit as a payment instrument for export sales because of the perception of the higher security and certainty of payment provided by the irrevocable undertaking.

The time a bank may take to check documents for compliance has been compressed over time. Initially, this was simply set as a “reasonable time, but by the time the UCP 500 was released in 1993, pursuant to Article 13 b, this had been set to a “reasonable time, not to exceed seven banking days following the day of receipt of the documents” (International Chamber of Commerce 1993, p. 19), for each of the banks involved in the Letter of Credit transaction. This time frame was further compressed by the UCP 600, Article 16 d that specifies that rejection of a document must be notified to the presenter “no later than the close of the fifth banking day following the day of presentation” (International Chamber of Commerce 2006, p. 29). This compression of time is particularly useful to the exporter where payments are linked to the sighting of the documents with the issuing bank, that is, where there is no payment trigger link to an antecedent event, such as a transport document issue date. This means that, in theory, the exporter may be paid comparatively quicker than before and this is positive from both a cash flow perspective as well as a country/customer/bank risk – the earlier the payment the less the risk exposure.

Other events that necessitated changes to the rules include the introduction of the non-negotiable sea-waybill, the air waybill, clarification as to the insured amount and types of acceptable insurance clauses, the introduction of international banking standards for the checking of documents and the possibility of electronic documentation lodgement.

One area that continues to generate debate is that of documentary compliance. The 1993 rules separated the Letter of Credit from the contract of sale, the **independence principle (or doctrine)** remains in the rules, and is discussed in greater detail in Chapter 3. In relation to the invoice, Article 33 of the 1933 rules, states (in part) that ‘in order to determine the quality of the goods, banks may refer to the indications given in the invoices, which should correspond with those stipulated in the credit” (Taylor 2008,

p. 59). In the 1951 revision, the wording to Article 33 was changed to read (in part) “the description of the goods in the Commercial Invoice must correspond with the description in the credit” (Taylor 2008, pp. 76, 92, 113, 136) and this wording remained unaltered in 1962 (Article 30); 1974 (Article 32 c); 1983 (Article 41 c); and 1993 – UCP 500 – (Article 37 c) – the applicable rules for this thesis. In 2007, the wording of the UCP 600 was altered to read as follows, pursuant to Article 18 c, “the description of the goods, services or performance in a commercial invoice must correspond with that appearing in the credit” (International Chamber of Commerce 2006, p. 31). The introduction of the precise data content requirements on the invoice, that ‘must match’ the Letter of Credit, is commonly referred to as the **principle (or doctrine) of strict compliance** and this has, in part, generally been regarded as a contributing factor towards documentary discrepancies. Documentary data requirements and discrepancies will be discussed in greater detail in the following chapters.

It should be noted that effective 1 July 2007, a new set of rules was promulgated by the ICC, the UCP 600. However, these rules are not in the focus of this thesis, as the text of UCP 600 had not been released at the time the surveys were administered and, at the time of writing the thesis, a definitive body of practice and knowledge on the new rules had not as yet been fully developed.

The next Chapter provides a literature review on risk management and Letters of Credit, as well as proposing a new model that may be used as a framework of risk for this thesis.

3. Literature Review

A Letter of Credit[2] is an undertaking to pay, given by the bank issuing the Letter of Credit in favour of a beneficiary (seller). A Letter of Credit is a discrete transaction, with unique demands and obligations, the fulfilment of which will lead to payment. The Letter of Credit is a conditional payment undertaking issued by a foreign bank in favour of the seller (beneficiary). The Letter of Credit is commonly used as a trade finance facilitation tool. It is primarily used in the international sale and purchase of goods and it is typically not tradable in the open market, because specific performance, that is, the tender of documents (purported to represent goods despatched) to a bank, is required in order to satisfy the documentary demands of the issuing bank and trigger payment.

This chapter provides a literature review in three parts. The chapter aims to identify, *inter alia,* a framework of risk that may be suitable for the analysis of risks associated with Letter of Credit documentation processes. Part I focuses on risk management literature that may be relevant to Letter of Credit transaction processes. Part II focuses on literature about Letter of Credit in general and, more specifically, research on discrepancies – what are the contributing factors and mitigation processes. Part III considers an internal audit approach to managing Letter of Credit risk.

PART I

3.1 Risk Management Literature Relevant to Letter of Credit Transactions

Risk is inherent and omni-present and "you cannot get away from it" (Frame 2003, p. 2).

Apparently the word risk is derived from the Italian *riscare,* meaning 'to dare'. In the renaissance period, in southern Europe, the meaning of dare included "a concept of action with uncertainty, potential benefit and possible injury or loss" (Christensen 2006, p. 10). In the early 20th century, in discussing risk, uncertainty and profit, Knight

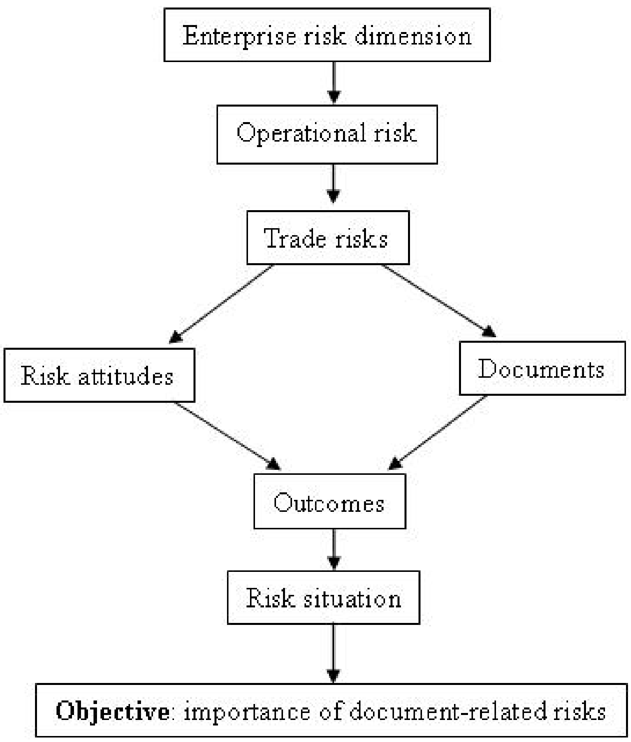
[2] The Letter of Credit referred to in this thesis, unless otherwise stated, is irrevocable, meaning that once issued, it cannot be altered without the consent of the exporter (beneficiary). This type of Letter of Credit is standard. A revocable Letter of Credit is one that may be changed or revoked by the bank that issued it, without reference to the exporter (beneficiary). Revocable Letters of Credit were not the standard in the rules applicable to the research in this thesis, and in the new rules, applicable since 1 July 2007, revocable Letters of Credit no longer exist. The tem Letter of Credit is used as a synonym for documentary credit.

(1921) suggested a definitional separation of risk and uncertainty. According to this author, uncertainty is where it is not possible to calculate chances, therefore, probabilities cannot be assigned to an event; whereas risk should be regarded "as a known chance" (Knight 1921, p. 21). In more recent times, the definition of the word risk in itself has been a point of focus by a number of authors who have published in the area of risk management (Frame 2003; Koller 2007; Marshall 2001; McNamee 1996; Mehr and Hedges 1974; Merna and Al-Thani 2005; Shimell 2002). These authors provide slightly different variations of a basic definition but all seem to encompass an element of possible negative consequences or impacts as a result of an event, whether predicted or not. These authors also point out that the 'negative side' is what is commonly referred to as the risk, whereas the positive side is commonly referred to as the 'opportunity'. It appears that the general trend in literature is basically to consider risk from the 'negative' angle and this is probably due to the fact that for "too many organisations risk is a four letter word that they try to insulate themselves from" (Merna and Al-Thani 2005). Testament to this approach are the many definitions of risk, that seem to reinforce the negativity of risk, for example, "risk means being exposed to the possibility of a negative outcome" (Borge 2001, p. 4); "risk as the chance of injury, damage or loss; a hazard" (Chorafas 2001, p. 9); "risk – the possibility that a hazard will cause loss or damage" (Sadgrove 2005, p. 5); or "risk is the possibility that an event will occur and adversely affect the achievement of objectives" (Committee of Sponsoring Organisations of the Treadway Commission 2004b, p. 16).

Some definitions of risk management are also biased towards the negative side of risk. Authors provide definitions such as "risk management is the practice of protecting an organisation from financial harm" (Blake 2003, p. 58), or "as being concerned with identifying and managing a firm's exposure to financial risk" (Kaen 2005, p. 423). Other definitions of risk management appear to include opportunity as "risk management is the application of analysis techniques and the definition of measures to quantify the amount of financial loss (or gain) an organisation is exposed to" (Gorrod 2004, p. 3), and "if you approach risk management as a discipline …you are concerned with the opportunity for gain as well as loss" (Frame 2003, p. 5). Other authors define risk management as a "field of activity seeking to eliminate, reduce and generally control … and to enhance the benefits [of risk]" (Waring and Glendon 1998, p. 3); "the discipline that clearly shows management the risks and returns of every major strategic decision" (Van Deventer, Imai and Mesler 2005, p. 6); "taking deliberate action to shift the odds in your favour – increasing the odds of good outcomes and decreasing the odds of bad outcomes' (Borge 2001, p. 4); "the process whereby organisations methodically address the risks attaching to their activities with the goal of achieving sustained benefit" (The Association of Insurance and Risk Managers, ALARM The National Forum for Risk Management in the Public Sector and The Association of Insurance and Risk Managers 2002, p. 2) and "the cultures processes and structures that are directed towards realizing potential opportunities whilst managing adverse effects" (Joint Technical Committee OB-007 Risk Management 2004, p. 4). Notwithstanding these definitions, most risk management models appear to be focusing on preventative and proactive actions designed to avoid the 'down-side' of risk, in order to avoid some form of loss.

In the context of this thesis, the focus is on business risk, in particular, aspects of enterprise risk dimensions. Figure 3.1 shows the risk dimensions that are aligned to Letter of Credit processes, developed from the literature and adapted to the context of this thesis.

Figure 3.1: Risk dimensions for a Letter of Credit



It is claimed that there is a "lack of credit risk evaluation modelling from the point of [the] exporter in [sic] literature" (Pridotkiene, Snieska and Snieskiene 2006, p. 7), with a multitude of models designed for banks and financial institutions to value bonds, loans and individual risks. Expectedly, these organisations consider their transactions from a dissimilar perspective to that of the exporter, as the bank's exposure to country risk is influenced by different activities. Consequently, as the principal aim of this research is to understand the causes and effects of documentary discrepancies related to Letter of Credit transactions and processes, a number of risk management models, described below, is not appropriate to this context.

The **Value at Risk** (*VaR*) model has been described by Saunders and Allen (2002) as a model that "… essentially seeks to measure the minimum loss (of value) on a given asset or liability over a given period of time at a given confidence level (e.g., 95 percent, 97 ½ percent, 99 percent)" (p. 84). Choudhry (2006) describes this model as "… essentially a measure of volatility, specifically how volatile a bank's assets are" (p. 14). "*VaR* summarises the worst loss over a target horizon with a given level of confidence" (Jorion 2001, p. 22) Although *VaR* is claimed to have "become an accepted standard in the financial industry" (Scholes 2000, pp. 18-19), it has been criticised for its reliance "on a number of unrealistic assumptions" (Simons 1996, p. 3). This model is not considered to be applicable to Letter of Credit transactions and documentary processes, as *VaR* is essentially a model to measure the value of a portfolio.

The **Capital Asset Pricing Model** (CAPM)

> "captures the basic finance relationship between risk and expected return where a more risky asset (relative to market portfolio) will have a relatively higher expected rate of return to compensate risk averse investors for the greater risk" (Layton and Valadkhani 2004, p. 7).

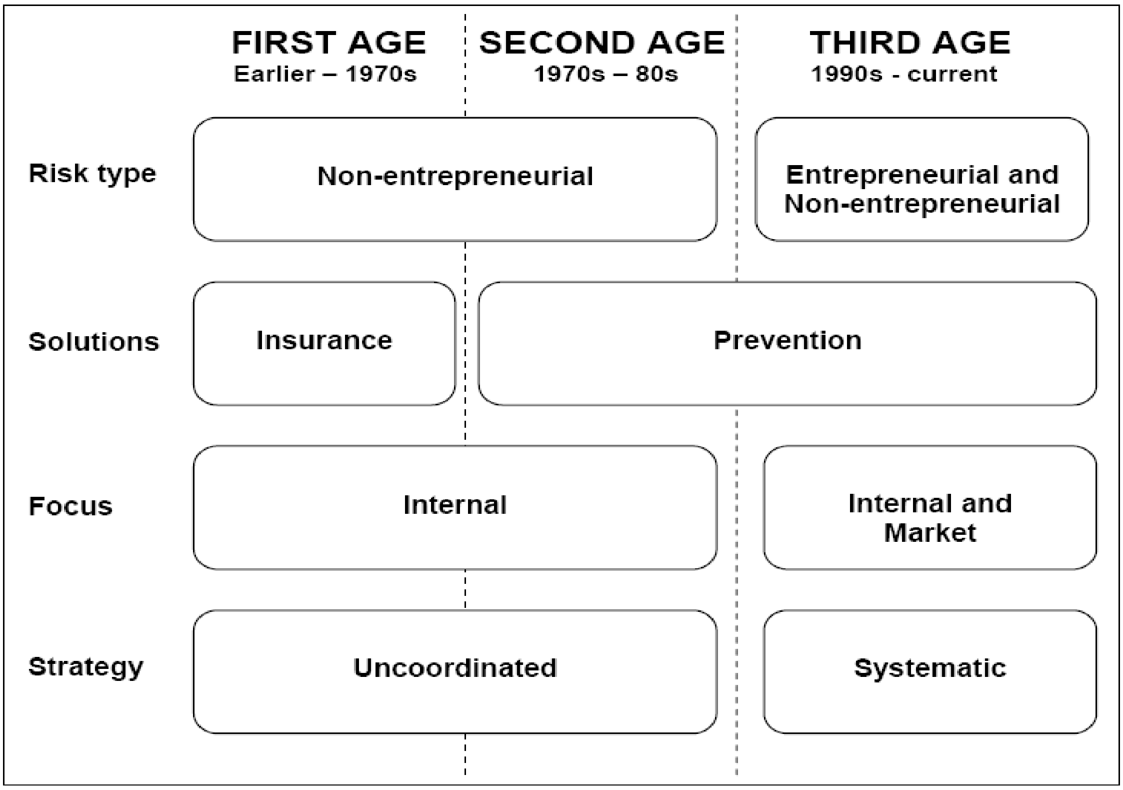
The CAPM is "based on equilibrium in capital markets" (Jorion 2003, p. 303) and "estimates expected annual returns on common stock" (Gardner and Dixie 1998, p. 103) and the "relevant measure of risk is the *systematic risk of the project*, measured by its beta" (Peirson et al. 1998, p. 556). As the CAPM relies on a diversified portfolio of assets for its application, in order to measure investment returns, this model is not appropriate to Letter of Credit transactions and processes for at least two reasons. The first reason is because the Letter of Credit is issued with a fixed cycle (predetermined expiry date) and a fixed amount and currency, typically extending credit terms for periods less than six months, as this payment instrument is used for short-term trade finance transactions. Typical exporters consider Letter of Credit transactions not as a portfolio but rather as individual transactions. The second reason is because a Letter of Credit market, as such, does not exist. Letters of Credit, although in themselves negotiable documents, are not traded in the open market, as if they were a commodity (Anon., Personal correspondence to Bergami 2009b). The arrangements for a Letter of Credit are between the issuing bank (giving the undertaking to pay) and the beneficiary (seller/exporter) who is the recipient of the funds and not third parties. By request, an exporter may apply to have the proceeds of future receivables under a Letter of Credit discounted by their bank but the decision to do so rests with that bank, which is under no obligation to act upon the request (Anon., Personal correspondence to Bergami 2009b). Therefore, as Letters of Credit are not openly traded, it is not feasible to establish equivalents of the variables involved (alphas and betas). It is acknowledged that banks may be able to conduct analysis based on their Letter of Credit business but this is not the focus of this research.

Because of the nature of Letters of Credit, a framework of risk, or a philosophy, or a conceptual (non-statistical) model may be more appropriate to this research than a statistical model. The reason behind this statement is that the variation in Letter of Credit business is only limited by one's imagination. The documentary data stipulations, and the specific performances required against a Letter of Credit transaction, give rise to a number of varying degrees of risk, according to the individual circumstances. As risk management approaches, at times, developed concurrently in different areas of the world, e.g., USA and Australia, the literature review follows themes, rather than chronological events.

It is acknowledged that the notion of risk is not new. There is evidence that risk consideration formed part of business decision making as far back as the Hammurabi code of 2250 B.C. (MacMinn 1999), through arrangements such as the sea loan, the *foenus nauticum*, although in those days the codification of risk, the development of models and frameworks for risk management had not reached the sophisticated levels of today.

Modern risk management has been gradually developing since the 1960s (Tye 1980) in response to expanding and changing patterns of domestic and international business transactions and it has been suggested that development of systems for managing risks has proceeded in three stages (Pitinanondha 2008), as shown in Figure 3.2.

Figure 3.2: The three ages of risk management – adapted from Sadgrove 2005 (Pitinanondha 2008, p. 16)



As can be observed the attitude to risk changed dramatically from a reactive inwards-looking approach to a more open and proactive approach that considered externalities in the conduct of one's business. As evidence of the shift in risk management focus exposure that might have relied on insurance solutions in the early age – "by using risk reactively or defensively to see how much insurance they should buy" (Sadgrove 1996, p. 1) is now addressed through a prevention approach – that is, risk reduction "by introducing new policies and practice" (Sadgrove 1996, p. 2) . Likewise, the focus moved from just internal to being internal and external and what were once unco-ordinated strategies are now systematic ones.

These changes gave rise to new ways of considering risk and changed attitudes to the principles of managing risk. As an example, the expansion of the American banks in the early 1980s, through acquisitions and ventures into new complex businesses, such as capital markets and investment banking, caused a shift in auditing practices away from monitoring individual transactions risks towards monitoring “the systems that monitor the risks of those transactions” (Clark 1987, p. 36). Consequently, risk containment programs began to evolve in a manner that reflected the changes in the business environment (Huss and Jacobs 1991).

3.1.1 The COSO framework

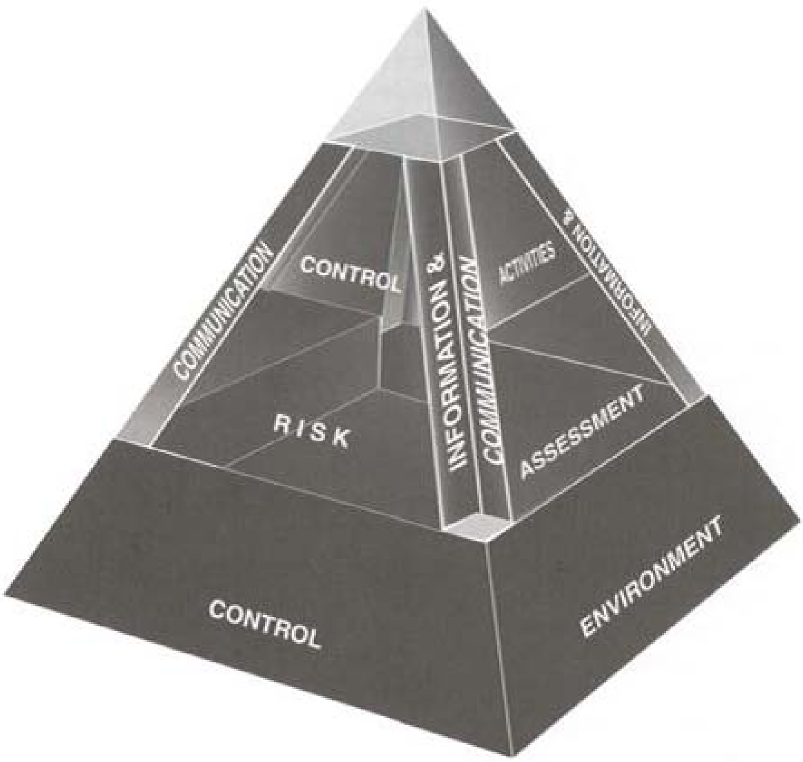
The period of change during the late 1970s and early 1980s was not without its problems, as evidenced by a number of high-profile company failures. These failures led to the formation of the Committee of the Sponsoring Organisations of the Treadway Commission (COSO) in the USA, in 1985. COSO is an independent private sector initiative formed to sponsor the National Commission on Fraudulent Financial Reporting. The National Commission sponsoring organisations are the American Accounting Association (AAA), the American Institute of Certified Public Accountants (AICPA), Financial Executives International (FEI), The Institute of Internal Auditors (IIA), and the National Association of Accountants (now the Institute of Management Accountants [IMA]). Additional independent representation on the National Commission came from industry, public accounting, investment firms and the New York Stock Exchange.

The primary aim of the National Commission was to study the causal factors that can lead to fraudulent financial reporting. COSO had a mandate to address enterprise-wide risk management and governance issues. The COSO project ultimately resulted in the publication of the ‘Internal Control – Integrated Framework’ in 1992. The focus of this work was very much on internal controls because these “are put in place … to minimise surprises along the way” (Committee of the Sponsoring Organisations of the Treadway Commission 1992, p. 3). COSO provides an enterprise level framework for corporate governance, focusing on five areas (Committee of the Sponsoring Organisations of the Treadway Commission 1992, p. 17), as shown in Figure 3.3:

- control environment – where people conduct their activities and perform their control responsibilities. This is the underpinning component to the rest of the model;
- risk assessment – undertaken by management to achieve specified objectives;

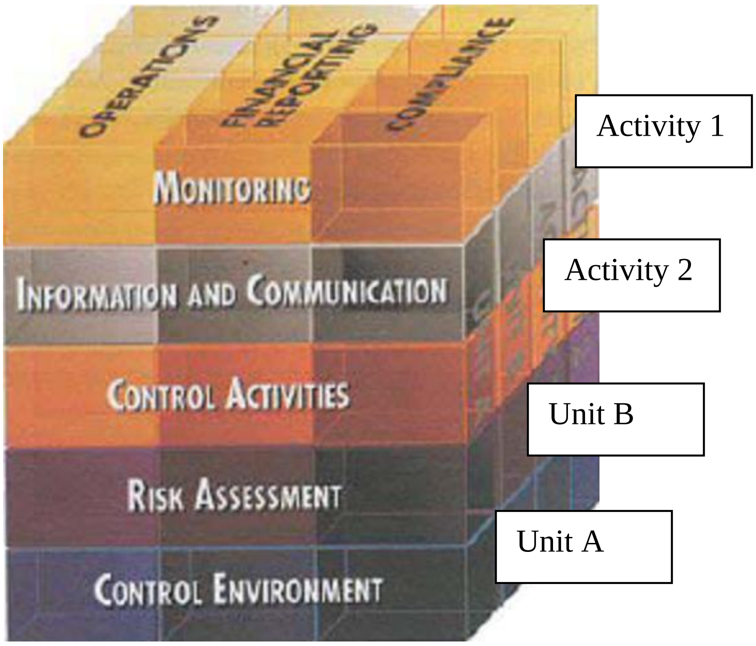
- control activities – in accordance with management directives, these are implemented to assist to address the risks identified;
- information and communication – captured and disseminated to relevant parties throughout the organisation; and
- monitoring – processes that are continuously monitored and modified accordingly.

Figure 3.3: The COSO Internal Control Components (Committee of the Sponsoring Organisations of the Treadway Commission 1992, p. 17)



COSO also devised a cube to represent the relationships between the organisational objectives and components and this is shown at Figure 3.4 The COSO cube shows the “dynamism of internal control systems” (Committee of the Sponsoring Organisations of the Treadway Commission 1992, p. 18) between the three objective categories (operations, financial reporting and compliance – the vertical columns), the five components (represented by the horizontal rows – monitoring, information and communication, control activities, risk assessment and control environment) and the units or activities subject to internal controls (unit A, unit B, activity A, activity B), however, by its own admission, COSO acknowledges that “internal control cannot prevent bad judgements or decisions” (Committee of the Sponsoring Organisations of the Treadway Commission 1992, p. 16).

Figure 3.4: COSO Cube: relationship of objectives and components (Committee of the Sponsoring Organisations of the Treadway Commission 1992, p. 19)



However, the notion of internal controls may have been undermined when COSO, rather surprisingly, decided to “arbitrarily and explicitly exclude from its internal control definition such critical management undertakings as strategic planning and goal setting.” (Root 1998, p. 113). These exclusions included “mission and value statements … risk management and corrective actions” (Root 1998, p. 117), although risk identification and analysis were not excluded.

The COSO framework has been criticised because its “preoccupation with financial reporting … results in a distorted perspective” (Root 1998, p. 122) - “internal controls help ensure the reliability of financial statements” (Committee of the Sponsoring Organisations of the Treadway Commission 1992, p. 3) – yet, perhaps curiously, COSO “does not require corporations to report on their process of internal control” (Miccolis and Shah 2000, p. 5).

The COSO framework, although not perfect and limited in its scope was, nevertheless, a significant event in the early developments of risk management and organisational-wide systems to deal with risks. It “changed the way we look at internal control” (Simmons 1997, p. 68) and became “widely accepted as the benchmark for evaluating internal controls for businesses” (Minter 2002, p. 10).

In the context of the research focus on Letter of Credit transactions in this thesis, the 1992 COSO framework is not considered to be appropriate because it is too general and vague in its nature, does not provide any details of how the framework ought to be implemented, excludes risk management as part of its internal control definitions and is heavily focused on financial reporting objectives. Consequently, the COSO 1992 framework is not well aligned to documentary Letter of Credit processes and risks and, therefore, it is not useful to the focus of this thesis.

However, COSO was probably the catalyst for the ensuing focus on Enterprise Risk Management (ERM) approaches, as “it does set out a framework of ERM within an organisation” (Miccolis and Shah 2000, p. 5). ERM, and other similar approaches, may be worthy of consideration in the context of understanding the development of risk management approaches and attitudes, in general, that have shaped modern day practices. It appears from the literature since the 1990s that the management of risk across the enterprise has gained increasing attention and the main approaches are discussed below.

3.1.2 The emergence of ERM

It would seem that ERM emerged as a management concept within corporations in the 1990s (Dickinson 2001). According to Dickinson (2001), the reason for the emergence of ERM was a result of high-profile company failures and the increasing importance of shareholder value concepts that “draw their inspiration from finance theory, where risk has always played a central role” (Dickinson 2001, p. 360). ERM is a system of analysing and managing a firm’s risk with a consistent and comprehensive framework, so that the interrelationships between strategic, operational, financial and hazard risk are considered holistically, that is, from an enterprise-wide perspective (Scherz and Macaky 1998). ERM aims to move away from the traditional approach of managing risk, one that relied on discrete decision making by unrelated organisational units – without any consideration of the overall impact on the entity as a whole – what Scherz and Mackay (1998) refer to as the ‘silo” mentality that they claim is “no longer effective or prudent" (p. 30). It has been recognised that risk management "has been part of business management for some time, but in separated, isolated areas" (Cross 2000, p. 2). Matters, such as insurance, project management and occupational health and safety have all been subjected to different aspects of risk management but have used different terminology and focus, resulting in a process that did not provide a single integrated approach.

3.1.3 Integrated business management system

Statzer (1999) argues that when a "company takes on an integrated, strategic approach to managing … risks, both immediate and long-term benefits result" (p. 30). Statzer (1999) proposes a model referred to as an **'integrated business risk management system' (BRMS)**, as shown in Figure 3.5, that appears to follow the principles of ERM.

Figure 3.5: Integrated nature of business risks (BRMS) (Statzer 1999, p. 30)

In advocating the benefit of an enterprise-wide approach to risk, Statzer (1998) acknowledges the difficulties of implementing a system required to produce a culture change in an organisation. As 'the foundation of internal control is business ethics and values" (Root 1998, p. 122), it is not difficult to imagine the challenges that may be encountered in trying to change the culture of a business, so much so that Statzer (1998) recommends that the task of implementing BRMS be left to an external third party organisation, under some form of partnership agreement.

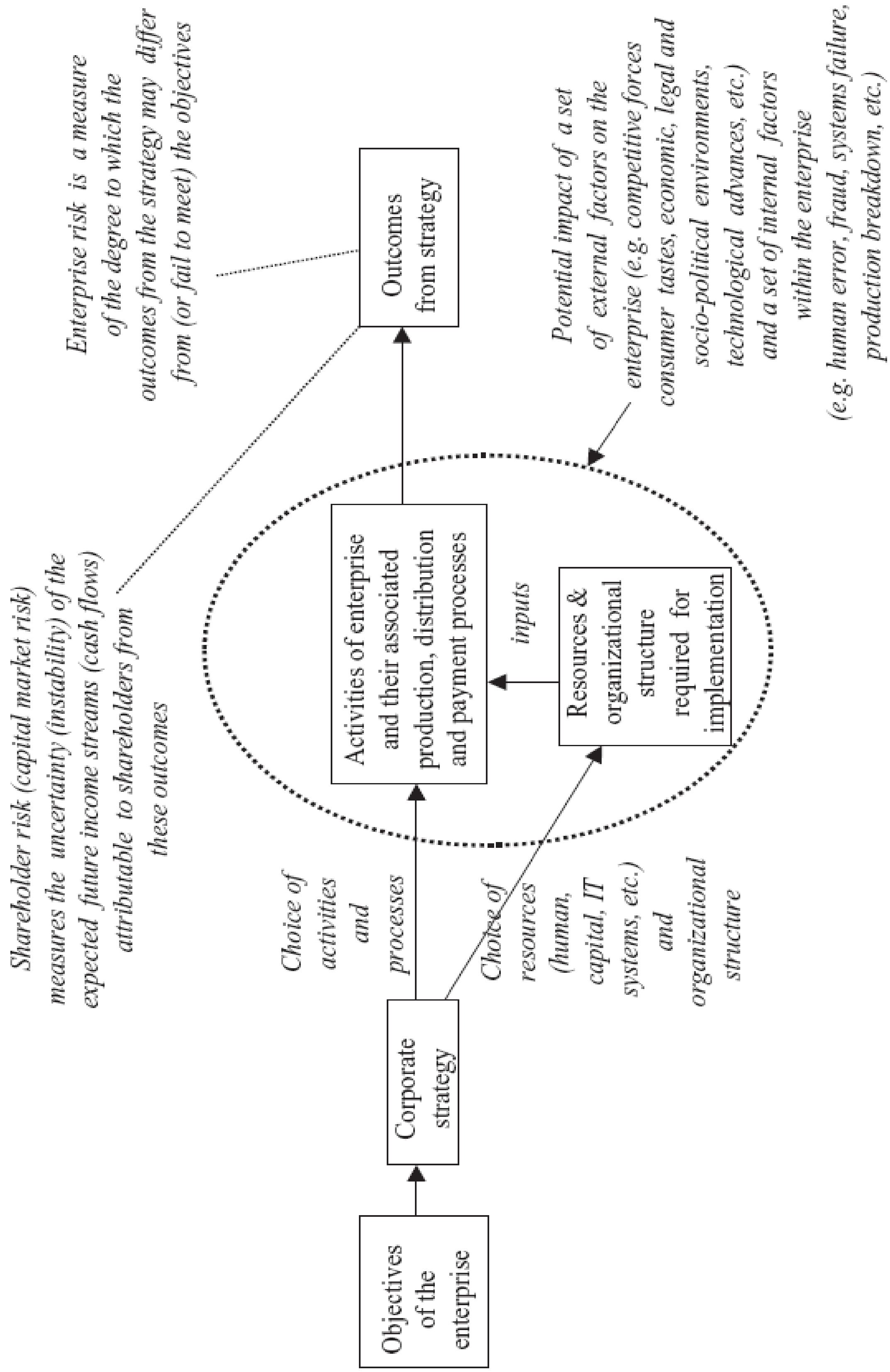
The BRMS model's focus is at the macro level and it is without definition of the possible relevant components of the model, e.g., transportation and financial risks. This model embraces a coherent approach to risk management but lacks detail about its composition and implementation. Missing from this model are external (and internal) factors that might contribute to losses in Letter of Credit transactions, particularly in relation to the production of various required documents – a process that may involve a number of independent parties, including superintendent companies, government permit issuing agencies or Chambers of Commerce. It is difficult to see how or where the BRMS could be applied to Letter of Credit transactions and, consequently, this model is considered inadequate for this research project.

3.1.4 Measuring enterprise risk

A strategy that an organisation adopts in meeting its objectives will have a degree of risk attached to it – risk is after all omni-present and inherent in any activity. Dickinson (2001) argues that the strategy adopted by a firm, therefore, has a number of external and internal factors that can cause the outcome of the firm's activities to vary from those of its objectives. External factors may include changes in competition or product mix on that industry segment or even changes in financial and capital markets and /or legal, technological and political environments. Dickinson provides an approach to measuring enterprise risk management as shown at Figure 3.6.

Beginning with the objectives of the enterprise, the corporate strategy is developed and this determines the choice of activities, processes and resources. The activities and the processes of the enterprise include the associated production, distribution and payment processes. The resources include human capital, information technology systems and the organisational structure. As can be observed from Figure 3.6, the resources become inputs to the activities of the enterprise as they support these processes. The resources and the processes are subject to external factors (competition, technological advances, changes in consumer tastes, etc.) and internal factors (human error, fraud, production breakdown, etc.) – these are commonly referred to as 'operational factors'.

Figure 3.6: Measuring enterprise risk (Dickinson, 2001, p. 362)



The outcome from the strategy is measured in terms of enterprise risk. This is the degree to which the outcomes from the strategy differ or fail to meet the objectives. The main aim of this model appears to be that of managing risk through risk transfer strategies such as insurance or self-insurance schemes and other financial products such as hedging.

"Insurable risks and financial risks are both sub-sets of enterprise risk" Dickinson (2001, p. 363) argues. He also claims that "most of the risks that a company faces cannot be insured, and so they must be retained and financed internally" (Dickinson 2001, p. 363). This claim, though, would not seem to apply to international sales, as a number of export credit agencies offer insurance against buyer default and country default, without excluding Letter of Credit transactions as payment options.

From a Letter of Credit transaction point of view, aspects of the Dickinson model are relevant, such as payment systems and human errors, but this model does not provide enough micro detail to consider the other aspects relevant to Letter of Credit transactions, such as bank or sovereign risks. Although the model mentions payment processes, the lack of detail about the complexities of Letter of Credit transactions, and the management of their peculiar risk, are not considered by the author, consequently, the model proposed by Dickinson (2001) is not adequate for the purposes of this research.

3.1.5 The emergence of risk management standards

In 1995, the world's first risk management standard, AS/NZS 4360: 1995 (ANZ/NZS 1995), was jointly issued by Standards Australia and Standards New Zealand. This standard provided a "generic framework for identification, analysis, assessment, treatment, and monitoring of risk" (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk Management 1995, p. 2). Although the AS/NZS 1995 standard is generic and does not enforce risk management system uniformity, it states that the "management of risk is an integral part of the management process" (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk Management 1995, p. 8), thus, this standard is diametrically opposed to the COSO Internal Control framework of 1992 that excludes risk management in its definition of internal control. The AS/NZS 1995 appears to advocate an ERM approach to risk management, describing this as a “multifaceted approach, appropriate aspects of which are often best carried out by a multi-disciplinary team” (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk Management 1995, p. 8). The standard also recognises that in some situations, it may not be possible to integrate risk management across the organisation and under these circumstances it is proposed that “it may still be possible to apply it successfully to individual departments, processes, or projects” (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk Management 1995, p. 2).

The main elements of this iterative risk management process overview, shown at Figure 3.7 (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk Management 1995, p. 9) are as follows.

- Establish the context – establish the strategic, organisation and risk management context for the rest of the process, including setting the criteria for risk assessment (e.g., operational, financial, etc.) and defining the structure of the analysis.
- Identify the risk – what, how and why things can arise, as the basis for further analysis.
- Analyse risks – estimate the level of risk based on the likelihood of an event happening and its potential consequences and magnitude.
- Assess and prioritise risks – compare risk levels (above) with previously established risk criteria in order to prioritise same for management. Note that low risk levels may be acceptable and, therefore, these do not require treatment.
- Treat risk – for low priority risk accept and monitor; for other risks a management plan should be developed and implemented and this should include funding considerations based on cost of risk reduction measures, as per Figure 3.8.
- Monitor and review – the performance of the risk management system and any changes that may affect it are to be monitored and reviewed.

The process itself, with a more detailed flow, is represented diagrammatically at Figure 3.9, and the risk treatment process at Figure 3.10.

Figure 3.7: AS/NZS 4360: 1995 Risk management overview (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk Management 1995, p. 9)

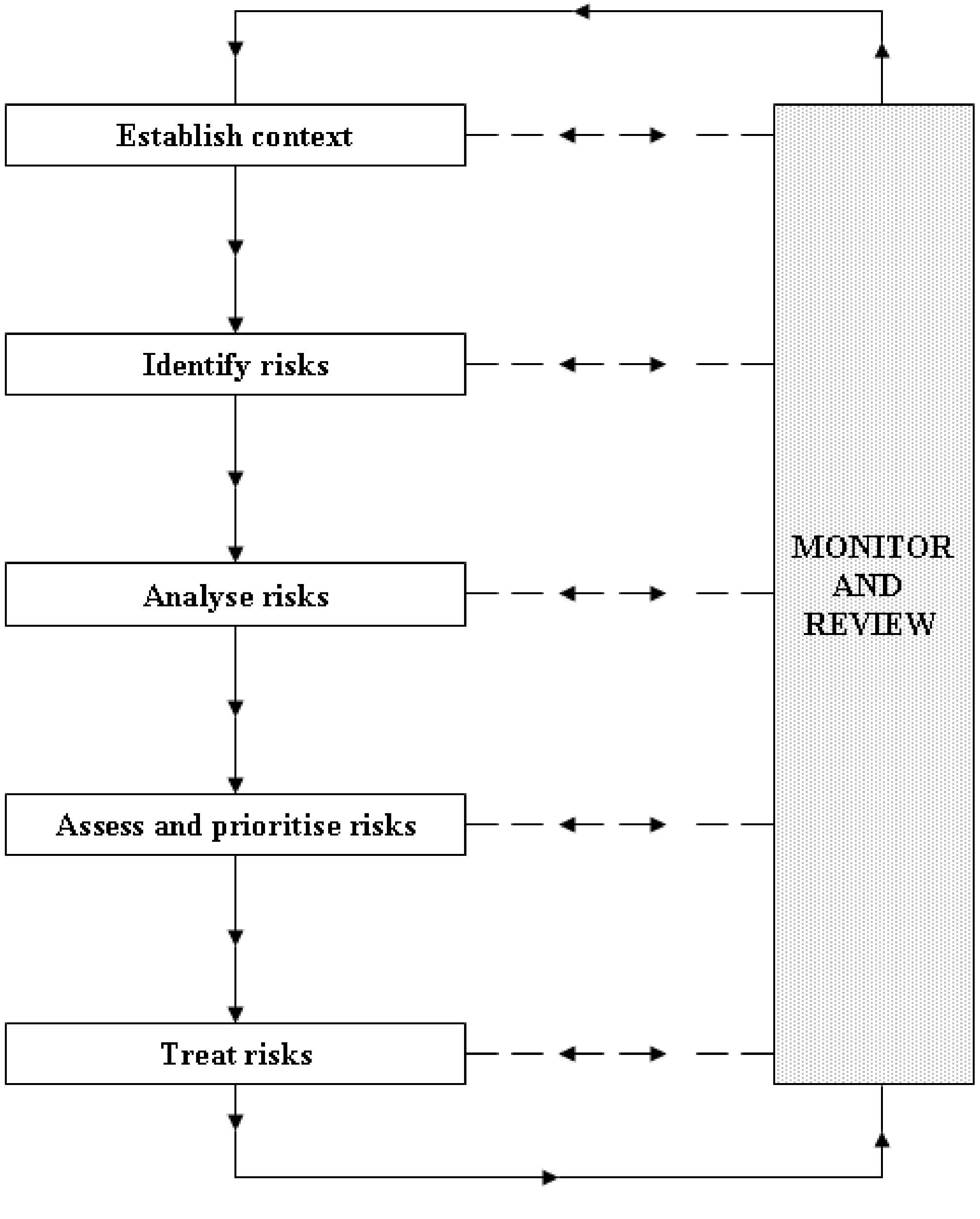


Figure 3.8 shows how risk treatment options may be evaluated, based on “the extent of risk reduction and the extent of benefits or opportunities created” (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk Management 1995, p. 17). There is a cost versus benefit balance that needs to be achieved in treating risks, because “in general, the cost of managing risks needs to be commensurate with the benefits obtained” (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk

Management 1995, p. 17). The standard recommends the implementation of options that have a high risk reduction with low cost associated with their implementation – this is shown by the area labelled ‘implement reductions measures’, in Figure 3.8. The shaded area in the middle of Figure 3.8, labelled ‘use judgement’ applies to that range of risk reductions options that need to be justified on a cost versus benefit basis. The clear right area under the curve labelled ‘uneconomic’ shows the range of decisions that should “take account of the need to carefully consider rare but severe risks, which may warrant risk reduction measures that are not fully justifiable on strictly economic grounds” (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk Management 1995, p. 17).

Figure 3.8: Cost of risk reduction measures (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk Management 1995, p. 17)

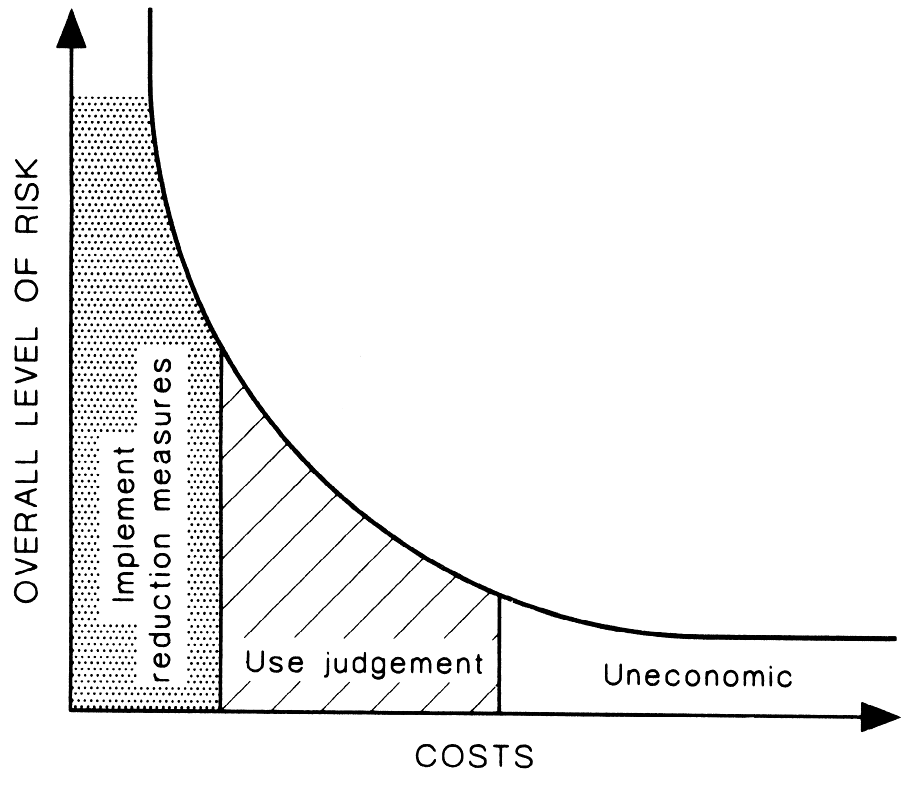
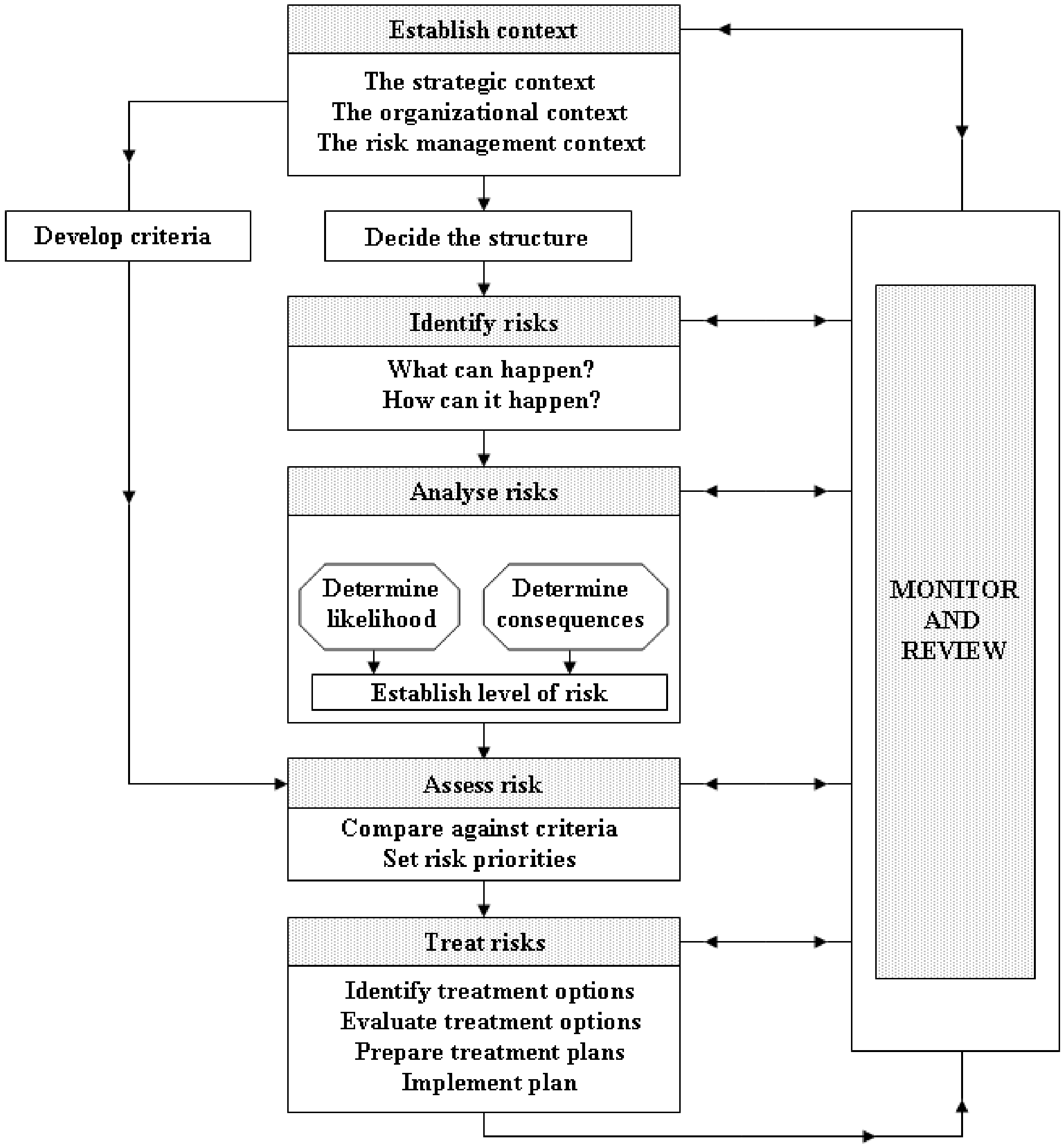


Figure 3.9 shows a more detailed process than that of Figure 3.7, by providing additional information under each of the main elements discussed earlier, as well as introducing the ‘develop criteria’ step. “Criteria may be affected by internal and external perceptions and legal requirements. It is important that appropriate [risk

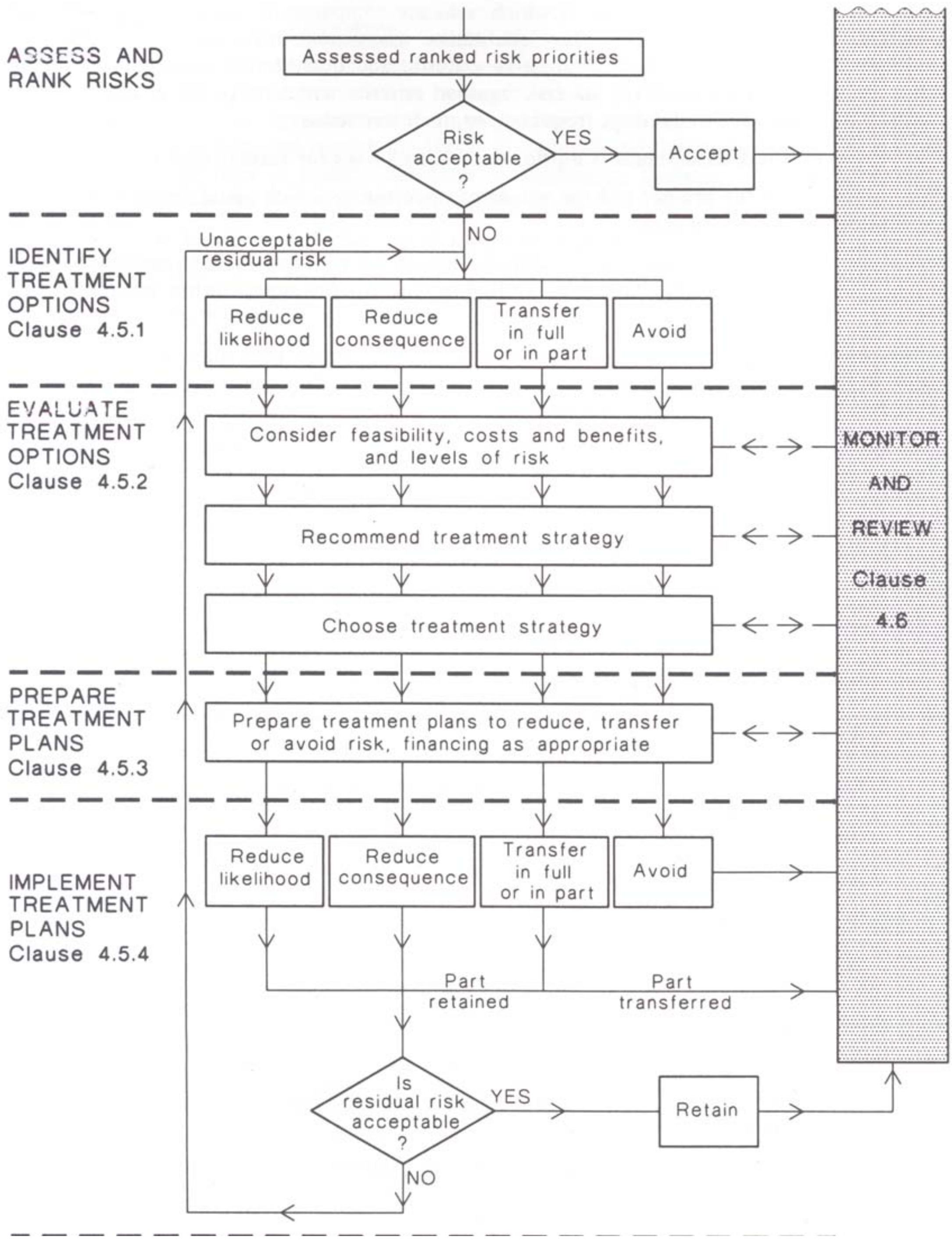
assessment] criteria be determined at the onset" (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk Management 1995, p. 12)

Figure 3.9: Risk management process (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk Management 1995, p. 11)



The treatment process outlined in the flowchart at Figure 3.10 may only have limited application to Letter of Credit transactions because, often, documentary discrepancies are not able to be easily (if at all) corrected, especially when these relate to third party (externally issued) documents. Discrepancies are typically discovered by the bank documentary check procedures that take place after it has received the requisite documents. By this stage the transport document has been issued because the goods have already been shipped. As discrepancies are a post-shipment event, preventative measures are not easily devised under such circumstances.

Figure 3.10: Risk treatment process (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk Management 1995, p. 16)



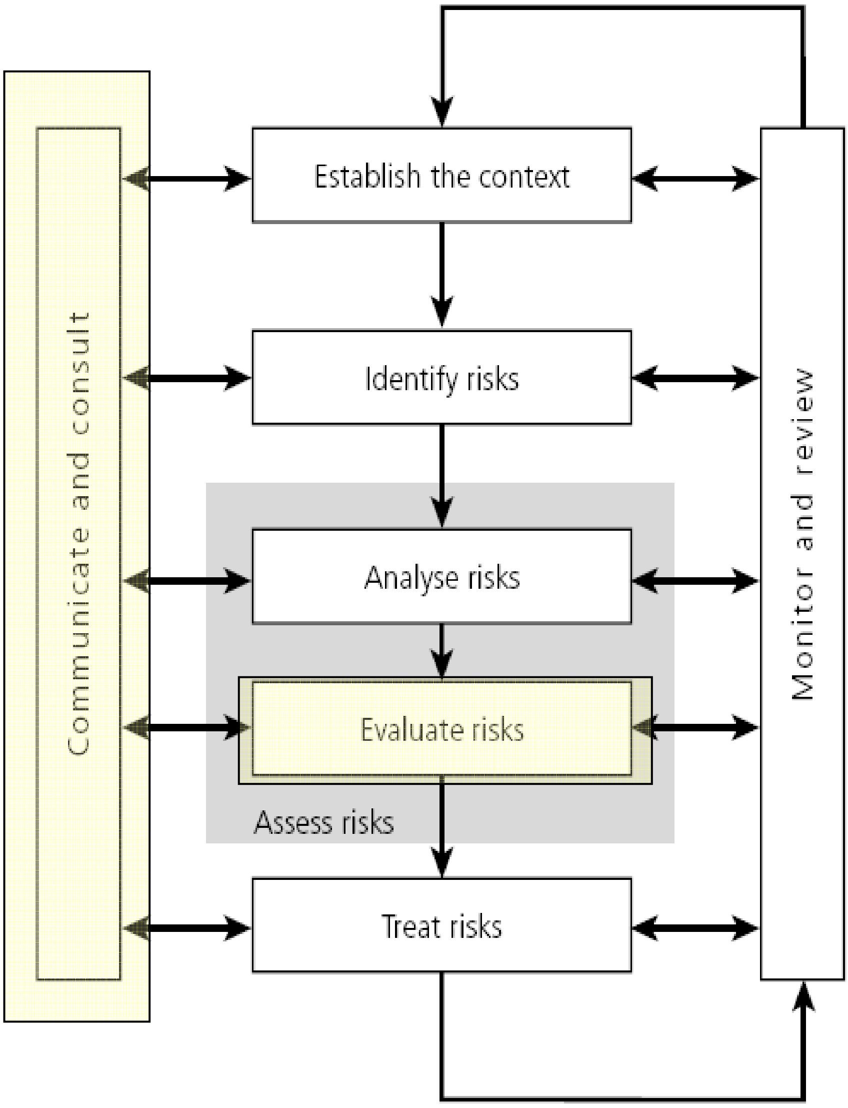
The appendices to the standards provide examples of possible sources of risk (e.g., commercial/legal, human behaviour, economic circumstances, management activities and control, individual activities); classification of risk (e.g., economic and human perils, financial and diseases) and action to reduce or control likelihood and consequences (e.g., structured training and other programs [an issue that will be considered later in the thesis as part of the research data discussion] and contract conditions).

Although the AS/NZS 1995 Standard clearly advocates an enterprise-wide approach, the standard itself "is generic and independent of any specific industry or economic sector. The design and implementation of the risk management system will be influenced by the varying needs of an organisation" (Joint Standards Australia/Standards New Zealand Committee OB/7 on Risk Management 1995, p. 2). This standard, therefore, only provides a general framework, without any specific guidance on how these processes may work for a particular firm's process. Whilst commercial relationships and human behaviour are identified as possible sources of risk, these are provided as generic examples, without any further detail or guidance in how to deal with them or how to implement appropriate risk management processes. The sample documentation provided in the standard includes a risk identification template, a risk register and risk treatment schedule and plan and a risk action plan but these are in simple form and not aligned to the documentary process risks inherent in Letter of Credit business. This generic approach, therefore, leaves it to the individual organisation to devise its own micro processes within the context of a broad macro standard. The lack of detail in the AS/NZS 1995 standard prevents it from being useful in the context of Letter of Credit transactions risks. For example, there is no clear identification of the risk components of Letter of Credit business, such as, country, customer or bank risk and, consequently, the AS/NZS 1995 standard is not appropriate to the purposes of this research.

The AS/NZS 1995 Standard was amended twice. The first amendment, in December 1995 merely rectified errors on the details of the committee's participants. The second amendment in January 1998 replaced the word assessment with evaluation. These changes were incorporated in the subsequent version of the standard.

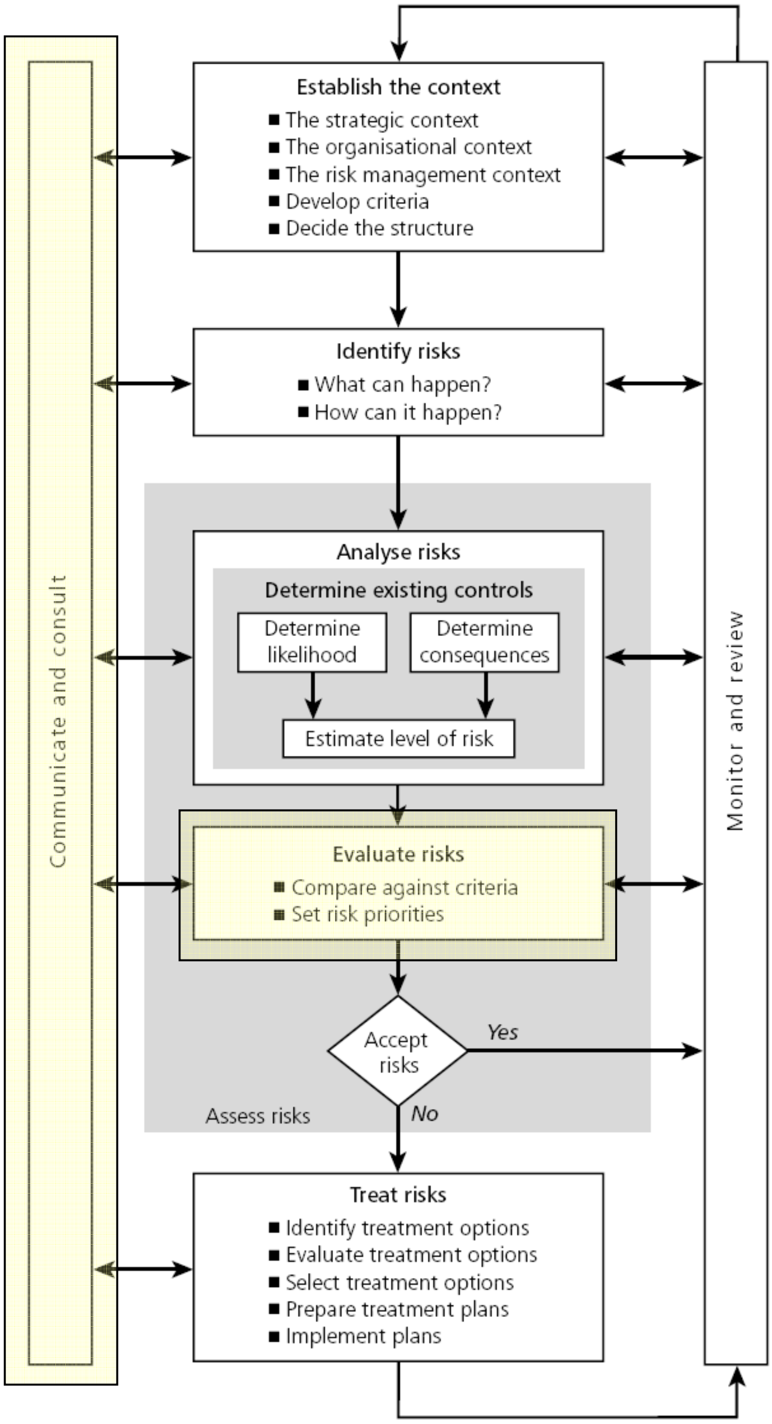
In 1999, a new version of the standard was published – AS/NZS 4360: 1999 Risk Management (AS/NZS 1999). The overall risk management process was enhanced and the overview, the risk management process and the risk treatment are shown at Figure 3.11, 3.12 and 3.13, respectively.

Figure 3.11: Risk management overview (Joint Technical Committee OB/7 - Risk Management 1999, p. 8)



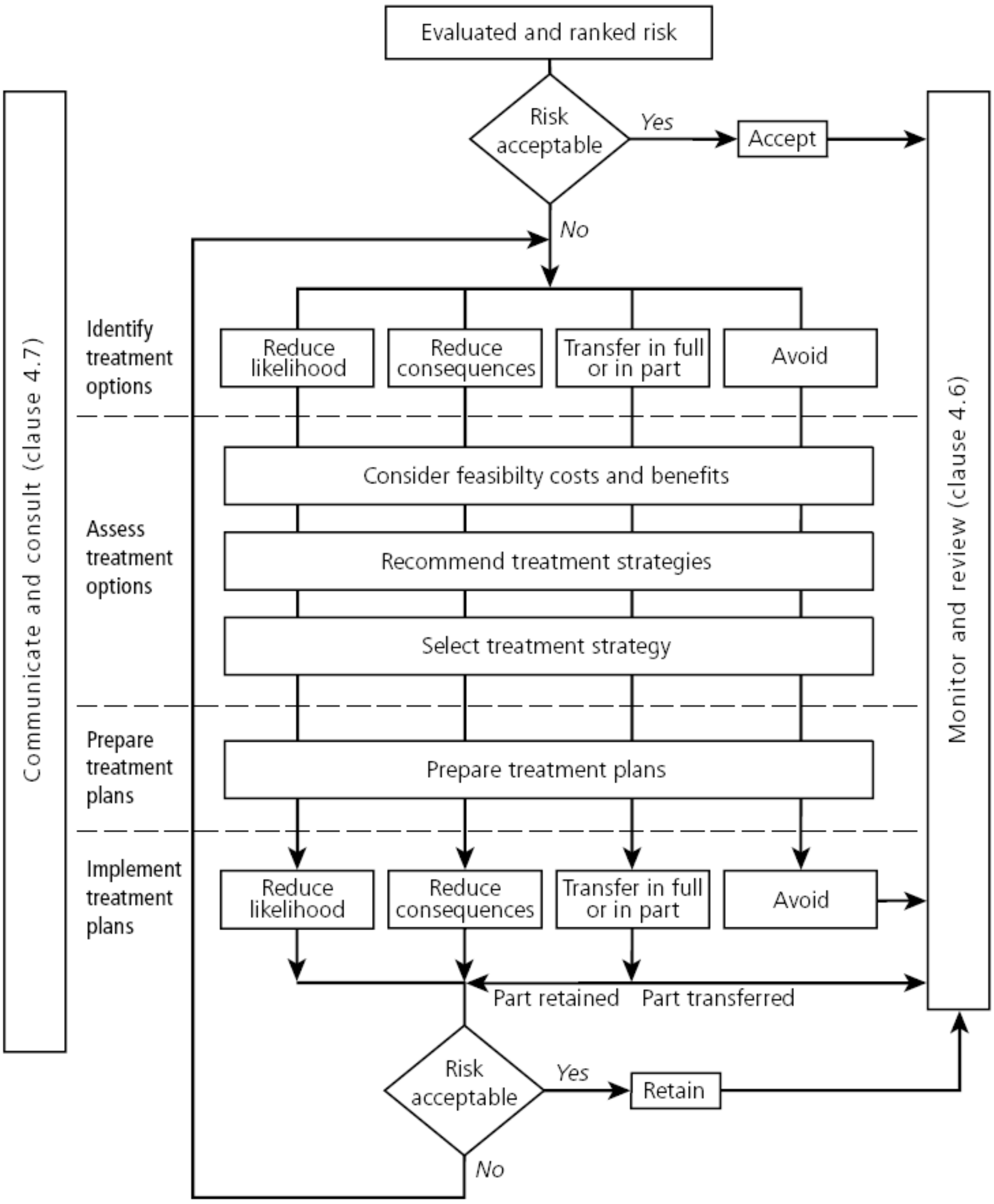
By comparison with the original 1995 standard shown at Figures 3.7 and 3.9, the AS/NZS 1999 standard (Figures 3.11 and 3.12) added communication and consultation processes and what were once 'assess and prioritise risks' became 'evaluate risks' (these are reflected by the yellow shaded areas) and the risk assessment (the background shadowed area in Figure 3.11, 3.12) included not only evaluation but also analysis.

Figure 3.12: Risk management process (Joint Technical Committee OB/7 - Risk Management 1999, p. 11)



Communication and consultation processes were also added to the risk treatment flowchart (see Figure 3.10 versus Figure 3.13). These changes were regarded as an improvement to the original standard, however, the criticism about the lack of detail in the 1995 standard equally applies to the 1999 version. This version did not provide any more guidance than the generic framework that was touted to be applicable to any "public, private or community enterprise or group" (Joint Technical Committee OB/7 - Risk Management 1999, p. 1).

Figure 3.13: Risk treatment process (Joint Technical Committee OB/7 - Risk Management 1999, p. 17)



The AS/NZS standards no doubt contributed to the world-wide discussion of risk management processes. Despite differences between COSO Internal Control 1992 and the AS/NZS 1995 and 1999 standards, ideas were beginning to emerge slowly in favour of more inclusive risk management processes.

3.1.6 Later ERM developments

Several concepts of enterprise-wide risk management approaches were developed over the past decade. These included the:

- integrated risk management by Association of Insurers and Risk Managers in Commerce (AIRMIC) (1999);
- enterprise-wide risk management by DeLoach (2000);
- the business risk management process by Hodgkinson (2001); and
- enterprise-wide risk management by Mottershead and Godfrey (2001).

All of these approaches focused on describing basic process frameworks, but "such guidance offers limited advice on how organisations might deploy and develop RM [risk management]" (Ward 2003, p. 9). Indeed, there is nothing in the approaches listed above that is particularly relevant or aligned to the Letter of Credit transaction and, consequently, these will not be considered further.

As ERM is a "systematic and disciplined approach to managing risk throughout the organisation … fundamentally a transformation process that changes the way an organisation perceives and manages risk" (Funston 2003, p. 60), Ward (2003) argues that lack of detailed guidance may lead to the development of simplified processes that, whilst easy to implement, lack robust risk management principles. This may later create difficulties when attempting to make the risk management process more sophisticated or more closely aligned to decision making.

Whilst ERM, in a broad sense, was beginning to gain ground as a possible holistic framework for risk management, by the turn of the 21st Century it was not as widely implemented as might have been hoped. In a large scale benchmarking survey on Enterprise Risk Management (ERM) undertaken in 2001 by the Institute of Internal Auditors Research Foundation (USA) and Tillinghast-Towers Perrin, in cooperation with the Conference Board of Canada, fifty-five percent of respondents reported that organisational culture was a barrier to ERM implementation and 50 percent stated that

ERM was “not yet perceived as a priority by senior management” (Merkley 2001, p. 28).

The findings in that survey were supported by separate data presented by KPMG at a Global Risk Management Summit in July 2001. According to the KPMG data, about 81% of companies claimed to be using an integrated enterprise-wide risk management approach but that, in reality, only 5 to 10 percent in North America were truly practising ERM, with another twenty percent “in various stages of legitimate integration … [as] the mammoth objective to lead your organisation into the era of ERM is intimidating” (Kayfish 2001, p. 64).

At about the same time (in 2001) COSO announced a new study on ERM, a landmark project with the aim to “provide extensive guidance that contains both a conceptual framework and accompanying detailed application guidance to assist companies in the management of risk” (Beasley, Prawitt and Rittenberg 2002). The catalyst for this study was probably the realisation that whilst firms may have been utilising risk models, these were probably in-house developments and not enterprise-wide integrated models, as the KPMG survey results indicated. The resulting new COSO ERM Framework would “offer boards and management a commonly accepted model for discussing and evaluating an organizations’s risk management efforts” (Chapman 2003, p. 32).

Up until 2003, even though ERM had begun to be implemented, available literature was basically confined to the trade press and industry surveys, with a “lack of academic literature regarding the determinants of ERM” (Liebenberg and Hoyt 2003, p. 39). These authors argue that the driving forces behind ERM are due to two basic influences: internal and external. The maximisation of shareholder’s wealth through an integrated approach that reduces inefficiencies is an internal influence, whilst external influences “have driven firms to approach risk management in a more holistic manner” (Liebenberg and Hoyt 2003, p. 40). Examples of external influences include globalisation, industry consolidation, deregulation and technological advances enabling better risk quantification and analysis.

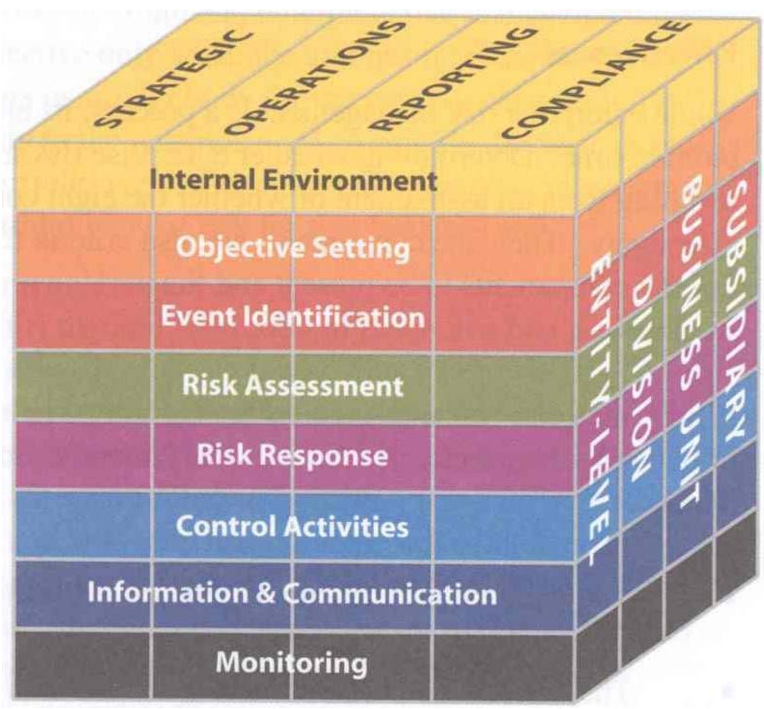
The year 2004 saw the publication of two significant works: one in the USA – the COSO Enterprise Risk Management – Integrated Framework (COSO 2004), and the other in Australia – the Australia/New Zealand Risk Management AS/NZS 4360: 2004

(AS/NZS 2004), both of these are discussed below. In looking at both of these approaches it becomes evident that risk management focuses on an enterprise-wide approach. Some authors, early in 2004, highlighted the shortcomings of enterprise-wide risk management such as: it is not for everyone; it is not a product or a project, but rather on ongoing process; and that exposure identification is not easy. However, these authors also point to positive longer-term benefits of the enterprise-wide approach as it focuses organisational considerations of risk at an earlier stage, "rather than try to retrofit risk management tools and techniques after decisions have been implemented" (Corbett 2004, p. 53) Others were predicting a future where "risk management … will be ubiquitous" (Tippins 2004, p. 10).

3.1.7 COSO Enterprise Risk Management 2004

The original COSO 1992 framework was reviewed, expanded and refocused resulting in the release of the COSO Enterprise Risk Management – Integrated Framework in September 2004. The five components and three objectives of the COSO 1992 framework were replaced with eight components and five objectives in the new 2004 approach, as shown in Figure 3.14.

Figure 3.14: COSO 2004 ERM Cube: relationship of objectives and components (Committee of Sponsoring Organisations of the Treadway Commission 2004b, p. 23)



COSO was apparently influenced by the earlier AS/NZS 1999, seen as an

> important first step in establishing worldwide risk management standards, and almost certainly got others … thinking about standard publishing in this area …this standard was almost certainly and influence on the content and even the development of COSO ERM (Moeller 2007, p. 335).

The AS/NZS 2004 standard is discussed after the COSO 2004.

The components of the COSO 2004 ERM approach are:

- internal environment – where management sets a philosophy of risk and establishes a risk appetite. In a diagrammatic form, the risk appetite is shown at Figure 3.15. The internal environment recognises that people are at the core of any business and it is they who view and address the risk and controls. Individual attributes, such as integrity, ethical values and competence influence the internal environment;
- objective setting – ERM ensures that there is a process for management to set objectives that are in line with the entity's mission and consistent with its risk appetite;
- event identification – these are events that may potentially impact on the organisation. There should be a distinction between events that represent risks, opportunities or both. Opportunities are sent back to management for strategy and objective setting review;
- risk assessment – once identified, risks are assessed on both an inherent and a residual basis, with likelihood and impact forming part of the risk assessment;
- risk response – may be avoiding, accepting, reducing and sharing the risk, in accordance with organisational risk tolerances and risk appetite;
- policies and procedures – to ensure management response choices are effectively executed;
- information and communication – identified, captured and communicated in a timely manner to relevant persons. Clearly defined roles and responsibilities are required. Information at all organisational levels is needed to identify, assess and respond to risk; and

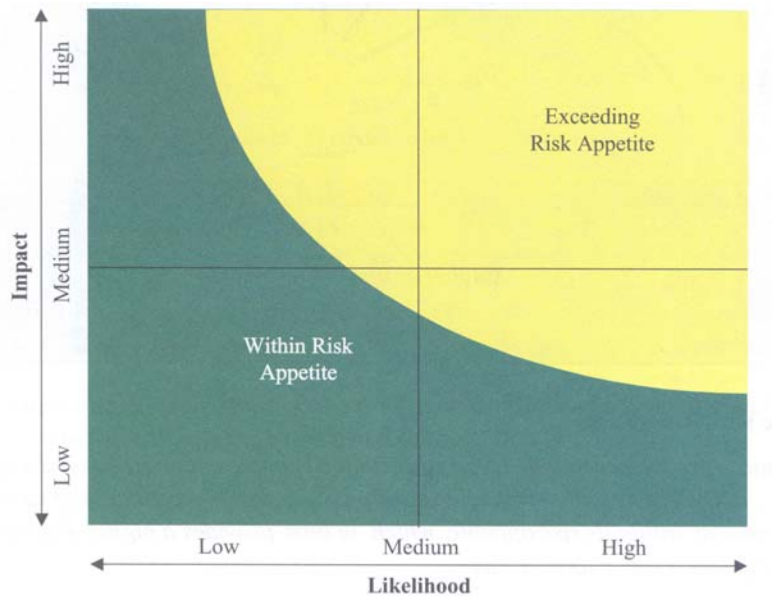
- monitoring – the whole of ERM is monitored and modified as necessary, to ensure dynamic reactions to changing conditions. Monitoring should comprise management activities, separate evaluation of ERM or a combination of both.

It can be observed in Figure 3.14 that “each component row ‘cuts across’ and applies to all four objective categories” (Committee of Sponsoring Organisations of the Treadway Commission 2004b, p. 23) and the entity and its units are shown as the third dimension of the cube.

To assist in the implementation of the ERM approach to risk management, COSO published an Application Techniques ‘volume’ (just over 100 pages), with examples of how the framework could be implemented. In this volume the description of risk appetite, mentioned above and shown at Figure 3.15, is the

> “amount of risk an entity is willing to accept in pursuit of value. It reflects the enterprise’s risk management philosophy and in turn influences the entity’s culture and operating style” (Committee of Sponsoring Organisations of the Treadway Commission 2004b, p. 28).

Figure 3.15: COSO 2004 Forming risk appetite (Committee of Sponsoring Organisations of the Treadway Commission 2004a, p. 17)



The measurement and setting of risk appetite is a strategic decision that should be aligned to an organisation’s objectives thereby driving its risk tolerance. Because risks can arise from external and internal sources, the establishment of objectives is “a precondition to effective event identification, risk assessment and risk response” (Committee of Sponsoring Organisations of the Treadway Commission 2004a, p. 13).

As Figure 3.15 depicts, the likelihood and the impact of an event will influence the risk appetite. The risk appetite is set by the organisation based within the context in which it operates. The yellow shaded area (with arrows) in Figure 3.16 represents residual risk that is outside the risk appetite that the organisation has set. Any event that is likely to fall within the yellow area would require "management to take action to reduce the likelihood and/or impact of the risk to bring it within the company's risk appetite" (Committee of Sponsoring Organisations of the Treadway Commission 2004a, p. 17).

The Application Techniques volume of the 2004 COSO framework provides other examples of implementation that are useful at a broad level, with, importantly, external risk considerations, as can be seen in the event identification mechanism shown at Figure 3.16.

Figure 3.16: Event identification mechanism (Committee of Sponsoring Organisations of the Treadway Commission 2004a, p. 30)

	External Factors					Internal Factors			
Mechanism – Input from	**Economic**	**Natural Environment**	**Political**	**Social**	**Technological**	**Infrastructure**	**Personnel**	**Process**	**Technology**
Industry/technical conferences	✓	✓	✓	✓	✓	✓	✓	✓	✓
Peer company websites and advertising campaigns	✓				✓				
Political lobbyists			✓						
Internal risk management meetings						✓	✓	✓	✓
Benchmarking reports	✓				✓	✓	✓	✓	✓
Competitors' regulatory filings	✓			✓	✓				
Key external indices	✓	✓	✓	✓	✓				
Key internal indices/risk & performance measures/scorecards						✓	✓	✓	✓
New legal decisions	✓		✓	✓					
Media reports	✓	✓	✓	✓	✓				
Monthly management reports						✓	✓	✓	✓
Analyst reports	✓		✓	✓					
Electronic bulleting boards and notification services	✓	✓	✓	✓	✓				
Industry, trade and professional journals	✓	✓	✓	✓	✓				
Timing of new product launches versus competitors							✓	✓	✓
Profiling calls to customer service	✓				✓			✓	
Real-time feeds of financial market activity	✓								

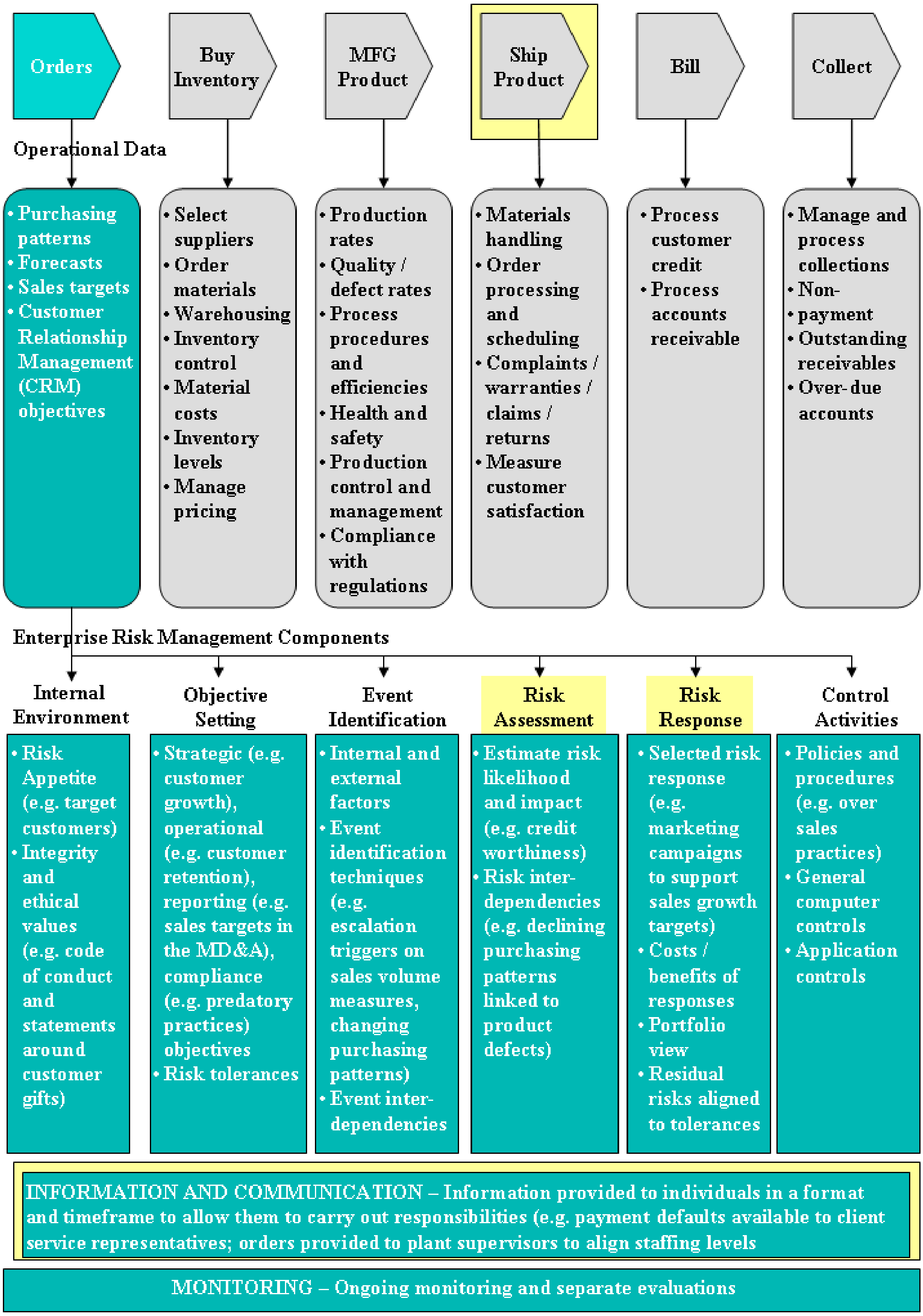
A few of the events shown in Figure 3.16 (highlighted in yellow) could have application in the consideration of selecting the Letter of Credit as the method of payment for an international trade transaction. For example, key external indices, such as a country's economic scorecard (balance of trade, balance of payment, financial viability, etc.), or industry, trade and professional journals (whence a company's profile may be derived). However, in the context of this thesis, the focus is not limited to why a Letter of Credit may be used or not, but also on other risk management aspects of meeting its documentary requirements in order to ensure payment. These aspects, such as bank risk and country risk, are not considered in the event identification mechanism, therefore, the list provided by COSO is not helpful.

Another example provided by the Application Techniques volume is that of information flow across a sales process, as shown in Figure 3.17. Unfortunately, the explanation that is provided against this diagram is rather scant. The reader is merely informed that the diagram:

> … illustrates how information used in enterprise risk management is an inherent part of and integrated with business processes – in this instance the sales process (items listed under the component headings include only examples of relevant information) (Committee of Sponsoring Organisations of the Treadway Commission 2004a, p. 73).

The areas of concern in this diagram have been highlighted in yellow. Whilst Figure 3.17 specifically considers credit worthiness as part of the risk assessment against the "Ship Product" option, and shows a link to credit worthiness under "Risk Assessment", there does not appear to be a link to this in the "Risk Response" category. The text box labelled "Information and Communication" makes reference to "payment defaults available to client service representatives" – it is not clear what is actually meant by these words. For example, who are the client services representatives and what are their roles? In the case of a Letter of Credit transaction between the selling organisation and a buyer in another country, exactly how would the client services representative enforce payment, given that payment comes from the bank and not the buyer? The lack of detail prevents this approach being explored further.

Figure 3.17: Information flow across a sales process (Committee of Sponsoring Organisations of the Treadway Commission 2004a, p. 74)



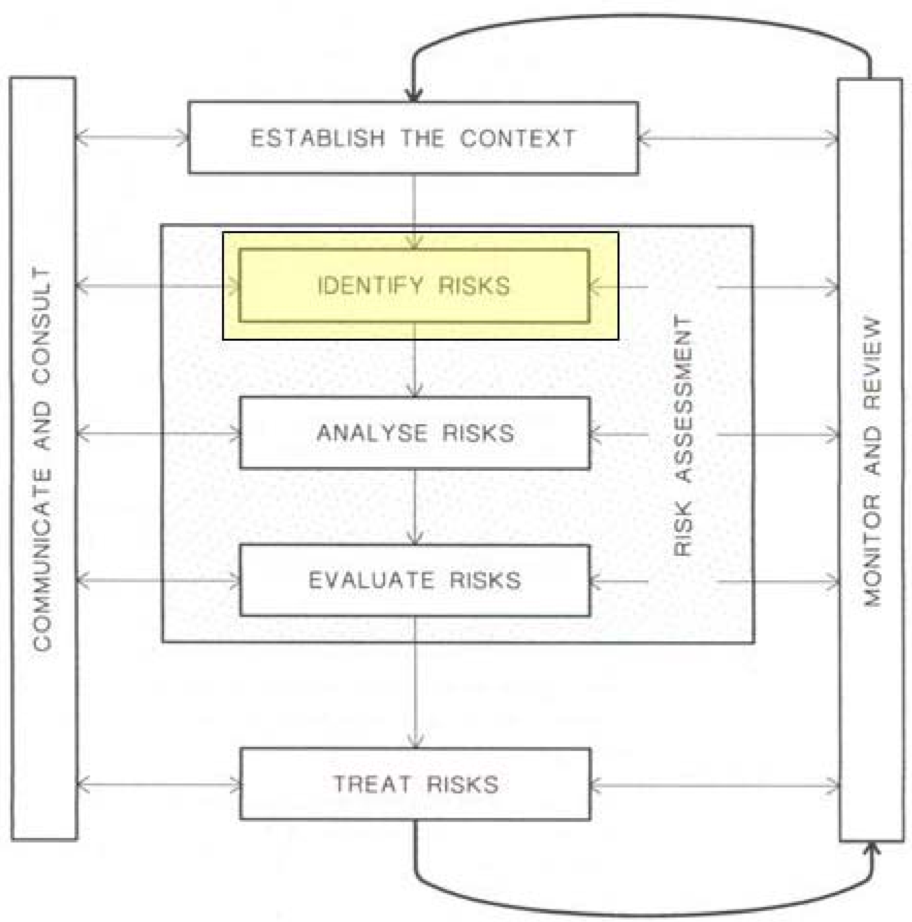
Since its release, the COSO 2004 framework has been criticised because of lack of detail, by academics and a number of industry practitioners. “As a general management framework, COSO is useful in providing a set of standards for ERM, but its bias is more from a governance, compliance and audit perspective”, according to James Lam (Quinn 2005). The COSO structure has been claimed to focus too much on the company’s objectives and placing “insufficient weight on the allocation of roles and responsibilities, training, contingency planning and external auditing” (Sadgrove 2005, p. 283). It also appears that there is a “lack of instructions, or a formal system against which external assessors could measure the company’s performance” (Sadgrove 2005, p. 283). “Funston refers to COSO as a big step forward … but the model is flawed, in some ways fatally. But it does give us our first lexicon” (Quinn 2005, p. 39).

3.1.8 Australia / New Zealand Risk Management Standard 2004

The developments that had taken place in the USA with the release of the COSO 2004 framework were paralleled in Australia and Zealand with the revised Risk Management Standard – AS/NZS 4360: 2004 (AS/NZS 2004) (Joint Technical Committee OB-007 Risk Management 2004). In the lead up to the release of this standard, some comparisons were made between the AS/NZS 2004 and COSO 2004. On one occasion, criticism was levelled at COSO 2004 for being ‘congested’ with “too many words, too much jargon and too little clarity” (Kloman 2003, p. 4), whereas the AS/NZS 2004 was touted as a “model of clarity. It is brief … complete and refreshingly well written” (Kloman 2003, p. 4). It could be that these comments were perhaps a little biased, as they were part of an address to the Australasian Institute of Risk Management on 13 June, 2003 by none other than P.J. Barrett, the then Auditor-General of Australia. Whilst some of the criticisms of COSO 2004 may be supported by others, Barrett’s claims about the AS/NZS 2004 may not necessarily be true. Whilst brevity may be desirable in certain contexts, it may also be a problem in a situation where the reader is seeking guidance and examples as a way of being assisted with the problem at hand. Consequently, brevity does not necessarily equal comprehensiveness and may, in fact, fail to be helpful - perhaps this is supported by the decision to publish the Risk Management Guidelines Companion to AS/NZS 4360: 2004. So, on the one hand, the standard is kept brief, but more details are made available in a related publication.

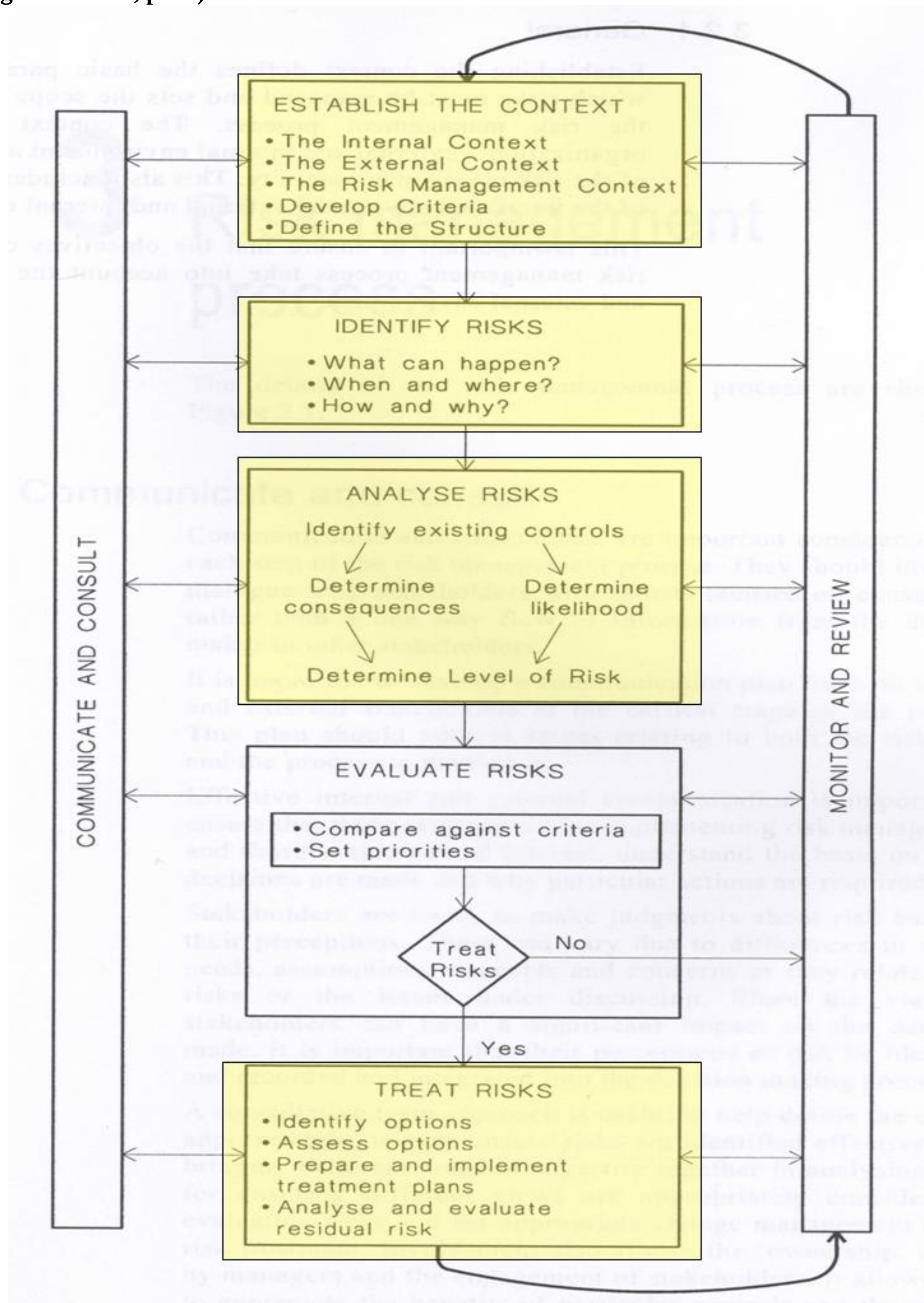
The AS/NZS 2004, as expected, made some changes to its earlier version. In the risk management process overview shown at Figure 3.18, it can be observed that the risk assessment additionally includes 'identify risks'.

Figure 3.18: Risk management overview (Joint Technical Committee OB-007 Risk Management 2004, p. 9)



Additional changes were also incorporated in other areas – these changes are highlighted in yellow background on the relevant figures. The risk management process in detail diagram, shown at Figure 3.19, has some elements changed from the 1999 version (Figure 2.12). Within the 'establish the context' box, the strategic and organisational contexts were replaced with internal and external contexts.

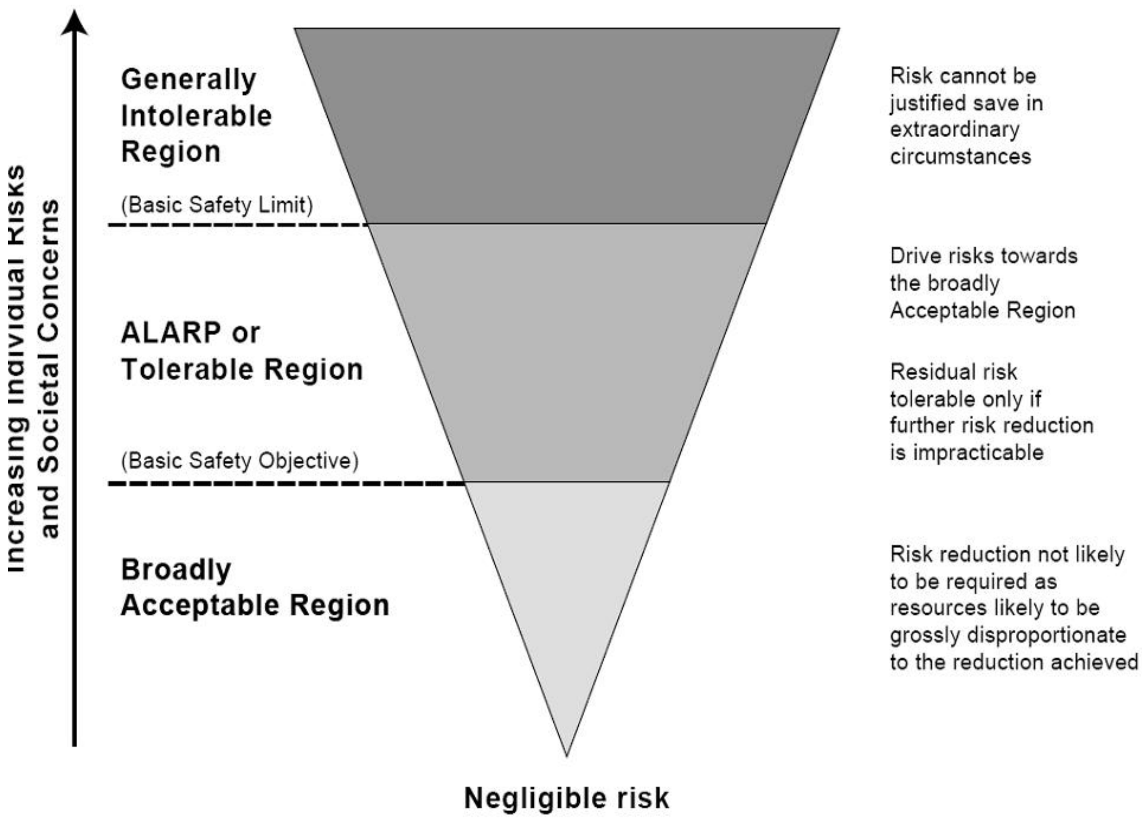
Figure 3.19: Risk management process - in detail (Joint Technical Committee OB-007 Risk Management 2004, p. 13)



The highlighting and separation of internal and external factors appears consistent with other literature and also the COSO 2004 framework. In the 'identify the risks' box, the 'when', 'where' and 'why' questions were added. The 'analyse risk' box now identifies existing controls, whereas earlier it claimed to be determining these. The level of risk is now no longer estimated but rather determined. And finally, the 'treat risk' box considers the notion of residual risk as part of the treatment process. AS/NZS 2004 received criticism because "like other risk standards is laboured and cumbersome when examining risks and deciding what do with them. It has too many steps and these could cause … repetition" (Sadgrove 2005, p. 278).

However, risk evaluation according to the AS/NZS 2004 Guidelines is based on a simple risk criteria that "divides risks that need treatment from those which do not" (Standards Australia/Standards New Zealand 2004, p. 65) according to the "As Low As Reasonably Practicable" (ALARP) principle and, diagrammatically, this is shown at Figure 3.20.

Figure 3.20: The ALARP principle (Standards Australia/Standards New Zealand 2004, p. 66)



"It will usually not be cost-effective or even desirable to implement all possible risk treatments" (Standards Australia/Standards New Zealand 2004, p. 72), consequently, residual risk is an acknowledged part of risk treatment processes in the standard. The guidelines suggest sharing the risk as one way to treat risk. This is a good approach but, in practice, this may be problematic for the Letter of Credit transaction. Two examples of risk sharing are provided in the guidelines: contracting and insurance.

In the context of the standard, contracting appears to be related to outsourcing of contracts, where, ‘through specific wording in the contract document” (Standards Australia/Standards New Zealand 2004, p. 77) the risk can be allocated to another party. This approach would seem to be unlikely in a Letter of Credit transaction, as third party issuers of documents would resist attempts to make them liable for any documentary errors through contractual clauses. Often the exporting organisation is not in a position to make demands of third party issuers – a probable function of economic power imbalance. A shipping line or airline, with pre-existing conditions of carriage, some of which are the subject of international conventions, would certainly not be inclined to be held liable for data errors on a document. Similar comments may also apply to other organisations, such as Chambers of Commerce and the like. The Letter of Credit transaction means that the accuracy of the data provided on the documents remains the responsibility of the seller, regardless of who executes the documents. This is simply because the undertaking to pay is given by the bank issuing the Letter of Credit to the seller and not third parties. Additionally, one needs to consider that other contracts entered into for the purposes of fulfilling the specific performance of a sales contract, such as contracts of carriage, are independent contracts and do not bind all parties. For example, the contract of carriage may be between the seller and the carrier but would not bind the buyer or the bank. It is therefore difficult to see how outsourcing could reduce the risk, unless the documentary process was to be outsourced in its entirety; although possible, this is not routine.

Insurance is an interesting consideration, because sovereign risk and buyer default are insurable interests, but only on terms dictated by the insurer and, of course, for a fee. For example, an exporter wanting to sell goods internationally would firstly need to disclose the details of the country and the buyer to the credit insurance agency, so they may undertake due diligence processes. At the end of these processes, the insurer may decide not to underwrite the risk or may withdraw from a market due to changed circumstances. There are several international markets that fail to attract credit insurance options, even where the transaction is via a Letter of Credit, as the insurers are simply unwilling to buy the risk from the seller.

In summary, the ASNZS 2004 provides a good framework for the management of risk utilising ERM principles, but as stated at the onset, "this standard provides a generic guide for managing risk" (Joint Technical Committee OB-007 Risk Management 2004, p. 1). The guidelines are a helpful supplement to the standard, however, these provide "generic guidance for establishing and implementing effective risk management processes in any organisation" (Standards Australia/Standards New Zealand 2004, p. ii). In adopting a 'one-size-fits-all' approach, the standard and guidelines fail to provide sufficient implementation details in the risk context of an international Letter of Credit transaction and, consequently, their use is limited. Although the ASNZS 2004 was up-dated five years later (Standards Australia/Standards New Zealand 2009) amendments to the standard do not have any impact on the focus of this thesis.

3.1.9 USA and European surveys on ERM in 2004-2005

In 2004 a study was funded by the Institute of Internal Auditors, to

> gather information on organisations' stage of ERM development and specific risks addressed and (ii) assess the role of the internal audit function in organisations' ERM processes, including the impact of ERM on internal auditing (Beasley, Clune and Hermanson 2005, p. 68).

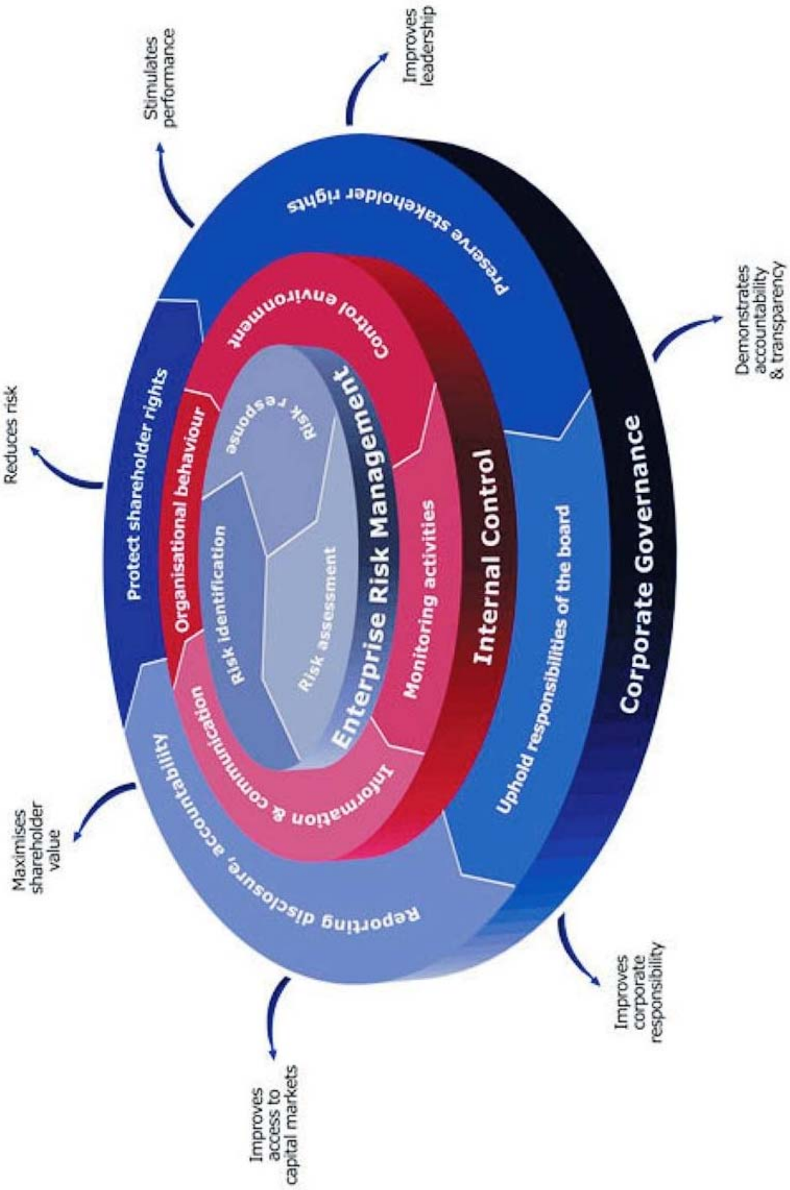
Although internal auditors do play an important function in a company's risk management processes, this aspect will be discussed later in this chapter. In the context of ERM 'readiness', the data from the study revealed, not surprisingly, variance between organisations' implementation stages. Of the 175 responses received, eleven percent reported complete implementation of ERM and thirty-seven percent were at the partial implementation stage. The results of that study were confirmed by a separate survey in 2005 on current ERM practices, commissioned by The Conference Board and Mercer Oliver Wyman (Gates 2006). Of the 271 responses received from executives in Europe and North America, most indicated that they were building or "want to build ERM processes into their organisations, but only eleven per cent have completed their implementation" (Millage 2005, p. 16). Perhaps it is coincidence but, curiously, the implementation rate in both of the above independent studies was reported to be the same, that is, eleven percent.

In a separate 2004 Global Risk Management Survey, by Deloitte, the conclusion was that "ERM continues to be an elusive concept that varies widely in definition and implementation, and reaching full maturity may take several years" (Fagg 2009, p. 1).

3.1.10 Turnbull framework

Literature on enterprise-wide risk management models and approaches has contributed to the growing discussion about risk management approaches in the past few years, especially since 2004. Some of it alludes to the developments of earlier approaches as the true genesis of ERM.

Figure 3.21: The Turnbull Framework (Roberts 2005, p. 3)



For example, the COSO 2004 framework has been linked to the earlier UK published 1999 Turnbull Report by Roberts (2005). In a diagrammatic form the Turnbull Framework is shown at Figure 3.21.

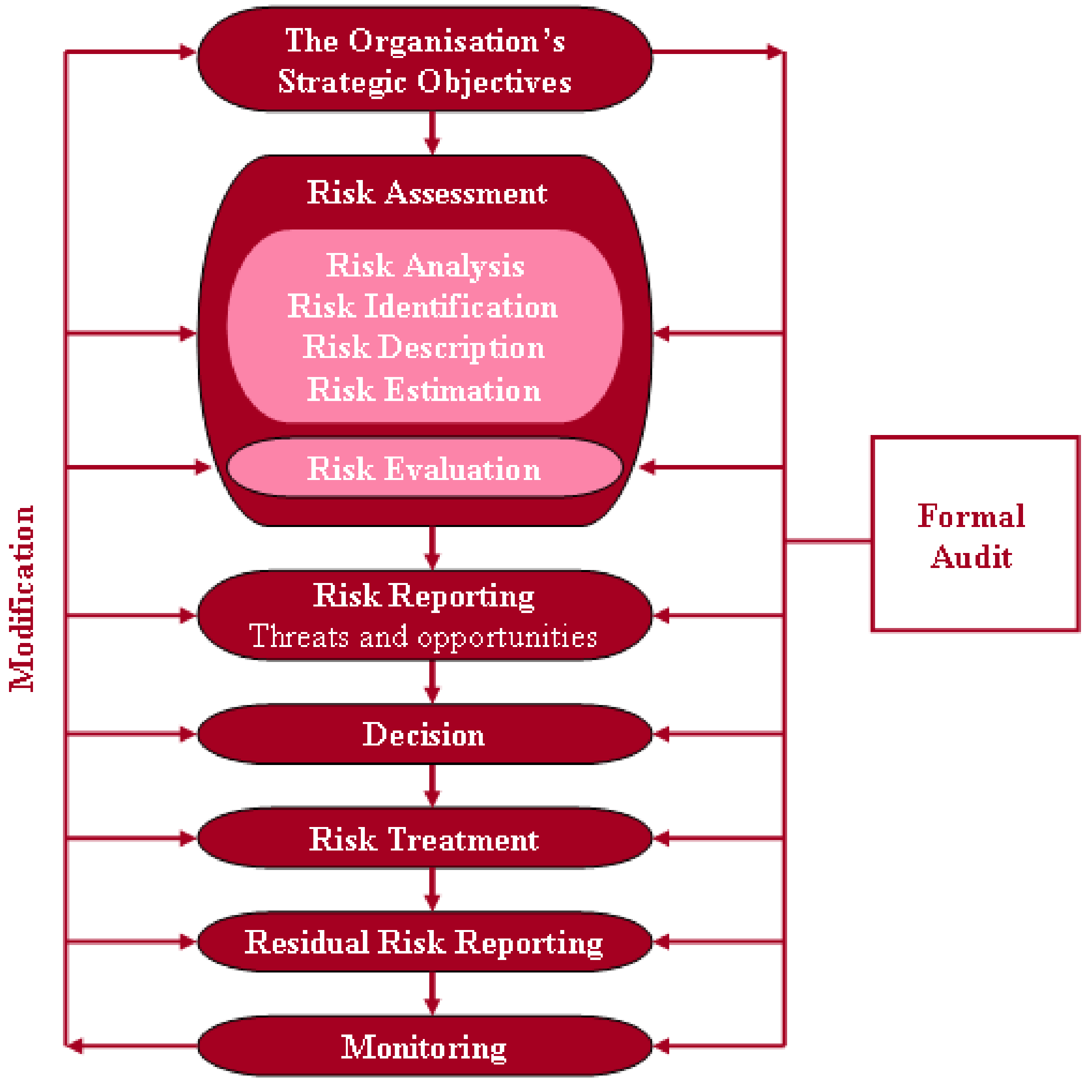
Although the Turnbull Framework does refer to ERM as the basis for risk identification, assessment and response, what is now beginning to emerge as a common theme is the familiar lack of detail. It seems that like many other approaches, the Turnbull Framework focuses on internal controls for compliance, governance and growing shareholder value. Whilst these are essential elements of any successful business operation, the framework does not provide any details at the micro level in how to implement an appropriate risk management approach to Letter of Credit transactions and, consequently, the Turnbull Framework is of little assistance to this research.

3.1.11 Other risk management standards approaches

The benefits of ERM have been extolled by a number of authors, who have each concentrated on different aspects of an holistic approach to enterprise-wide risk management. Examples of these include using ERM for proactive risk management practice as opposed to traditional "post-production or what is called end-of-pipe approach " (Jablonowski 2006, p. 37). Considering the human side of risk, that is, staff that work for the organisations and their need to be committed to the process and be competent in what they do, is an important factor, because "as competence goes down, risk goes up" (Jackson 2007, p. 39). As communication has always been an integral part of human interaction, it has been suggested that "a common language is needed to cut through the layers and break down the silos … [and] … the first reason that an organisation needs a risk language is to enhance its risk culture" (Roth 2007, p. 69). "Risk can be mitigated through implementing ongoing educational programs" (Mark 2008, p. 131). "It means that employees must be educated and trained in how to be aware of risks in their realm … and effectively deploy responses to mitigate risk" (Mandel 2008, p. 10). Unfortunately, none of the articles provide any specific detail on the implementation of ERM. In an attempt to overcome this apparent gap, checklist approaches have been developed, but their brevity prevents them being helpful. As an example, a recent article proposes ten checklist items and deals with the implementation of ERM in less than one page – brevity sees one of the issues dealt with, in total, this way: “use metrics to monitor the effectiveness of the risk management process where possible” (Walker and Shenkir 2008, p. 31) – this short statement does not help the reader at all to envisage implementation.

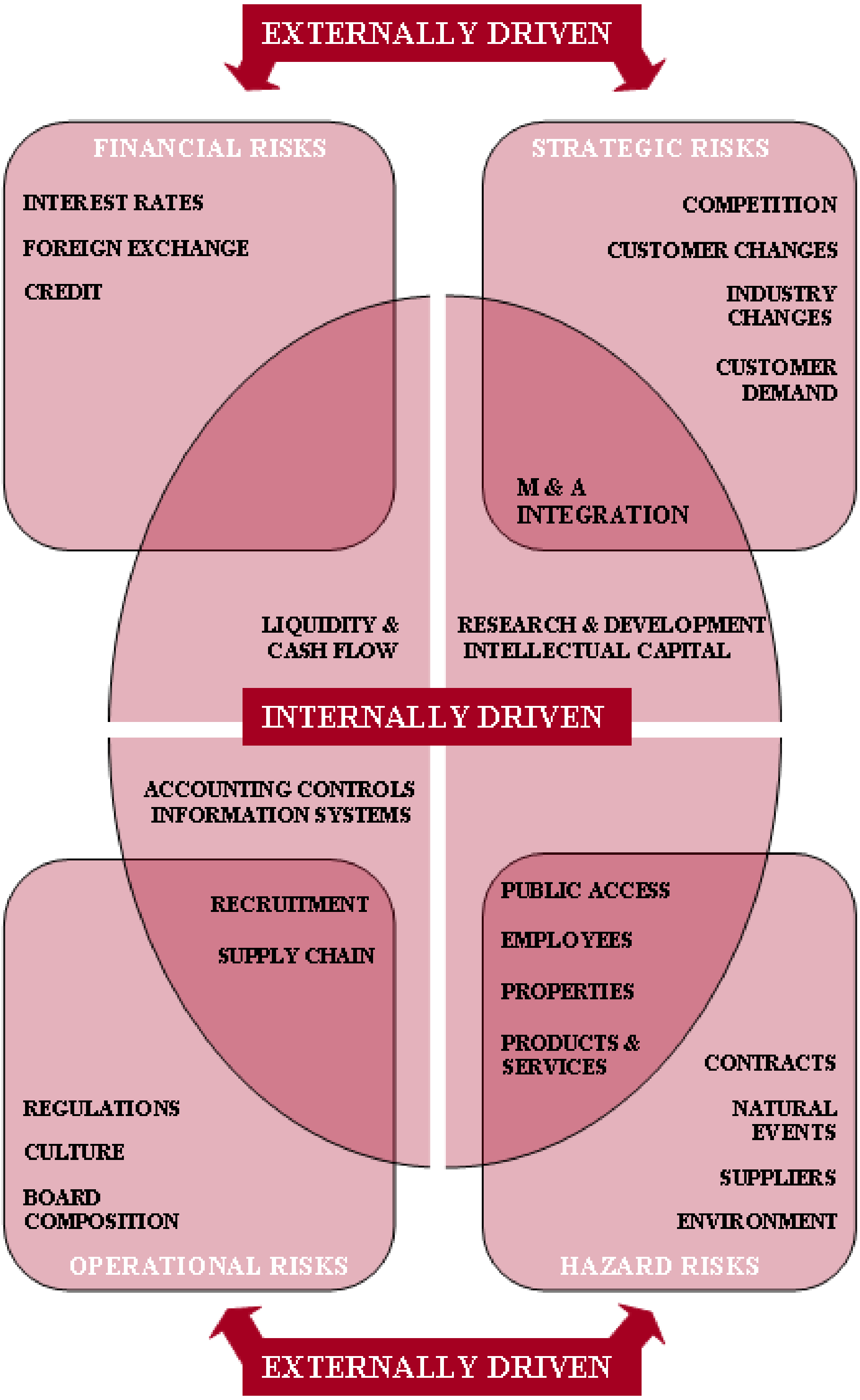
It has been claimed that “no two ERM approaches will be identical … [and that] … every ERM program is and should be custom-made” (Skipper and Kwon 2007, p. 293). If we accept these claims, then “though ERM is conceptually straightforward, its implementation is not” (Nocco and Stulz 2006, p. 8) would ring very true. Nocco and Stultz (2006) point out some of the difficulties of implementing ERM, such as the risk identification, the use of credit ratings and the regulatory versus economic capital requirements of a firm, but these bear little relevance to the study of Letters of Credit transaction risks. Skipper and Kwon (2007) propose that standards are a helpful platform for risk management implementation planning. They claim that three standards are commonly referred to: the COSO 2004 ERM Framework and the Australia/New Zealand 2004 Risk Management Standard (discussed earlier), and the UK 2002 Risk Management Standard. The Institute of Risk Management, ALARM – The National Forum for Risk Management in the Public Sector and The Association of Insurance and Risk Managers are the organisations that contributed to the UK Risk Management Standard, published in 2002. The risk management approach adopted in this standard is shown at Figure 3.22. If this is compared with Figure 3.19, the AS/NZS 2004 Risk Management Standard, a number of similarities in the approach to risk becomes evident, with a number of risk management steps that appear in both Figures 3.19 and 3.22. These include risk analysis; risk identification; risk evaluation; risk treatment; and monitoring. Perhaps this is an indication of the convergence of ideas on risk management philosophies and implementation that consider the whole-of-enterprise approach.

Figure 3.22: The risk management process (The Association of Insurance and Risk Managers, ALARM The National Forum for Risk Management in the Public Sector and The Association of Insurance and Risk Managers 2002, p. 4)



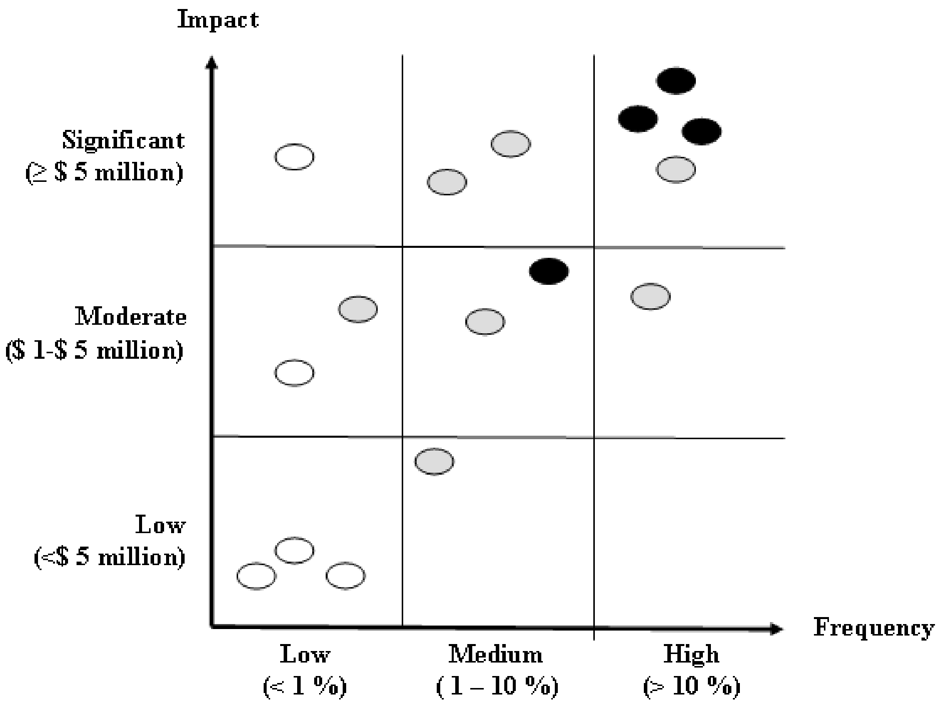
The UK standard provides examples of the drivers of key risks and this is shown at Figure 3.23. Some of the items listed in the Figure have relevance to this research, such as: credit within the financial risk area; contracts and suppliers within the hazard risk area; and supply chain within the operational risk area. The UK standard, however, is lacking in detail on several issues. In a comparison between the UK standard, COSO and AS/NZS, it is pointed out that in the UK standard "there is no specific section dealing with objective setting … and risk identification … guidance is very limited" (Rudnicki 2005, pp. 10-11).

Figure 3.23: Examples of key drivers of risk (The Association of Insurance and Risk Managers, ALARM The National Forum for Risk Management in the Public Sector and The Association of Insurance and Risk Managers 2002, p. 3)



Skipper and Kwon (2007), who also compared the three standards mentioned above, claim that these all have the same principles, with the UK standard adding two 'distinctive' features: one specifies the duties for risk reporting and communication at all levels; and the other is a basis for the development of a risk map. The risk map is shown at Figure 3.24.

Figure 3.24: Risk Map (Skipper and Kwon 2007, p. 304)



The determination of risk is a function of the financial impact and probability resulting in a colour coded approach. A dark oval represents an immediate opportunity or threat, a white oval is the potential for opportunity or threat that does not require immediate action and the lightly coloured oval is for an event or opportunity that is somewhere between the dark and the white oval. This approach appears similar to the qualitative risk analysis matrix in the AS/NZS 1999 standard, shown at Figure 3.25.

The matrix may actually provide more flexibility. However, neither the matrix, nor the map provide adequate details for documentary risk processes under a Letter of Credit transaction and do not consider country, customer or bank risks, and, therefore, are not helpful.

Figure 3.25: Qualitative risk analysis matrix - level of risk (Joint Technical Committee OB/7 - Risk Management 1999, p. 35)

	Consequences				
	Insignificant	Minor	Moderate	Major	Catastrophic
Likelihood	1	2	3	4	5
A (almost certain)	H	H	E	E	E
B (likely)	M	H	H	E	E
C (moderate)	L	M	H	E	E
D (unlikely)	L	L	M	H	E
E (rare)	L	L	M	H	H

NOTE: The number of categories should reflect the needs of the study.

Legend

E: extreme risk; immediate action required

H: high risk; senior management attention needed

M: moderate risk; management responsibility must be specified

L: low risk; manage by routine procedures

A comparison of nine risk management standards was published by Raz and Hillson (2005). Curiously, the comparison did not include COSO but did include the AS/NZS 2004 and the UK Standard, as well as, among others, risk management standards from the Japanese Standards Association and the Canadian Standards Association. The conclusion of this study was that

> although there is a wide consensus regarding the main steps and activities of a generic risk management process, there is still room for a comprehensive document which will not only combine the best elements of the existing standards, but also provide broad coverage of the issues related to instituting such a process (Raz and Hillson 2005, p. 65)

It appears that such a comprehensive document still eludes us today. Examples of more recent risk management publications do not provide the coverage that Raz and Hillson (2005) were hoping for. For example, the British Code of Practice for Risk Practices of 2008 recommendations are

> generic and intended to be applicable and scalable to all organizations (or parts thereof) across the public and private sector, regardless of type, size and nature. How recommendations are implemented will depend on an organization's operating environment and complexity (Insurance Networking News 2008).

The International Standard Organisation (ISO), at the end of June 2009, is planning to release a new standard - Risk Management - Principles and Guidelines (ISO 31000:2009). At the time of writing, this had not yet been released, however, this new standard is not expected to provide any further assistance with this research project. Based on preliminary information released by ISO, it appears that this is yet another generic standard from which organisations will need to develop their own *modus operandi*

> ISO 31000:2009 is not specific to any industry or sector ...can be applied throughout the life of an organization, and to a wide range of activities, including strategies and decisions, operations, processes, functions, projects, products, services and assets ... [and it] can be applied to any type of risk, whatever its nature, whether having positive or negative consequences. Although ISO 31000:2009 provides generic guidelines, it is not intended to promote uniformity of risk management across organizations. The design and implementation of risk management plans and frameworks will need to take into account the varying needs of a specific organization, its particular objectives, context, structure, operations, processes, functions, projects, products, services, or assets and specific practices employed. It is intended that ISO 31000:2009 be utilized to harmonize risk management processes in existing and future standards. It provides a common approach in support of standards dealing with specific risks and/or sectors, and does not replace those standards (Internationl Standards Organisation 2009).

ISO 3100:2009, therefore, is unlikely to be useful to deal with the specific risks that arise from Letter of Credit transactions and, consequently, will not be considered further.

Although ERM has made considerable progress in the past decade, some literature in 2009 claims that “still, much of risk management is in an evolutionary state. The assessment and measurement of risk – even financial risk – is not fully developed” (Barton, Shenkir and Walker 2009, p. 31). The implementation of ERM remains at various stages across the globe. For example, it is claimed that “few professionals are experienced in dealing with ERM design and implementation in East Asia” (Ng 2008, p. 45), and according to a survey by Marsh’s Consulting, in 2009, “more than half [of the respondents] have yet to adopt any standard for implementing this [ERM] process” (Wade 2009, p. 17). Notwithstanding the above, ERM remains an important concept today, as evidenced by the behaviour of some rating agencies that have cautiously “been working to further develop consideration of ERM as a component of their rating methodologies" (Maxwell 2008, p. 44) and the decision of the New York-based Risk and Insurance Management Society Inc[3], to endorse ERM "as a key indicator of a well-managed company". Although ERM's philosophical approach is worthwhile in the context of risk management practices, it does not provide a specific model that deals with Letter of Credit transaction risks at the micro level, a requirement of this study.

In the context of Letter of Credit transactions, an internal audit approach to risk management, provides another perspective, as there is a particular model (McNamee 2000) that may be useful as a framework for this research. However, before considering the McNamee model, it is appropriate to review the literature on Letters of Credit, as this will provide a greater contextual background for the application of the model.

PART II

3.2 Risk Management Literature Relevant to Letter of Credit Transactions

Although a body of literature on the subject of Letters of Credit exists, most of this has been written from the perspective of the banks or within the academic legal area. There is a dearth of published material that considers Letter of Credit transactions from the trader's perspective and even less from the perspective of the small exporting organisation. As it is not feasible, or possible, to undertake a detailed examination of all publicly available works, especially as a significant portion is not directly relevant to the research in this thesis, the review will follow major themes relevant to Letter of Credit transactions including contractual applications/obligations; the reasons for choosing this method of payment; the problems with discrepancies; the standard for documentary checks; why discrepancies occur; and what has been proposed as error prevention or corrective action. The focus of this review will be from an operational framework perspective and primarily through the lenses of the seller and buyer's points of view.

[3] The Risk and Insurance Management Society (RIMS) is a not-for-profit organization dedicated to advancing the practice of risk management. Founded in 1950, RIMS represents more than 3,500 industrial, service, non-profit, charitable and governmental entities. The Society serves more than 10,000 risk management professionals around the world. is a no-for-profit. This information was retrieved from the internet at: http://www.rims.org/aboutRIMS/Pages/MissionandDescription.aspx (viewed, 27 June 2008).

The specific roles of the various banks involved in Letter of Credit operations are discussed in greater detail in Chapter 4.

Letter of Credit transactions are governed by codified rules adhered to by banks on a world-wide basis. These codes have been issued periodically during the past century, by the ICC. The rules currently applicable to Letter of Credit transactions are the Uniform Custom and Practice for Documentary Credits, 2007 Revision, commonly referred to as the UCP 600, and in force since 1 July 2007. The research on this topic began prior to the current rules being issued and implemented and, consequently, this thesis focuses on the previous rules, being Uniform Custom and Practice for Documentary Credits, 1993 Revision, commonly referred to as the UCP 500, that operated between 1 January 1994 and 30 June 2007. Therefore, the review will concentrate on publicly available literature primarily relevant to the UCP 500.

It is argued here that detailed research on the UCP 600 is currently not feasible, as the new rules have been in operation for too short a period and a sufficient body of knowledge regarding their use and implementation has not yet developed. Academic writing on the UCP 600 is not voluminous and there is a number of outstanding issues that need to be clarified by the ICC. Additionally, there are areas of contention that have not yet been vigorously tested, therefore, a definitive position has not yet been established. For example, the ability for a bank to exclude some, or a substantial portion, of the rules applying to Letter of Credit transactions – this issue has commanded the attention of exporters, importers and commentators, but the ICC is yet to clarify it or express an official position. Another matter of concern relates to the application of international banking standards for checking documents presented under a Letter of Credit. It is not clear, at the time of writing this thesis, whether the common standard, issued by the ICC, should be the only one that is applied, or whether other (proprietary) standards are just as appropriate. Unfortunately, the rules have a loophole that obfuscates the issue. The ICC, to date, has not made its position altogether clear. Discussion on the UCP 600 is provided in more detail in Chapter 4, when examining the most significant developments in Letter of Credit transactions since their first codification in 1933, and discussing the rules relevant to this research and the rules that were issued subsequently.

3.2.1 The legal status of the Letter of Credit

The legal status of a Letter of Credit differs across the globe, as

> the quality of statutory provisions varies widely, from comprehensive coverage – such as that found in Article 5 of the Uniform Commercial Code of the United States – to much simpler rules that do not contain much more than a reference to the applicability of 'the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce" (Schutze and Fontane 2001, p. 10).

Australia does not have specific laws on Letters of Credit (Schutze and Fontane 2001, p. 139) and, consequently, common law, contract law and precedent cases would be relied upon for legal arguments. As it is not the focus or the scope of this study to provide comparative legal analysis, reference will be limited to English law, as this is where Australian law derived its legal system. It should be noted that the USA has specific legislation for Letter of Credit transactions, pursuant to the Uniform Commercial Code (1995), Article 5; however, as the research in this thesis focuses on trade between Australia and ASEAN countries, this legislation is not heavily relied upon in the discussion provided here.

Under English law, Letter of Credit contracts present challenges. Offer and acceptance are essential characteristics of a contract, and "a contract comes into existence at the time, and place, an offer is accepted" (Lindsay 1992, p. 26). However, the Letter of Credit does not fit into this theoretical notion easily, and the 'contract between the seller and the buyer is difficult to rationalise" (Lindsay 1992, p. 76). The case of *Westpac v. Commonwealth Steel Co. 1983, N.S.W.L.R. 735* provides a good example, as

> it was observed that the object of the issue of a documentary Letter of Credit was to create a type of currency (by permitting a bill of exchange or draft to be drawn under it and negotiated) and, thus, it cannot be said that an offer constituted by an irrevocable documentary Letter of Credit is accepted only when payment is sought from the bank which issued the credit. Furthermore, the time at which an offer in the form of an irrevocable documentary Letter of Credit is accepted is when the Letter of Credit is communicated to the beneficiary or when it is drawn upon (Commentaries and Case Notes 1984, p. 19).

Despite these conceptual difficulties, "English law takes a pragmatic view and upholds the Letter of Credit" (Cranston 1997, p. 422, 2002, p. 386). It is important to establish, therefore, who the parties to a Letter of Credit transaction are and the "autonomous, though interconnected contracts" (Lord Diplock in The American Accord (at 725), quoted by McCraken and Everett 2004, p. 488) that arise from the establishment of this payment mechanism.

3.2.2 The roles of the parties to a Letter of Credit transaction

It is important to be able to establish the roles of the parties involved in the establishment of the Letter of Credit, because the tendering of documents by the exporter to the bank is an offer that is subject to acceptance by the bank, therefore, common legal principles apply to these transactions. There are differing views in the literature as to the contracts arising from the Letter of Credit transaction.

Some claim that there are only three parties to a Letter of Credit transaction, with relationships existing between the seller and the buyer through the sales contract; a contract between the buyer and the issuing bank though the Letter of Credit application; and another contract between the seller and the issuing bank through the Letter of Credit being issued (Daniels and Radebaugh 1995; Shapiro 2010). It is interesting to note that the Letter of Credit examples provided by these authors are out-dated. The Daniels and Radebaugh (1995) text features an example (p. 642) that cites the 1983 revision of the rules, even though the 1993 rules became operational on 1 January 1994. The Shapiro (2010) example is worse, as this text was released during 2009, and the example shown at page 640 refers to the 1974 revision of the rules, however, since 1974, the rules have been revised in 1983, 1993 and 2007. Other authors do not seem to be faring much better, with examples of two Letter of Credit facsimiles under the rules in effect prior to 1994 for a textbook released seven years after the UCP 500 (1994) became operational (Platz and Fitch 2001), and further evidence is provided by a recent Australian publication that, although acknowledging "the current revision UCP 600 coming into effect on July 1st 2007" (Ioppolo 2008, p. 140), nevertheless refers to "a revocable Letter of Credit" (Ioppolo 2008, p. 139) – yet this type of credit was specifically removed by the UCP 600. Other post-UCP 600 publications erroneously state "the buyer must indicate either revocable or irrevocable on the application to the issuing bank" (Hinkelman 2009, p. 75) and that "there are basically two types [of Letters of Credit]: revocable and irrevocable" (Madura 2010, p. 563) . These comments indicate that although there is a wealth of published materials on the subject of Letter of Credit transactions, there are also instances of factually incorrect information provided by ‘experts’. This is of concern when dealing with the complexities of Letters of Credit transactions and their web of contracts.

Other authors provide different opinions as to the contracts arising from the Letter of Credit, claiming that:

> the contracts include (A) the sale of good contract between the buyer and seller; (B) the bill of lading, a receipt and contract issued by the carrier; and (C) the Letter of Credit, a promise by Buyer’s Bank (and, if confirmed, also by Seller’s Bank) to pay seller under certain conditions concerning proof that seller has shipped the goods (Folsom, Gordon and Spanogle 2004, p. 125).

In the above example, it is difficult to envisage how contract (B) would necessarily arise in the establishment of the Letter of Credit. It is even more difficult to see the relevance of this contract if the goods were to be transported by any mode of transport, except sea. If the logic of the application of contract (B) is extended, then the contract of insurance should also be considered, as well as any other ‘contract’ that is required to be entered into under the terms of the Letter of Credit. It is argued here that the contracts arsing out of the establishment of the Letter of Credit should not include subsequent performance contracts required to satisfy the terms of the Letter of Credit. This is because these contracts, such as carriage contracts, arise typically on cargo movements that may in reality occur some considerable time after the Letter of Credit has been established and cannot therefore be considered as primary contracts. Furthermore, it is implied in the words of this proposition that confirmation would be done by the seller’s bank – as discussed in the previous section, this is not necessarily the case, consequently, the position of these authors is not accepted here.

Another author proposes a situation, as:

> these contracts include:
> (i) the underlying contract between the buyer and the seller;
> (ii) the contract between the applicant (account party) and the issuing bank whereby an indemnity and fee is paid by the former to the latter;
> (iii) the contract between the issuing bank and the beneficiary, where the former performs the function of a paymaster;
> (iv) the contract between the issuing bank and the confirming bank where the payment is made through a confirming bank in the beneficiary’s country … and;

(v) the contract between the confirming bank and the beneficiary when the former confirms and advises the latter that the credit has been issued, thereby assuming the same responsibility as the issuing bank (Islam 1999, p. 340).

Some agreement can be observed between this proposition and the one above it. Contracts (A) and (C) in the previous proposition are synonymous with contracts (i) and (iii) in this proposition. The addition of Item (ii) here recognises that the buyer (applicant) enters into a contract with their bank to have the Letter of Credit established, through the lodgement of the relevant application. Contracts (iv) and (v) do not necessarily apply in all circumstances, as the confirming bank is a voluntary, rather than mandatory, inclusion. On close examination of the words ‘confirming bank’ used by this author, in contract (iv) and (v) only, are perhaps meant to be read as ‘advising bank’, a position that would be consistent with that of Lord Diplock in *The American Accord* cited earlier, however, in that particular case ‘the bank (Royal Bank of Canada) … had confirmed the credit” (Schmitthoff 1986, p. 376). Perhaps Islam (1999) like others (Poh 1999) either did not pick up on this fine, but important distinction, or did not think it warranted separate qualification[4], however, from a bank’s liability point of view and an exporter’s risk mitigation strategy, this is indeed an important distinction because a confirmed Letter of Credit has a different risk profile to that of an unconfirmed (standard) Letter of Credit. It must be remembered that in an unconfirmed Letter of Credit, the exporter substitutes the buyer’s credit risk with that of their bank, but the exporter remains exposed to issuing bank default and country risk. Confirmation of a Letter of Credit is akin to “getting a second guarantee [that] reduces these risks” (Frost 2004, p. 103). Whilst a Letter of Credit is invariably advised to the exporter through a local bank (to avoid fraud, as a risk mitigation strategy, if nothing else),

[4] It has been claimed that “some of the earlier cases use the expression ‘confirmed’ in discussing a credit which is irrevocable” (Tyree 1990, p. 390). This author cites as an example of this Lord Denning’s speech in *Pavia & Co SPA v. Thurmann Nielsen* [1952] 1 QB 84. “in more recent times, however, the meaning of the two expressions have become separate and distinct. Today, a credit is ‘confirmed’ “only if an intermediary bank assumes a direct obligation to the beneficiary” (Tyree 1990, p. 390). The distinction and separation between the terms ‘confirmed’ and ‘irrevocable’ apparently took place “only when the United Kingdom, which had continued to use the terms ‘confirmed’ and ‘irrevocable’ interchangeably acceded to the Uniform Customs [1962 revision of the Letter of Credit rules], could confusion surrounding the term ‘confirmed’ be said to have been eliminated” (de Rooy 1984, p. 37) .Given the distinction between these terms was made a considerable time before the works of Islam (1999) and Poh (1999), it is argued here that it would have been proper for these authors to explain any changes to expressions, so as not to obfuscate this issue. Other authors, such as McCraken and Everett (2004, p. 488) correctly identified that the court case in question was based on a confirmed Letter of Credit.

confirmation of a Letter of Credit is quite a different circumstance, requiring additional obligations from the bank providing such confirmation, as discussed earlier in this section. Whereas the "advising bank acts as an agent[5] of the issuing bank and does not give an independent undertaking to pay the seller" (Carr 1999, p. 281), the whole purpose of the confirming bank is indeed to provide, to the exporter, an additional undertaking to pay, as the confirmation is an "undertaking in addition to, and not in substitution for, that already given by the issuing bank" (Watson 1990, p. 144). Islam's (1999) failure to specify that this proposition only applies to a confirmed Letter of Credit transaction is, at least, confusing as it conflicts with the different roles and definitions of the advising and the confirming bank, pursuant to the UCP 500 and UCP 600 rules. Furthermore, Islam's (1999) proposition does not consider the role of the advising bank, as a separate party to the transaction and, therefore, cannot be accepted.

A different proposition considers that the contracts arising from the issue of a Letter of Credit are:

(a) between the seller and the buyer as a result of the contract of sale;
(b) between the buyer and issuing banks, as a result of arrangements made for opening the credit;
(c) between issuing bank and advising bank; and
(d) between issuing bank and seller (Carr 1999, p. 281).

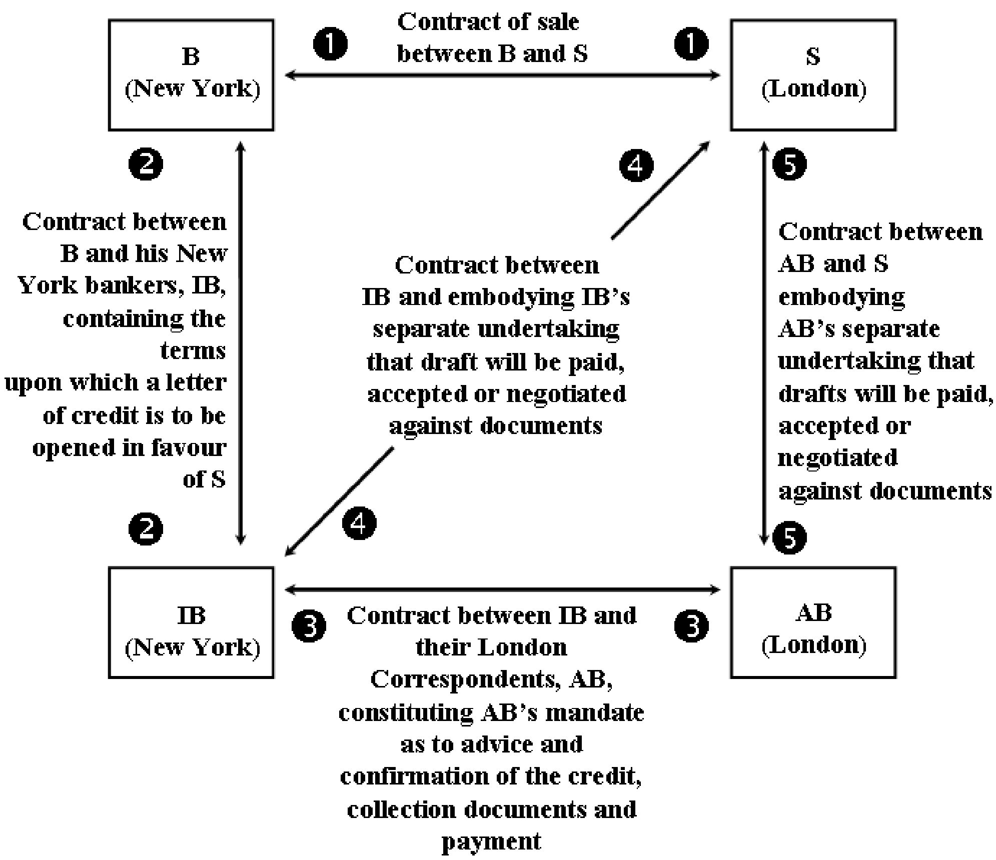
Contracts (a), (b) and (d) above, mirror Islam's (1999) contracts (i), (ii), and (iii). Contract (c) reflects the inclusion of the advising bank in the transaction – a worthwhile addition given "in practice there is usually a second bank involved in the Letter of Credit transaction" (Ward and Wight 1993, p. 432). This proposition, however, does not consider the relationship between the exporter and the advising bank, that is, the "corresponding notification from the advising bank" (Schmitthoff 1986, p. 339), a step that has been described as being "of great importance to the exporter" (D'Arcy, Murray

[5] "It would seem that to characterise the advising bank as agent of the issuing bank without qualification is misleading" (Ward and Wight 1993, p. 435), because this is not agency in the technical sense of the word . Ordinarily an agent is one who "can enter or vary legal relations with third parties on behalf of a principal" (Mugasha 2003, p. 196). However the advising bank's role is that of a 'limited' agent, because the advising bank has "minimal discretion .. and does not have room for deviation in the terms it advises … because the advising bank has no mandate to contract on behalf of the issuer" (Mugasha 2003, p. 196). The advising bank advises the Letter of Credit without responsibility, and it may do so because it is acting as an independent party, in what Mugasha (2003) describes as a "quintessential function" (p. 196). This author points out that "while it has been readily assumed that the advising bank is an agent of the issuer, a close reading of the cases does not support that assertion" (p. 196).

and Cleave 2000, p. 169) and, consequently, Carr's (1999) proposal is not accepted here.

Aspects of Carr's (1999) proposition are evident in an earlier approach, listing five contracts, as shown in Figure 3.26. From Figure 3.26 it can be observed that Goodes' (1995) proposed contracts 1, 2 and 4 are, respectively, synonymous with Carr's (1999) contracts (a), (b) and (d). Contract 3 between the issuing bank and the advising bank, according to Goode (1995) constitutes a mandate as to advice and confirmation of the Letter of Credit, collection of documents and payment. However, it should be noted that the decision to advise, or confirm, a Letter of Credit is voluntary, not mandatory, as per the relevant articles of the rules. As mentioned before, there is a clear distinction between the different roles, and resulting duties and obligations of advising banks and confirming banks. Although the advising bank and confirming bank may, in reality, be one and the same establishment, they are so in their separate roles by choice – that is, an advising bank does not automatically become a confirming bank and there is no pre-requisite for a confirming bank to be the advising bank.

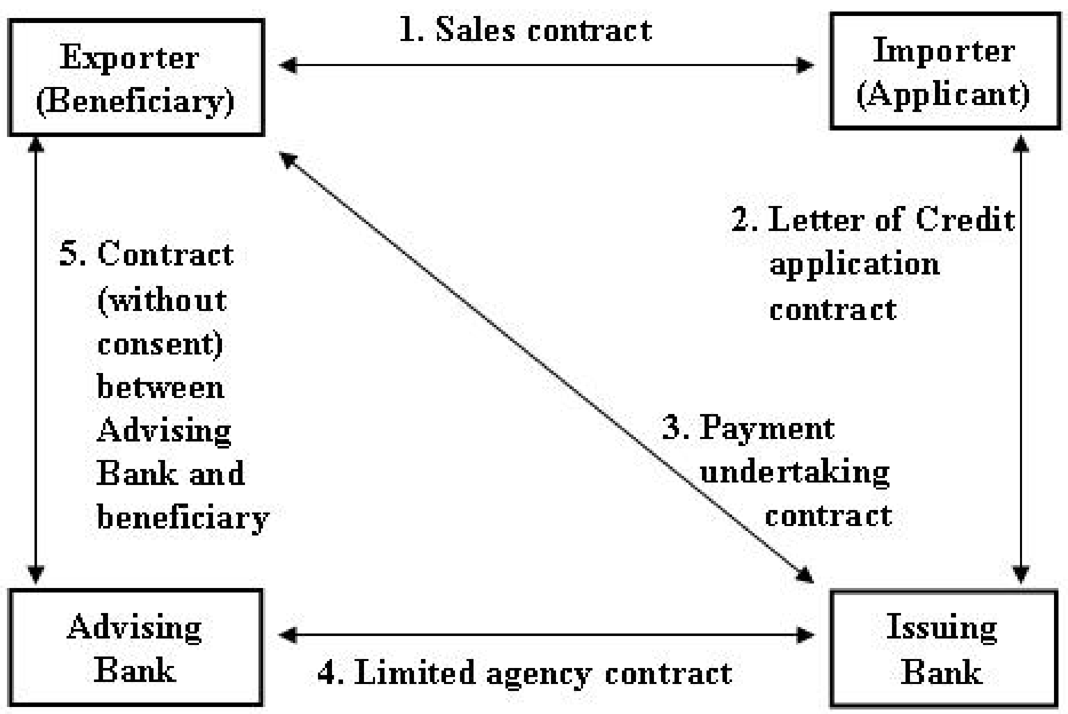
Figure 3.26: Letter of Credit contract (Goode 1995, p. 995)



Step 5 recognises a contract between the advising bank and the seller, but this is predicated on the advising bank confirming the credit. If this were to be the case, contract 2 would become superfluous, insofar as the payment 'guarantee' is concerned, because the undertaking to pay the exporter would shift to the confirming bank. The proposition outlined by Goode (1995) appears incorrect and is refuted by later (and apparently more correct) arguments put forward by Mugasha (2003). As beforehand, therefore, Goode's proposition is not accepted here.

The most comprehensive proposition appears to be one suggested by Burnett (1994, 1999, 2004), and this is shown in a diagrammatic form in Figure 3.27.

Figure 3.27: Letter of Credit establishment contracts



From Figure 3.27 five contracts can be observed that lead to the establishment and advice of the Letter of Credit:

1. contract of sales between the seller and the buyer. This is the contract that specifies, *inter alia*, the method of payment ;
2. contract between the buyer (applicant) and the issuing bank. Under this contract the buyer applies to their bank (issuing bank) to have the Letter of Credit issued;

3. contract between the issuing bank and the seller (beneficiary). This represents the undertaking from the issuing bank to pay;
4. contract between the issuing bank and the advising bank. As discussed earlier this is in the form of a limited agency contract, a quasi-agent role; and
5. contract between the advising bank and the beneficiary. This has been described as a "contract without consent" (Burnett 1994, p. 142, 1999, p. 159, 2004, p. 175). However, where this bank

> agrees to 'negotiate' the credit it has the responsibility of inspecting the documents and paying the beneficiary. In that case it would have some right of recourse against the beneficiary if the documents are rejected by the issuing bank (Burnett 1994, p. 142, 1999, pp. 159-160, 2004, p. 175).

There is, however, a conflict of opinions on whether the advising bank and the beneficiary are actually engaged in a contract, where the advising bank does not confirm the Letter of Credit. Some argue that the "advising bank has no formal commitments or obligations *vis-a'-vis* the beneficiary. Rather it has a duty towards the issuing bank to advise the Letter of Credit" (Gozlan 1999, p. 7). Others argue that the advising bank, unless it specifically advises otherwise, may have some commitment towards the transaction "since in advising the beneficiary of the issuance of the accredit it has inspired the confidence that it will also be prepared to honour his documents in due course" (de Rooy 1984, p. 86). Yet others are of the opinion that if the bank in the seller's country (advising bank) does not add its confirmation, but merely advises the Letter of Credit, then "it appears unlikely that there would be any contractual relationship between it and the beneficiary" (Creed 2001, p. 41). However, according to Creed (2001), the advising bank "may be an accepting or negotiating bank (in which case the issue of whether, and when, a contract comes into existence between it and the beneficiary is problematic" (p.41). Creed (2001) does not provide any clarification as his work is "beyond the scope of this [his] paper" (p. 41). The contractual position of the advising bank does not seem to be altogether clear, because different laws may apply to the transaction depending on the activities conducted, for example

> the obligations of the [issuing] bank (except the payment incident) may be governed by the law of the place at which the bank carries on business, but the payment incident may be governed by another law, *viz.*, the law of the place at which the payment has to be effected (Schmitthoff 1988, p. 581).

It should be noted that the advising bank does not have automatic right of recourse if it elects to pay the beneficiary independently of the instructions given by the issuing bank. An example of when this may happen is in circumstances where the beneficiary is a customer of the bank. Typically, under these circumstances, the advising bank will pay the beneficiary and then send the documents to the issuing bank claiming reimbursement. The issuing bank may not pay if, on examination, the documents are found to be discrepant. Therefore, it would be usual for the advising bank specifically to communicate its right to recourse in case of non-payment by the issuing bank.

Another situation may be envisaged where an exporter ‘discounts’ the bills in a deferred payment Letter of Credit transaction – that is, the exporter’s bank agrees to ‘advance’ money to the exporter on the strength of the compliant documents and the undertaking to pay from the issuing bank, at a future point, in accordance with the terms of the Letter of Credit. The sum paid to the exporter will be reduced by a discount factor that is calculated on a combination of interest rate charges and bank fees. Invariably the exporter’s bank will reserve the right of recourse, that is, to have the money advanced returned should the issuing bank, for whatever reason, fail to pay as due. Under this arrangement, there is a contract between the exporter’s bank and the exporter, but again it is a contract that is separate, but interrelated. Discount proceeds options typically do not appear in the terms of the Letter of Credit, yet it is because of the existence of the Letter of Credit transaction that these arrangements arise.

In the USA, the advising bank is known as the ‘adviser’. The role of the adviser has been tested in the courts and “the adviser is the agent of the issuer” (Dolan 1996, p. 1.13).

Further legal argument on whether the advising bank has a ‘firm’ contract, or not, with the beneficiary, is unlikely to clarify this issue, or be of further critical importance to the research in this thesis. The inclusion of the advising bank, in the process of establishing a Letter of Credit and distributing this to the beneficiary, is generally well accepted. For example, Dolan claims that “in nearly all credits ... a bank local to the seller … [is] … involved” (2004, p. 1.12) and the issuing bank will “stipulate that the credit is available at the counters of bank established in that country [the seller’s country] … It will forward the credit to that bank which will … advise the beneficiary that the credit has been issued” (de Rooy 1984, p. 35). In practice, “in Australia … the exporter often never sees the actual Letter of Credit itself and relies upon the terms of the credit as specified in the letter advising the credit from the advising bank" (Buckely 1996, p. 234).

It appears, therefore, that the proposal suggested by Burnett is most encompassing and reflects current usage and practices in relation to Letter of Credit operations and, consequently, this is the proposal accepted for this research.

Having established the contractual ties that are generated by the establishment and advice of the Letter of Credit, the obligations of each of the four parties involved in the transaction are briefly considered next. Further discussion on the operations of Letter of Credit is provided in Chapter 4.

3.2.3 The obligations of the four parties to a Letter of Credit transaction

Trade finance has been described as the

> bread-and-butter operation of international lending. Indeed, trade finance is the great grand-daddy of international banking … the prime instrument of trade finance is the Letter of Credit (Hughes and MacDonald 2002, p. 105).

Obviously banks charge fees for Letter of Credit business but they consider these instruments of payment as "contingent liabilities since most will never require the bank to make a payment" (Hughes and MacDonald 2002, p. 105). This is because under normal circumstances, a bank will secure the issue of a Letter of Credit by obtaining security from the buyer (applicant) beforehand.

The level of security required by banks varies form country to country. For example, in Australia, banking industry sources reveal that virtually all import Letter of Credit business, (that is, business issued from Australia) requires the applicant to provide one hundred percent collateral guarantee (this requirement is slightly relaxed for the very large corporations), and this appears to be consistent with the conservative behaviour of banks in Australia. In cases where the security given to the bank is in the form of foreign currency, banks are known to "seek up to 120% security (to cover any exchange rate fluctuation)" (Anon., Personal correspondence to Bergami 2009d). These approaches have the effect of preventing the bank's liability moving from contingent to realised, because the bank already has enough available security to meet the demand for payment.

In other countries, where less than one hundred percent security is obtained, the bank may be financially exposed by the shortfall in security arranged at less than one hundred percent. As an example, the following situation could develop. In a Letter of Credit transaction, the bank only takes seventy percent security. The Letter of Credit is issued, the goods are despatched and compliant documents are presented by the exporter seeking payment. The bank already holds seventy percent of the amount required, and to meet its payment undertaking fully, seeks the balance of the funds (thirty percent) from the applicant. However, the applicant is unable to raise the balance of thirty percent, due to financial difficulties. As the bank must honour its undertaking to pay on time, it must therefore make good the shortfall of thirty per cent from its own reserves and, subsequently, aim to recover from the applicant. If the bank is unable to do so, it will incur a bad debt. Therefore, it is not difficult to see that, in a Letter of Credit transaction, a bank wants to obtain prior security from the applicant, in order to avoid having to meet their undertaking to pay obligations from their own reserves.

In summary, "in international practice the [Letter of Credit] transaction, is usually rectangular" (Dolan 1992, p. 396), with four participants: the exporter, the importer, the issuing bank and the advising bank.

The primary obligations of the importer in a Letter of Credit transaction

The obligations of the importer as the applicant of the Letter of Credit may be summarised as having to apply for the Letter of Credit and lodge security as demanded by the issuing bank. Given that the Letter of Credit, in effect, substitutes the buyer's credit risk with that of their bank, the buyer is no longer a party to the payment mechanism of the Letter of Credit, unless discrepant documents are presented, in which case the issuing bank may need written acceptance of the documents (waiver) from the buyer before effecting payment – this process is further discussed in Chapter 4.

The primary obligations of the issuing bank

The obligations of the issuing bank are to establish the Letter of Credit and make this available to the exporter, typically via the advising bank, and to check documents and accept or reject these and pay accordingly. The high discrepancy and rejection rates (up to 70% on first presentation, according to the ICC) were largely claimed to be the result of documentary checking procedures. The standards by which documentary checks are practised have been the subject of much controversy over the years. The

UCP 500 became effective in 1994 and in Article 13 there is a reference to the fact that documentary compliance “shall be determined by international standard banking practice as reflected in these articles” (International Chamber of Commerce 1993, p. 19). The problem with this statement is that no such standard actually appeared in the UCP 500, consequently, “the lack of such a published practice has resulted in an environment where various banks have different rules on acceptability, or otherwise, of documents” (Walden 2003, p. 23). Banks were expected to discharge their obligation against a specified ‘standard’ that did not actually exist and, consequently, devised their own ‘standards’ – just how a unified standard could have been expected to develop in these circumstances continues to remain a mystery.

In fact, the ICC did not correct the anomaly of a lack of standard for ten years, when finally, in 2003, the ‘International Standard Banking Practice for the Examination of Documents under Documentary Credits” (International Chamber of Commerce 2003b), and commonly referred to as ISBP, was released. One banking expert claimed that “in one sense the ISBP is ten years late” (Collyer 2003), in fact, simple arithmetic would put the release of the ISBP exactly ten years late and the meaning of ‘in one sense’ is not easily understood.

The ISBP was a contentious document. It was touted as a ‘fix’ to the perennial problem of documentary discrepancies in Letter of Credit trade. It was seen as “a strong first step in clearing away some of the mystique that has risen around the letter-of-credit process – and to restoring a winning scenario for all parties worldwide” (Smith 2002b, p. 11), because the practices documented in this publication, should enable parties to deal successfully with almost any examination eventuality” (Smith 2002a, p. 31). It was claimed that the ISBP “aims to encourage uniformity of practice, thus decreasing transaction costs in trade finance” (Mehta 2004a, p. 1), and certainly the ICC itself boldly stated that it had “taken steps to reduce dramatically the number of letters of credit rejected on first presentation, thereby causing costly delays and slowing world trade” (International Chamber of Commerce 2003a). These comments were supported by articles claiming that the ICC had “approved a best-practices paper [ISBP] that is expected to reduce the number of documentary credits rejected by banks” (Association for Financial Professionals 2003). Further support for the ISBP, not surprisingly, came from the banking industry, with claims that

> since the onus is on exporters to produce LC [Letter of Credit] documentation that is in compliance with UCP 500 rules and regulations, they should find the ISBP very, very useful. The ISBP will help our export customers achieve a better understanding of how to prepare their trade documents in a way that will ensure faster trade resolution and payment (AmSouth Bank 2003, p. 2).

Unfortunately, the comments above did not portray the picture of reality, surrounding the ISBP. A more accurate picture of just what the ISBP contributed, or failed to contribute, to the ease of documentary compliance may be found by referring to particular sections of the ISBP text (International Chamber of Commerce 2003b), including

- "The ISBP does not amend the UCP. It explains, in explicit detail, how the rules are to be applied on a day-to-day basis" (p. 3);
- "It explains how the practices articulated in the UCP are to be applied by documentary practitioners" (p. 8); and
- "The incorporation of this publication into the terms of a documentary credit should be discouraged, as the requirement to follow agreed practices is implicit in the UCP" (p. 9).

It should be noted at the onset that the ISBP was written for bankers, not for traders, as "by using the ISBP, document checkers [working within the banking industry] can bring their practices in line with those followed by their colleagues worldwide" (International Chamber of Commerce 2003b, p. 4). An understanding of the ISBP presupposes a mastery of the UCP and an ability to read both sets of 'rules' and interpret these as if one were a banker – this task, if at all possible, is not easy.

It should also be noted that the ICC itself actually failed to impose a standard for documentary checks in Letter of Credit transactions, as a result of how the ISBP would be regarded (their status) and also in how they would be adopted (voluntary). As mentioned earlier, the ISBP principles do not over-ride the UCP, as they are merely a 'companion'. The ISBP contain a set of 200 'guiding principles' that, whilst potentially useful, have no status of their own, because they are not binding. Documentary discrepancies must cite breaches of the UCP, not the ISBP, and this is so because the ISBP are not to be incorporated into the Letter of Credit. In relation to the voluntary adoption of the ISBP, there is cause for concern, because a voluntary system runs counter to the notion that a common standard applies. For example, banks may be found

> adopting the ISBP for their import letters of credit but going more slowly when handling their export documents for fear that the issuing

> bank has not accepted the ISBP as their standard operating procedure" (Lidberg 2003).

Unless there is total adherence, a common standard may not apply, consequently, a two-tier banking system may develop: the ISBP-adhering banks on the one hand and, on the other, the non-ISBP-adhering banks. The differing approaches adopted by banks are captured in the following statement by a UK bank:

> We do not check documents in accordance with ISBP 645, since our letters of credit are not subject to ISBP 645. To put wording into our credits seeking to clarify or over-ride certain paragraphs of ISBP 645 would be illogical, as this would give credence to a document to which the credit is not subject. Having said that, any bank who chooses to ignore ISBP 645 would do so at its peril. It is a guide to how ISBP is generally interpreted and is an approved ICC publication, albeit not unanimously. It is probably prudent to say that although ISBP 645 reflects international practice, the practice is not reflected internationally. My own opinion is that in three or four years time, after much litigation, it may become standard practice for banks to issue letters of credit making reference to both UCP 500 and ISBP 645. It should be further borne in mind that with the ink on ISBP 645 barely dry, the ICC has embarked on the revision of UCP, with UCP 600 notionally due in two years' time. This would suggest that ICC regards ISBP 645 as a poor relation of UCP (Miller 2004).

It is difficult to see how uniformity of practice and consistency in documentary checking procedures, and outcomes, is actually achieved in such an operating environment. How could the ISBP indeed reduce discrepancies? The answer to this was to be provided by the comment made in the subsequent version of these guidelines, as discussed below.

There was an up-date to the UCP 500, with the release of the UCP 600, effective from 2007. Unlike its UCP 500 predecessor, UCP 600 was released with an up-dated version of the ISBP – the 2007 revision. Two points are worthy of note in relation to the 2007 ISBP revision.

One point is that

> though much of the ISBP remains unchanged from the 2002 version, certain changes had to be made. These are essentially to remove paragraphs from the ISBP where the principle has been incorporated in UCP 600; to make technical adjustments in capitalisation; to substitute UCP 600 article references for those of UCP 500; to change dates (from 2006 to 2007); and to incorporate changes in ISBP paragraphs necessary

> to bring the wording in line with the UCP 600 (International Chamber of Commerce 2007b, p. 3).

As can be observed from the above comments, the changes in the up-date were not fundamental.

The other point that is worthy of note is that the 2007 ISBP may have even less status than its 2003 counterparts, because of the vagueness of the UCP 600 Article 2 that defines, in part, a ‘complying presentation’ as being “in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice” (International Chamber of Commerce 2006, p. 17). Similar provisions also appear in Article 14 d of the UCP 600 that refer, in part, “to data in a document when read in context with … international standard banking practice” (International Chamber of Commerce 2006, p. 27). However, as the Secretary of the ICC Czech Republic Banking Commission points out that

> international standard banking practice in this context does not mean the ICC publication containing the ISBP. It means international standard banking practice in the broader sense, which definitely includes, but is not limited to, the ISBP publication (Andrle 2007, p. 18).

The subtle, but significant, point is that the ICC failed to specify explicitly to which international standard banking practices they refer. Whilst it may be implied that the intention was to refer to the ISBP, this cannot be definitively claimed, especially in light of the acknowledgement that “whilst many of these practices are contained in the [ISBP] publication, the practices [used in the banking industry] are broader than what is stated in this publication” (International Chamber of Commerce 2007a, p. 16). The lack of authority of the ISBP principles is also underscored by the UCP 600 Article 16 that, in dealing with discrepant documents, the bank is required to provide a single notice of refusal to the presenter that, pursuant to Article 16 c ii “must state … each discrepancy in respect of which the bank refuses to honour or negotiate” (International Chamber of Commerce 2006, p. 29). As stated before, as the ISBP are not an integral part of the Letter of Credit, discrepancies must be linked back to breaches of the UCP alone.

The impact of the ISBP in reducing discrepancy rates does not appear to have lived up to expectation, with the ICC stating that “anecdotal evidence suggests that this objective has been partially attained”(International Chamber of Commerce 2007b, p. 3).

In summary, an explanatory set of guidelines, the ISBP, has been issued designed to engender clarity and consistency in the application of the UCP, however, these guidelines have neither authority, nor mandatory application and, consequently, their relevance in reducing documentary discrepancy rates under Letter of Credit transactions is in doubt. The topic of documentary discrepancies, which is the main focus of this thesis will be discussed later in this section and also discussed in greater detail in Chapter 4.

Having considered the responsibilities of the issuing bank, it is important to consider the obligations of the advising bank.

The primary obligations of the advising bank

The obligations of the advising bank are potentially more difficult to define because the advising bank may assume a number of different roles, although still subject to the same requirement of the UCP. The advising bank, in the simplest role, acts as an agent of the issuing bank in advising the Letter of Credit to the exporter (beneficiary), after having reasonably established its *bona fide*, 'without responsibility on its part" (Venedikian and Warfield 1992, p. 347, 2000, p. 360). The advising bank need not do any more unless it agrees to do so. It may be that the advising bank having handed the Letter of Credit to the beneficiary is no longer involved in the transaction, This is particularly so if the exporter (beneficiary) is not a customer of that bank and the Letter of Credit is not restricted to any particular bank, meaning the documents may be lodged by the presenter at the counters of any bank in their country[6]. Under these circumstances the advising bank has very little involvement and responsibility. However, the role of the advising bank could be expanded, where it agrees to perform other functions. These other roles, discussed in greater detail in Chapter 4, include those of (Jimenez 1997): the 'nominated bank' – authorised to pay, issue a deferred payment undertaking or accept drafts; the 'negotiating bank' – purchases the draft and the documents from the exporter (beneficiary) with recourse[7]; the 'paying bank' – pays the

[6] Although it is possible for the Letter of Credit to require the documents to be presented in the country of the issuing bank, this is not usual practice,

[7] The negotiating bank retains the right of recourse in case the issuing bank fails to reimburse the negotiating bank. The negotiating bank may also be willing to discount the proceeds, as discussed earlier.

exporter (beneficiary); and/or the ‘confirming bank’ – adds its own irrevocable undertaking to pay and must pay without recourse[8] against compliant documents.

It is generally accepted that the majority of Letter of Credit business is not confirmed, with claims that “approximately 90% of all documentary credits are issued in an unconfirmed form” (de Rooy 1984, p. 36). Whilst it is difficult to ascertain the ratio of unconfirmed versus confirmed transactions, the tendency is not towards automatic requests for confirmation, mainly due to cost considerations, unless, of course, trade is conducted in a comparatively high-risk environment. The current global financial crisis provides evidence that, increasingly, traders are favouring Letter of Credit transactions, with confirmation becoming more popular at the present time.

Under a caveat of confidentiality (Anon., Personal correspondence to Bergami 2009c), banking industry sources in Australia claim that, in the period between the last quarter of 2008 to the middle of 2009, there has been a considerable shift in the methods of payment choice by Australian exporters, in general. Estimates are that up to forty percent of export business is under Letter of Credit terms and that in seventy-five percent of these cases the Letter of Credit is confirmed. This information appears to support the general notion that in times of economic difficulties businesses tend to operate more cautiously.

In recent years the popularity of the Letter of Credit, as a payment instrument, has received positive and negative support. Some argued that “letters of credit are no longer the only game in town … large importers prefer to trade on open account terms instead of using the LC [Letter of Credit], which is seen as unduly cumbersome and costly” (Jee 2005, p. 30), and “exporters are urged to be more aggressive in exporting their products by not relying on letters of credit” (Bernama 2003, p. 10). Others responded by pointing out that “L/C [Letters of Credit] continue to be the dominant payment method for many major finished good and retail importers” (Gustin 2004, p. 42) and that Letter of Credit business is a better option

> Today, exporters typically handle more transactions of lesser value – which equates to a higher cost of doing business. At the same time, a

[8] If the confirming bank accepts the documents as tendered and deems them compliant, it must pay without recourse, that is, without the ability to recover the money from the exporter (beneficiary). The confirming bank assumes the issuing bank’s credit and documentary risks, holding the exporter (beneficiary) harmless against these risks. If the issuing bank becomes insolvent, the confirming bank will incur a financial loss. If the issuing bank refuses to pay because of legitimate discrepancies, the confirming bank will incur the financial loss.

> growing customer base and the global economic malaise have heightened risk associated with transactions … it's more work upfront with the LC [Letter of Credit], but it's a secure transaction (Schlesinger 2003, p. 26).

For exporters, one of the main considerations remains the certainty of payment and that is what the Letter of Credit can provide and this "makes the L/C [Letter of Credit] highly useful in the world's most difficult markets ... [where] they remain a staple fare… [as] the prime tool for financing exports to … parts of Southeast Asia" (Ford 2005) – these comments are particularly relevant to this project, as it focused on export trade from Australia to ASEAN countries, the membership of which comprises some high financial risk destinations, such as Myanmar and Laos.

The primary obligations of the exporter

Viewed from the exporter's perspective, signalling theory can be observed where a bank in the exporting country decides to confirm the Letter of Credit, because they are indicating to the exporter (beneficiary) that the credit risk of the issuing bank (and by implication the host country) is at an acceptable level. It must be stressed that confirmation is a voluntary step for any bank. Regardless of the role the advising bank accepts, it still has to operate within the UCP framework and, if relevant, the ISBP influence, in the documentary checking procedures.

Whilst one of the bank's primary roles is that of the document checker, the exporter's primary concern is meeting the documentary requirements of the Letter of Credit. There are "two broad principles on which the law relating to letters of credit is based … the principle of autonomy is regarded as one … the other being the doctrine of strict compliance" (Chatterjee and Lefcovitch 2003, p. 72) – each of these two principles is discussed below. These principles are important because they provide the foundations for the operations of the Letter of Credit transaction.

The independence principle is embodied in the UCP 500 (International Chamber of Commerce 1993, p. 11) through Article 3 that states:

> **a.** Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever is included in the Credit. Consequently, the undertaking of a bank to pay, accept and pay Draft(s) or negotiate and/or to fulfil any other obligation under the Credit, is not subject to claims or

defences by the Applicant resulting from his relationships with the Issuing Bank or the Beneficiary.

b. A Beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the Applicant and the Issuing Bank.

Article 3 makes a clear separation between the Letter of Credit and the contract and reflects the claim that "no legal concept is held more sacrosanct to the Letter of Credit business than the 'independence' principle" (Carlson and Widen 1999, p. 1661). To be sure, Article 3 specifically removes any links between the banker's duties and obligations under the UCP 500 and the contract of sale, even where there is a reference to the contract. The contract of sale is the underlying transaction to the Letter of Credit but remains separate from the payment instrument and, consequently, through this principle of autonomy, Article 3 has the effect of "isolating the credit from the underlying transaction" (Turner 2003, p. 6). There are two important aspects to the mechanics of Letter of Credit operations. The first one is that banks are not a party to the contract of sale, therefore, they cannot be bound by such a contract. The second one is that, from the banker's point of view, Letter of Credit operations are based on documentary evidence alone, pursuant to Article 4 of the UCP 500 (International Chamber of Commerce 1993, p. 11), which states:

> In Credit operations all parties concerned deal with documents, and not with goods, services and/or other performances to which the documents may relate.

When Articles 3 and 4 of the UCP 500 are read jointly, it becomes obvious that the banker cannot be influenced by claims and counter claims for payment, or non-payment, by either of the contracting parties and that, furthermore, the banker can only rely on documents as the basis for payment, or refusal, as they case may be. This point was made by Lord Denning MR in *Power Curber International Ltd v. National Bank of Kuwait* [1981] 1 WLR 1238 at 1241 (Chatterjee and Lefcovitch 2003, pp. 73, 77)

> The bank is in no way concerned with any dispute that the buyer may have with the seller. The buyer may say that the goods are not up to contract. Nevertheless the bank must honour its obligations. The buyer may say that he has a cross-claim in a large amount. Still the bank must honour its obligations. A Letter of Credit is like a bill of exchange given for the price of the goods. It ranks as cash and must be honoured.

The doctrine of strict compliance is also well established, with cases upholding this principle going back nearly one hundred years. In *English Scottish and Australian Bank v. Bank of South Africa* (1922) 12 L1.L.R. 21, 24 Bailhache, J. stated (Ellinger 2000, p. 187)

> It is elementary to say that a person who ships in reliance of a Letter of Credit must do so in exact compliance with its terms. It is also elementary to say that a bank is not bound or indeed entitled to honour drafts presented to it under a Letter of Credit unless those drafts with the acoompanying documents are in strict accord with the credit as opened.

"The rationale behind this strict, uncompromising doctrine is the notion that bankers are financiers and not traders" (Ellinger 2000, p. 187). The unequivocal requirement for strict documentary data compliance, with the terms and conditions of the Letter of Credit, is commonly believed to be the primary cause for documentary rejection. Strict compliance applies to the documents and also to the banker's documentary checks, as Viscount Summer in *Equitable Trust Co. of New York v. Dawson Partners* (1926) 27 L1.L.R. 49,52 stated (Ellinger 2000, p. 188)

> It is both common ground and common sense that in such a [Letter of Credit] transaction the accepting bank can only indemnify if the conditions on which it is authorised to accept are in the manner of the accompanying documents strictly observed. There is no room for documents which are almost the same, or which will do just as well. Business could not proceed securely on any other lines. The bank's branch abroad, which knows nothing officially of the details of the transaction thus financed, cannot take it upon itself to decide what will do well enough and what will not. If it does as it is told, it is safe; if it declines to do anything else it is safe; if it departs form the conditions laid down, it acts at its own risk.

"Courts generally recognise that the credit cannot exist without independence from the underlying transaction" (Dolan 1996, p. 2.46) and, consequently, the "doctrine continues to reign supreme" (Ellinger 2000, p. 189) and, notwithstanding the promulgation of guidelines, such as the ISBP, aimed to ameliorate the discrepancy problems, rejection rates continue to be unacceptably high. This issue is at the core of this research and will be discussed in greater detail later in this chapter, as well as subsequent chapters.

The link between the doctrine of strict compliance and the UCP 500 is provided by Article 13 (International Chamber of Commerce 1993, p. 19), which states in part

a. Banks must examine all documents stipulated in the Credit with reasonable care, to ascertain whether or not they appear, on their face, to be in compliance with the terms and conditions of the Credit. Compliance of the stipulated documents on their face with the terms and conditions of the Credit, shall be determined by international standard banking practice as reflected in these Articles. Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in compliance with the terms and conditions of the Credit.

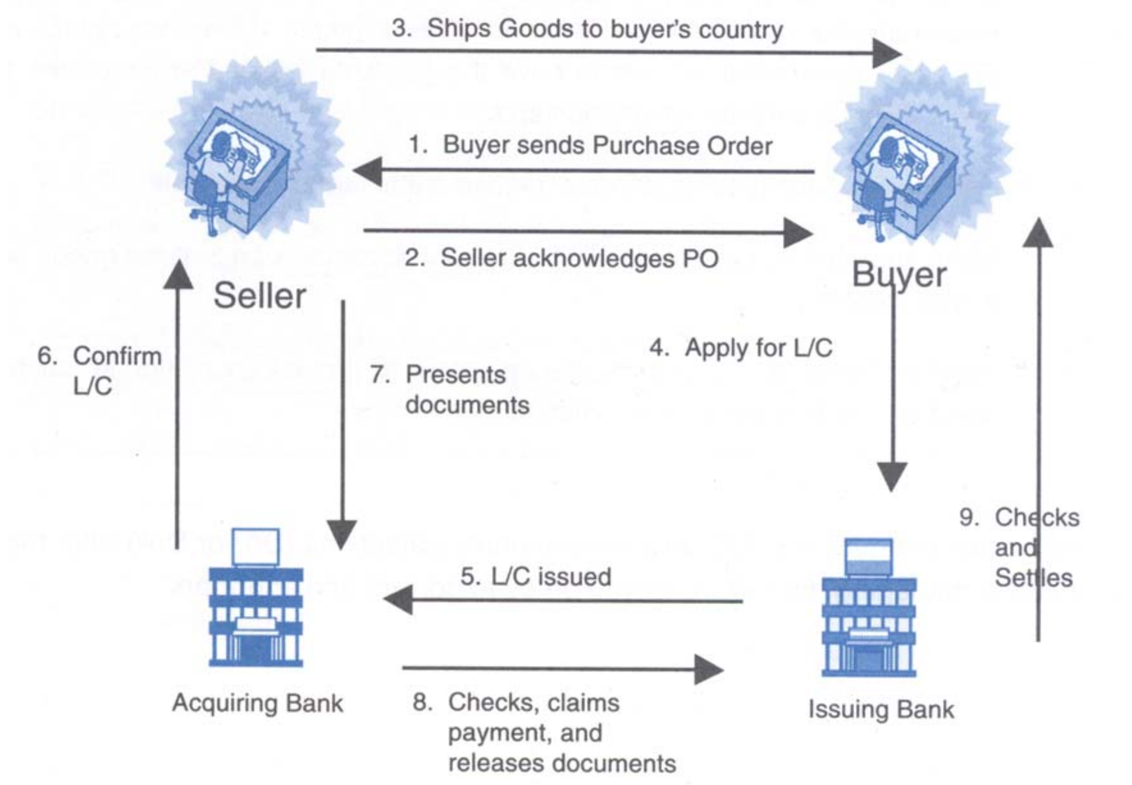
Whilst the subject of international banking standards was discussed earlier, the issue of what constitutes a compliant presentation also needs to be considered, not only in the light of the obligations imposed on banks by the UCP 500, but also, and especially, from the exporter's point of view in meeting the banker's requirements in order to obtain payment.

The responsibilities of the exporter are, therefore, to act in accordance with the Letter of Credit requirements, so as to take whatever necessary action is needed to effect the timely despatch of the goods and submit the documents to the bank within stipulated time frames. The data on the documents, and across the documents themselves, must match that required by the Letter of Credit for the payment to be triggered, even where those documents have been issued by third parties. Article 13 imposes an obligation on the bank to check the documentary data against the Letter of Credit and across the documents for compliance, because not all the data shown on the documents can be verified by reference to the Letter of Credit alone. For example, it would be unlikely that the Letter of Credit would show the weight and volume of the dispatched consignment, simply because the payment instrument is issued ahead of shipment. Checking these data against the Letter of Credit is, therefore, not possible. Shipment details are likely to be found on packing lists / slips and transport documents. When checking these data the banker compares the data between the documents for consistency and, in accordance with Article 13, treats data variation as an inconsistency and, consequently, regards the documents as discrepant. An example of this may be where the transport document shows a weight of 1250 kilograms but the packing list shows 1200 kilograms. This difference alone would be enough for the payment to be jeopardised – such is the application of the doctrine of strict compliance and this is probably why Ellinger (2000) refers to it as an uncompromising doctrine. The weight discrepancy would not be relieved by the banker's knowledge that the seller has, in every other respect, fully discharged their obligations against the contract specification and all other requirements of the Letter of Credit, because the seller (beneficiary) is prevented from "availing himself from the contractual relationship", as per Article 3 b of the UCP 500 (International Chamber of Commerce 1993, p. 11) – such is the application of the independence principle. These examples highlight the difficulties for the exporter in fully meeting the Letter of Credit requirements, as these processes are complex, with many parties involved in them.

3.2.4 The complexities of Letters of Credit

The complexities of the Letter of Credit cycle have been explained by diagrammatic representation in the literature, as shown in Figure 3.28.

Figure 3.28: UN ESCAP Letter of Credit flow diagram (United Nations Economic and Social Commission for Asia and the Pacific 2005, p. 19)



The diagram shown in Figure 3.28 is accompanied by the following explanation that, in part, states (United Nations Economic and Social Commission for Asia and the Pacific 2005, p. 18):

> An L/C [Letter of Credit] offers the seller the security of knowing that he will be paid while offering the buyer the assurance that payment will only be made when his bank is presented with documents that keep to the terms of the L/C. When both the buyer and seller agree on using the L/C as a mode of payment, the buyer first obtains the L/C from his bank. As shown in figure 2.4 [3.28 here], the buyer applies for the L/C from his bank in step 4. Once approved, the L/C is forwarded to the advising bank (step 5). The advising bank, which acts on behalf of the seller, has to confirm whether the L/C is in order. Once this is confirmed, the seller releases the shipping documents (step 8). The issuing bank releases the payment once the buyer has confirmed the collection of the goods.

Unfortunately, despite this publication being issued by a United Nations agency, the diagram shown at Figure 3.28 has a number of incorrect and missing steps in the Letter of Credit process and, additionally, the explanatory text appears incorrect and inconsistent with the diagram, as discussed below.

The bank in the seller's country is referred to as the 'Acquiring Bank', which is an unusual name and does not match the explanatory text that refers to this entity as the advising bank (the term generally used for this bank). The explanatory text states that the "advising bank acts on behalf of the seller" and this contradicts other literature and legal principles discussed earlier in this section – if anything the advising bank acts as a limited agent of the issuing bank. Steps 1 and 2 indicate the contract formation, which is the underlying transaction. Step 3 'Ship goods to the buyer's country' is out of sequence. The shipment of the goods invariably takes place after the Letter of Credit has been received and checked by the seller. This is because the payment against a Letter of Credit is only triggered against hundred percent data matching on documents. Therefore, it would be illogical to dispatch the goods ahead of the payment instrument being received, as the documentary data requirements cannot be known ahead of time – this is tantamount to reading a crystal ball to predict the future. It is curious to note that the UCP 500 actually allows the presentation of documents issued prior to the issue of the Letter of Credit, pursuant to Article 22 (International Chamber of Commerce 1993, p. 25)

> Unless otherwise stipulated in the Credit, banks will accept a document bearing a date of issuance prior to that of the Credit, subject to such document being presented within the time limits set out in the Credit and in these Articles.

Just how anyone can be certain to meet the requirement of an unknown request is not clear. Certainly, the exporter (beneficiary) would be able to issue in-house documents, such as invoices, packing slips, etc., in such a way as to meet the requirements of the Letter of Credit, even where the goods were dispatched ahead of the payment instrument being received. However, the same may not be possible for third party issued documents, such as transport documents, because, as mentioned earlier, shipment dates on transport documents cannot be changed due to fraud considerations.

Step 6 'Confirm L/C' seems either inappropriately labelled, or is presuming confirmation, which, as discussed earlier, is not automatic. The text refers to the advising bank "confirming whether the L/C is in order", however, the meaning of this is not altogether clear. Perhaps the authors did not mean confirmation but are referring to the fact that the advising bank needs to authenticate the Letter of Credit in accordance with the requirements of Article 7 of the UCP 500 that state in part "the Advising Bank … shall take reasonable care to check the apparent authenticity of the Credit which it advises" (International Chamber of Commerce 1993, p. 12).

The despatch of the goods is not shown in the diagram, but Step 7 'Present documents' is offered instead. The explanatory text states "the seller releases the shipping documents (step8)." Yet, the diagram shows the Acquiring Bank at Step 8 'Checks, claims payment, and releases documents'. The correct procedure appears to be for the seller to lodge the documents with the local bank for forwarding to the issuing bank. The issuing bank would then release the document to the buyer in accordance with the Letter of Credit arrangements.

The diagram does not show any funds being transferred to the seller, but merely shows the Acquiring Bank, at Step 8, as claiming payment – the omission of such an important step in the process is a cause for grave concern – the whole purpose of the Letter of Credit transaction is to ensure payment and it does not make sense to ignore this step.

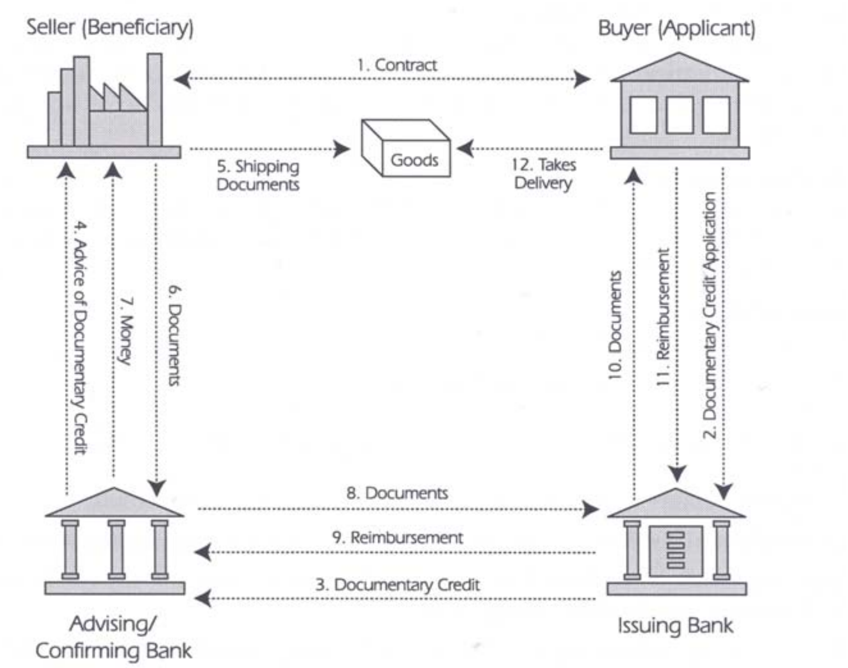
Finally, Step 9 'Checks and Settles' does not match the explanatory text that states "the issuing bank releases the payment once the buyer has confirmed the collection of the goods". This statement appears to contradict both Articles 3 and 4 of the UCP 500, and the independence principle, that decouple the contract, services or other performances from the Letter of Credit that relies solely on documentary compliance.

The release of the goods is not a pre-requisite to payment, for if it were so, and the goods remained uncollected by the buyer, the issuing bank would have no liability to honour its payment undertaking and that would make a mockery of the Letter of Credit transaction.

The position put by these authors, therefore, is strongly rejected and it is regretful to note that this publication was produced by the United Nations Economic and Social Commission for Asia and the Pacific Trade and Investment Division (ESCAP[9]), with the aim of “building the capacity of selected ESCAP member countries with economies in transition in the area of trade and investment” (United Nations Economic and Social Commission for Asia and the Pacific 2005, p. iii). The membership of ESCAP includes all of the ASEAN nations, the countries the Australian exporters surveyed in this thesis focus on.

Other flow diagrams, as shown in Figure 3.29, depict a different sequence of actions and this is generically supported by a number of authors (Branch 2000; British Exporters Association 2003; Burnett 2004; del Busto 1994; Ross 1999).

Figure 3.29: Generic Letter of Credit flow (Wickremeratne and Rowe 1998, p. 1.6)



[9] ESCAP membership incorporates all ASEAN nations, the focus of this thesis. Some of the ASEAN member states are high users of Letter of Credit business and the provision of incorrect information relating to these processes seems paradoxical to the notion of societal capacity building.

It should be noted that Figure 3.29 shows the generic Letter of Credit flows, and specifically where payment is effected by the Advising/Confirming Bank[10]. It does not provide for every possible variation in the role of the advising bank or the different flows resulting from deferred payment arrangements. However, for the purposes of the discussion in this chapter, the generic approach is sufficient. More detailed discussion on the variations is provided at Chapter 4.

It can be observed that steps 1 to 4, in Figure 3.29, are consistent with the earlier discussion on the contracts arising from the establishment, issue, and advice of a Letter of Credit, as shown in Figure 3.27. Of critical importance to the exporter are Steps 4, 5 and 6, indicating, respectively: the receipt of the Letter of Credit; the shipment of the goods; and the lodgement of the documents with the bank. These steps are critical because of their likely impact on documentary compliance.

Step 4 'Advice of Documentary Credit', is critical because it is at the onset that the exporter can be proactive by ensuring "that a local bank has authenticated the Letter of Credit" (United Nations Economic and Social Commission for Asia and the Pacific 2005, p. 20) and "that the terms, conditions and documents called for in the Documentary Credit are in agreement with the sales contract" (del Busto 1994, p. 32). If the Letter of Credit "is insufficient in amount, or calls for documents the exporter will not be able to supply before the credit's expiry the exporter must have the foreign buyer instruct its bank to amend the Letter of Credit" (Ross 1999, p. 5.3)

The amendment of a Letter of Credit is a fairly straight forward process and this is detailed in Articles 5 and 9 of the UCP 500. The buyer (applicant) lodges an application with the issuing bank to amend the Letter of Credit and, if this is approved, then the amendment is issued and is communicated via exactly the same channels as the original Letter of Credit. The amendment is issued in the form of an appendix, that is, a separate document to the original Letter of Credit. The irrevocable Letter of Credit, in accordance with Article 9 d i, "can neither be amended nor cancelled without the agreement of the Issuing Bank, the Confirming Bank, if any, and the Beneficiary" (International Chamber of Commerce 1993, p. 15). It is usual in Australia for the

[10] As discussed earlier, the advising bank may agree to be the Confirming Bank, but this is not automatic. Figure 2.31 is based on the presumption that th Letter of Credit is confirmed, and what more that it is confirmed by the advising bank. This notion is accepted here for the purposes of the literature review, but more discussion on these issues is provided in Chapter 4.

beneficiary to receive two copies of the amendment – one to keep and the other to sign and return to the advising bank, thereby indicating their acceptance.

Apart from making sure that the Letter of Credit and the sales contract match (British Exporters Association 2003; Mehta 1999), the exporter needs to perform additional checks immediately upon receipt of the payment instrument and certainly prior to shipping the goods, in order to minimise the opportunity for documentary discrepancy. According to the literature (Baker 2000; Branch 2000; British Exporters Association 2003; del Busto 1994; Hinkelman 1999; Ioma's Report 2003; Jimenez 1997; Prior 1996; Technical Officers of Global International Trade and Business Finance 2000; United Nations Economic and Social Commission for Asia and the Pacific 2005; Venedikian and Warfield 2000; Wickremeratne and Rowe 1998), the specific items the exporter should check include the following:

- that their company's name and address appear correctly on the Letter of Credit;
- that the Letter of Credit amount is sufficient to cover the shipment;
- that the Letter of Credit has the correct payment period;
- that the Letter of Credit specifies clearly and definitively which documents are required to be presented for payment and who is to issue such documents;
- that the description of the goods, quantities and unit price(s) are correct;
- that the correct mode(s) of transport are shown with corresponding transport document requirements;
- that the shipment dates can be met in a timely manner, allowing for partial shipment, if required, and that the shipment schedules can be met; and
- that the required documents can be lodged within the specified timeframes and within the expiry of the Letter of Credit.

In summary, the Letter of Credit, in the hands of the exporter, should be checked to make sure it is 'workable', that is, its requirements are able to be met fully by the exporter.

Once the exporter had decided to ship the goods (Step 5 in Figure 2.31) the documentation needs to be assembled and lodged with the bank in timely fashion. The exporter's own documentation, such as invoices and packing lists, may be produced at will at any time, at the exporter's pleasure. However, third party issued documentation may be subject to different timelines and processes that may present challenges for the exporter, in meeting the presentation period allowed under the particular Letter of Credit transaction. Examples of commonly issued third party documents include, transport documents[11], independent inspection certificates[12], 'official' certificates of origin and visaed (or legalised) documents[13].

As can be imagined, the number of documents and the interplay between the exporting enterprise and several document issuers, with their own peculiar requirements, and defined timelines for the lodgement of documents to ensure payment, contribute to a pressure cooker environment where it is not difficult for mistakes to occur and, as we have noted earlier, a 70% discrepancy rate is alarming to say the least.

In order to provide some assistance to exporters in minimising documentation errors, a number of checklists has been provided, varying from one page documents (Baker 2000; British Exporters Association 2003), to more comprehensive lists of several pages (del Busto 1994; Technical Officers of Global International Trade and Business Finance 2000). The usefulness of these checklists must be doubtful for, in light of their existence, discrepancy rates have not been reduced.

3.2.5 Major areas of documentary discrepancies

The literature highlights the major areas of documentary discrepancies as including (Baker 2000; Fact File 1999; Jimenez 1997; Mehta 1999; USB AG 2006; Venedikian and Warfield 2000; Wickremeratne and Rowe 1998):

- failure to meet the dispatch dead-line;
- presentation of incomplete documents;
- incorrect description of the goods on the invoice;
- conflicting data across different documents;
- documents not signed;
- insurance document dated after shipment date or showing incorrect currency and/or amount insured;

[11] Especially Bills of Lading that are subject to a tedious issuing process – discussed in greater detail in Chapter 4.
[12] Independent inspection agencies such as SGS and Bureau Veritas provide 'clean report of findings' that are required as part of the import permit process and, consequently, the Letter of Credit will commonly specify such documents, in those circumstances.
[13] Typically these documents are legalised – stamped under official seal – by local Embassies or Consulates of the importing country and, as these are usually a mandatory import documents for border control functions, the Letter of Credit typically stipulates these as a requirement.

- partial shipments effected when not allowed or incorrect invoicing for partially shipped goods (when partial shipment is allowed);
- documents not visaed or legalised or not appropriately authenticated when amended; and
- late lodgement of documents.

A number of the items listed above are controlled by the exporter, at least to the degree to which non-compliance is present on in-house documents. Other discrepancies may be explained by the failure of the exporter properly to instruct service providers, such as freight forwarders, carriers, chambers of commerce and others. Yet another explanation for documentary discrepancies may lie in human behaviour because, according to Lesley Stroh (the publisher of New York based trade magazine *The Exporter*), "real discrepancies are created by human beings" (Mehta 2004b, p. 2).

Whilst it is not possible to remove humans from transactions, perhaps automated systems may be able to assist, at least in part. The International Chamber of Commerce saw an opportunity to introduce the option to trade electronically with Letters of Credit and introduced a supplementary set of rules to the UCP 500 exactly for this purpose (the eUCP[14]), effective 1 April 2002. The eUCP were up-dated in 2007 with the release of version 1.1 (International Chamber of Commerce 2007c) to accompany the release of the UCP 600, and, like the ISBP, there were no substantive changes from the original 2002 version.

Despite the rhetoric, that "the eUCP is a watershed event in the history of the documentary credit" (International Chamber of Commerce 2002, p. 3), the eUCP were not the success hoped for. Just after the eUCP became effective, "a prominent Canadian banker said that most banks in Canada are not ready yet" (Pachnev 2002, p. 1). There are several issues that plague the introduction and the implementation of a truly electronic system for Letter of Credit business, including the need for IT investment not only by banks but exporters and importers, logistics service providers and insurers and all of these systems need to interface with each other – perhaps a nightmare in the making. Add to these problems the legal question of replacing negotiable documents

[14] This set of rules is formally known as the Electronic Supplement to the UCP 500. The purpose of this supplement is to substitute, as appropriate, the UCP 500 Articles, with those of the eUCP when dealing wholly or partially when an exporter electronically submits documents to the bank. The first release of these rules is identified by its version number – in this case version 1.0

with electronic messages. World-wide, legal systems are struggling with this notion, as the law has not caught up with the IT innovations presented to us today. Lastly, the eUCP have a few ‘stings in the tail’ for the exporter.

As an example, Article e 5 f states “an electronic record that cannot be authenticated is deemed not to have been presented” (International Chamber of Commerce 2002, p. 12). Presumably this means that the exporter and the bank will need to work through a private key-public key infrastructure security system, such as those provided by means of secure digital signatures. Banks in Australia have developed, to varying degrees, electronic ‘solutions’ for their customers – each bank has a proprietary, not generic, system, so the exporter may need to set up several configurations if they wish to retain the choice of dealing with a number of banks – this could be costly and, additionally, there may be IT security concerns for the exporter.

Another example is provided by the paradoxical requirements of the eUCP for notification of complete presentation and this requirement may produce a higher operational risk environment for the exporter. Under the eUCP, any party may present electronic documents directly to the bank and, unlike the traditional paper-based presentation, the electronic documents may be presented separately. To reap the efficiencies of technology, logic would suggest that a carrier should send the transport document required under the Letter of Credit, directly to the bank, instead of sending this to the exporter, for forwarding to the bank. However, in following the ‘efficiency’ route, the exporter is left exposed on two counts. Firstly, the exporter would not have the opportunity of scrutinising the final version of the document before it is lodged with the bank; therefore, the exporter would not know of any errors and would not be in a position to take remedial action prior to presentation. The discovery of mistakes post presentation may reduce or eliminate the opportunity for rectification due to the timelines allowed under the particular Letter of Credit; thus, an otherwise ‘fixable’ data error evolves into an unfixable discrepancy with consequent payment delays or, in a worse case situation, no payment at all. Secondly, pursuant to eUCP Article e 5 c,

> … the beneficiary is responsible for providing a notice to the Bank to which presentation is made signifying when the presentation is complete. The notice of completeness may be given as an electronic record or paper document and must identify the eUCP Credit to which it relates. Presentation is deemed not to have been made if the

> Beneficiary's notice is not received (International Chamber of Commerce 2002, p. 12).

If arrangements are in place with third parties for electronic lodgement of documents directly with the bank, how will the exporter know when this has been done? What mechanisms would have to be in place? Copying the transmission to the exporter does not seem to overcome the problem – the message may be delivered to one party but not to the other. At what stage does the beneficiary send the notice of completion? These considerations are important for the exporter, because it must be remembered that until payment is effected, the exporter carries the financial risk in the Letter of Credit transaction and this is especially so if there are discrepancies.

Seven years after its initial release, and two years after its first revision, the eUCP appears to have gained little ground in Australia, at least. Based on confidential comments from banking industry sources, the eUCP appears to be rather irrelevant: "I have never seen a set of documents lodged electronically …, so not very widespread at all" (Bergami 2009a); "electronic lodgement of document – not applicable" (Bergami 2009b); and

> eUCP usage is zero. We do not have any customers using electronic means of delivering their documents. I believe this is some years off before this will happen. Until you get shipping companies willing to issue electronic bills of lading there is no use.

The eUCP appears to have little relevance to this research in Australia and does not seem to be contributing a practical solution to the problem of documentary discrepancies in Letter of Credit business.

Documentary discrepancies, therefore, do not seem simple to solve and they have been lingering like some form of malaise. Yet, as persistent as this problem may be, research studies in this area do not seem to be abundant. The most in-depth enquiry into Letter of Credit discrepancies appears to be the one by Mann (2000), in the USA.

3.2.6 Mann's (200) study of Letter of Credit discrepancies

Mann (2000) investigated five hundred import and export transactions and interviewed ten bankers. His findings provided some interesting insights into Letter of Credit operations, discrepancy rates and their significance. For example, "the documents presented in the 500 transactions I examined conformed to the Letter of

Credit only 27% of the time” (Mann 2000, p. 2497) – this observation supports the claim made by the ICC in relation to average world-wide documentary discrepancy rates.

The financial impact of these discrepancies was described as follows:

> The payment transactions rendered the discrepancies irrelevant because the buyer waived the discrepancies in all but one case and provided full payment for the shipment in spite of the discrepant presentation (Mann 2000, p. 2497).

Mann (2000) provides details of this one case of less than full payment in the supporting footnote (13):

> Even in that one case (Profile 457), the seller did not refuse payment entirely, but authorized a discounted payment of 94% of the amount upon which the parties originally had agreed (Mann 2000, p. 2497).

Significantly, Mann (2000) seemingly claims that discrepancies did not cause any financial losses to the exporters, except in one case, where a six percent discount was offered, presumably as an ‘inducement’ to accept the documents. This is an important point, because it is likely that the exporting enterprise merely wrote off the ‘discount’ against its sales and this cost of doing business is probably not captured as a specific cost of Letter of Credit business. The point is that discrepancies carry a cost factor for the exporting organisation but it is not known with certainty how widespread is the practice of ‘discounting to get acceptance of documents and payment’, and what is its real cost. Mann (2000) does not appear to quantify the discounted percentages in financial terms but does offer a glimpse of some cash flow retardation resulting from discrepant documents, although he claims this does not have a high impact

> Several bankers suggested that applicants – even if they ultimately permit payment – commonly delay payment for a significant period of time to reflect dissatisfaction with the beneficiary's performance in the transaction. But the data suggest that applicants generally waived promptly. Of the 196 import files with discrepancies, the applicant in more than half of the files – 103 (53%) – waived the discrepancies within one business day after the issuer contacted the applicant about the discrepancy. By one week after the issuer contacted the applicant, they waived discrepancies in 165 (84%) of the files. By four weeks after the issuer contacted the applicant, only six files (3%) remained unaccepted (Mann 2000, p. 2514).

It should be noted that in discussing the data the author is referring to import, not export transactions, that is, purchases made by USA importers and, therefore, does not address the issue of exporter transactions from the USA. As Mann (2000) admits, he “did not examine the export-side transactions in the files of any overseas bank” (Mann 2000, p. 2510). Indeed this author acknowledges that a Letters of Credit plays a different function depending on its direction

> … the party sending goods into the United States tends to worry less about the likelihood of misconduct by the U.S. purchaser than a corresponding U.S. exporter considering the likelihood of misconduct by an overseas purchaser. Indeed, the same idea supports the notion that letters of credit on shipments into the United States serve a different function (unrelated to the reliability of the U.S. buyer) from the function that they normally serve on shipments out of the United States (where the reliability of the overseas buyer might be central to the use of the Letter of Credit) (Mann 2000, p. 2509).

In a supporting footnote (48) to the above quotation, Mann (2000) reports that

> one banker suggested that banks follow country-by-country conditions so closely that they step up the vigilance of their document checking in countries (such as Asian countries in recent years) that appear to be undergoing particular crises … As he explained, although the banks in the country under stress might honor discrepant documents 99% of the time under normal conditions, "in hard times they might reject half of them." (p. 2509).

The above statement lends support to the notion that the Letter of Credit tends to be used more frequently in high risk situations; and the reference to ‘hard times’ may also be inferred to apply to the current global financial crisis that has contributed to a spike in export Letter of Credit business, as evidenced by the comments made by Australian banking industry sources, reported earlier in this section. This would indicate that Australian exporters are seeking increased use of Letter of Credit transactions as a means to securing payment to mitigate customer, country and bank risk by seeking the have the Letter of Credit confirmed with a local bank.

Mann (2000) also asserts that the Letter of Credit is used to overcome information asymmetry, as both parties have some form of information imbalance at the beginning of the transaction and the author refers to the Letter of Credit as being a “verification institution” (p. 2498) – in reality this is signalling theory by a different name. That is, the bank is used to provide a signal to the exporter that payment is assured, because *inter alia* the foreign buyer is reputable – the issuing bank having already established the *bona fide* of that party prior to issuing the Letter of Credit. Mann (2000) concurs with this position as he states “banks effectively vouch for their customers when they issue letters of credit for them” (pp. 2524-2525) and “they will not issue letters of credit indiscriminately …[rather] they engage in a serious screening process of customers for whom they issue letters of credit” (p. 2526) and states that some banks “reported that they ‘persuade[d]’ or ‘pressure[d] their customer to waive the discrepancies in any case in which the seller’s performance was not *seriously* defective” (Mann 2000, p. 2525).

Mann (2000) makes a useful contribution in identifying the documentary discrepancies and tabulating these in order of occurrence, as shown at Table 3.1.

Table 3.1: Types of discrepancy (Mann 2000)

Type of discrepancy	**Occurrence**	**Percentage**
Defective Documents	293	85%
Missing Documents	75	22%
Late Shipment	62	18%
Late Presentation	48	14%
Expired	36	11%
Overdraft	16	5%
Incorrect Shipment	14	4%
Partial Shipment	7	2%
Other	2	1%
Total Discrepancies	**554**	
Total Discrepant Files	**365**	
Files Not Examined	**22**	
Files Examined	**343**	

It should be noted that the import and export discrepancies shown in Table 3.1 seem to have been aggregated in the data that the author reports. In another table, Mann (2000) shows that the import transactions have a discrepancy rate of 77% and the export transactions have a discrepancy rate of 68%. What is not known is whether the discrepancies rank the same for both sets of data and it might have been better for analytical purposes if the data sets had been presented separately. However, the data in Table 3.1 seem to be supported by other literature, mentioned earlier in this section. In looking at the data, it would seem that a considerable number of discrepancies, shown in Table 3.1, might have been avoided by the exporter with, perhaps, more attention to detail and generally better business processing procedures. However, the impact of these discrepancies appears to be low in terms of financial risk, as according to the bankers Mann (2000) interviewed, they claimed that “applicants would refuse payments in less than one percent of the discrepant files” (p. 2514).

In his conclusion Mann (2000) acknowledges the limitations of his study and, significantly, in relation to the discrepancy section of this paper, he states

> the inconclusive analysis of Part II illustrates the need from other countries and from other parties other than the banks to obtain even a simple understanding of the factors that correlate with the existence of discrepancies in commercial letter-of-credit transactions (p. 2533).

The comments by Mann (2000) appear to be quite appropriate to the aim of the research behind this thesis, as the survey of Australian manufacturing exporters should provide additional information and insights into the practices surrounding Letter of Credit business.

3.2.7 Main responses to Mann’s (2000) study

Mann’s work was both praised and criticised by others. The signalling theory for the operations of a Letter of Credit are challenged, as

> traditional signalling theory suggests that the Letter of Credit may be a relatively poor source of information. First, the signal is opaque. Mere issuance of a Letter of Credit makes no distinction between the applicant who barely qualifies and one who is beyond reproach. Compare this on/off system with more robust signalling systems such as graded ratings of securities by intermediaries, different warranty periods for goods, and different levels of investment in education at institutions of different quality (Gillette 2000, p. 2543).

It seems that Gillette (2000) is viewing Mann’s (2000) comments from a different perspective to what Mann intended. Mann’s (2000) comments should be read in the context of whether discrepancies ultimately become overlooked by the applicant (buyer) or whether they are rejected outright and become non-payments. As Mann (2000) makes the point, non-payment occurs in less than 1% of transactions and perhaps the bank’s role in being selective about their customer base and ‘persuading’ buyers to accept inconsequential discrepancies has merit.

Gillette (2000) highlights that Mann’s study as, valuable and provocative as it might be, is also biased, for “reliable empiricism demands that the relevant enquiries be made of all parties to the transaction" (p. 2547), because "after all, what would we expect banks to tell us about the use of a device that they find profitable?" (Gillette 2000, p. 2547). Indeed, Mann only investigated a selection of bank files, and interviewed some bankers, leaving out the obvious parties – the traders, the sellers and the buyers who could tell the real story behind the use of the Letter of Credit. Gillette (2000) calls for more empirical studies in this area, to probe further into Mann's (2000) assertions.

Another response to Mann's (2000) study seems to provide a high degree of support for the findings and labels the statistics as objective (Corre 2000, p. 2548) and this is in direct opposition to the comment of Gillette (2000). It is difficult to see how statistics designed to answer questions about a method of payment that has a four-party involvement, can justifiably do so when only one party is surveyed. Corre (2000) discusses the issue of discrepancies questioning why the Letter of Credit continues to be used, despite such a high documentary failure rate. He observes, rightly so, that the Letter of Credit "at least initially places the seller at the mercy of the buyer" (Corre 2000, p. 2548). This is because the goods, with the transport documents typically consigned to the Issuing Bank, are sent first and the documents lodged later seeking payment – if discrepancies exist, the seller runs the risk of payment delays or non-payment. Corre (2000) also points out an issue of responsibility for assembling the documents in the exporting enterprise. He asks (Corre 2000, p. 2549) "who will handle the task?" In the context of discrepancies, this is a good question and he postulates that it could be someone in shipping, or accounts, and it is likely that this person will not have all of the knowledge necessary to make a good documentary presentation and, most of all, "it seems unlikely that the party who must assemble the documents that the seller will present to the issuing bank had anything to do with the process by which the Letter of Credit was issued" (Corre 2000, p. 2549). This author concludes that whilst Mann's (2000) study was ground-breaking, further investigation is required to determine whether there are any differences between domestic and international Letter of Credit use and practice and whether the Letter of Credit "operates primarily as a payment mechanism" (Corre 2000, p. 2553) or some other form of guarantee.

Katz (2000) was another author who responded to the study of Mann (2000). Katz (2000) argues that Mann's work is incomplete, questioning the lack of explanations as to

> why parties contracting at a distance would want to use a commercial Letter of Credit as their mechanism for verifying information relevant to the extension of the credit, as opposed to some other device (p. 2555).

Additionally, Mann (2000) is criticised by Katz (2000) for focusing only on one side of the transaction, that of the seller incurring the risk of non-payment,

> but the buyer faces the corresponding risk that he will pay for goods that are defective or that the seller will not even ship … What Mann omits, in his focus on the seller's need to verify the reliability of the buyer, is that the commercial Letter of Credit is a bilateral assurance mechanism" (p. 2556).

The lack of data suitable to differentiate the origin and destination of the transactions analysed by Mann (2000), makes it difficult, according to Katz, to give credence to the claims by Mann (2000). For example, Katz (2000) challenges the claim that the high discrepancy rates for Letter of Credit shipments destined for the USA happen because of the relative reliability of Americans versus foreign buyers. In other words, foreign sellers are not too concerned about documentary errors in Letter of Credit transactions, because American buyers accept the documents and pay in any case. Katz (2000) argues that other plausible explanations may also exist, such as "the greater reliability of foreign sellers, the stronger reputation of U.S. banks, or the greater sophistication of U.S. buyers" (Katz 2000, p. 2571). In his conclusion Katz (2000) acknowledges the good contribution by Mann (200) on providing greater insights into the Letter of Credit business but calls for more empirical evidence to test the areas not adequately addressed by Mann (2000). The research relating to this thesis should contribute towards a greater understanding of Letter of Credit usage and practices.

Having considered the literature on risk management and Letters of Credit, the next section focuses on an internal audit approach to risk management and, in particular, examines a model that may be useful as a framework for this research project.

Part III

3.3 Internal Audit Approaches to Risk Management

As mentioned earlier, internal audit functions and controls play a useful role in organisational risk management and the audit approach may, therefore, provide a useful alternative in conceptualising a Letter of Credit transaction risk model. Auditors typically consider the various aspects of an organisation as part of their role, so in this respect they support the holistic approach that ERM advocates and, in a sense, it is argued here, that they also assist in breaking down the silo mentality. This is because no unit within an organisation works independently of the rest of the business but, rather, it is connected in some way. Therefore, an investigation into one process is likely to have a 'ripple' effect on other processes – essentially what may be considered as a cause and effect relationship. For example, a finished goods process may impact on the availability of stock, in turn, affecting warehousing and distribution functions, as well as sales results.

It is generally accepted that internal auditors have traditionally been concerned with control functions within an organisation, with the matter of delegated responsibilities and checks and controls over assets and finances as primary areas of focus. As part of the changing philosophy towards risk management approaches over the past two decades, the traditional role of the internal auditor has changed accordingly. It has been argued that the expanded role of the modern internal auditor has moved away from the traditional check-list approach towards an alternative approach, risk-based auditing, where "the auditor must have a thorough understanding of the business process" (McNamee 1996, p. 7). Indeed, McNamee, a supporter of COSO and internal auditing standards, was one of the proponents of risk-based auditing, where he argued that audit plans should

> be designed so that auditors spend more time on the areas of highest risk and greatest importance to the goals and less time on areas of low importance and low risk (McNamee 1996, p. 7).

The emergence of ERM and the debate over the internal auditor's role in the new environment has continued, with some questioning views on the level of involvement of internal auditors in enterprise-wide risk management processes. Some wonder who should be heading the organisation’s ERM processes – “the internal audit department … or chief risk officers and other traditional risk overseers from finance?” (Banham 2004, p. 66). Others advocate “that internal auditors take a back seat to more traditional risk managers” (Banham 2004, p. 66), so auditors can continue to provide the checks and balances, yet other organisations are “designating internal audit as the über risk manager” (Banham 2004, p. 66). Another opinion is that

> although auditors are not involved in establishing the ERM framework – that should be done by the business itself – when they conduct an audit, they are evaluating the elements of the organisation’s framework (Psica 2008, p. 53).

It would seem that while ERM continues to evolve, so, too, does the internal auditor’s role and function in the organisational risk management processes.

It should be noted that although a review of internal audit literature is not the focus of this thesis, a conceptual business risk model based on an internal audit approach does exist and it is useful to consider this as a starting point, at least, to establish its relevance to Letter of Credit transactional risks. The model in question – the Business Risk Model (McNamee 2000, p. 48) – is shown at Figure 3.30. The author claims that this model “is tied to understanding and imagination” (McNamee 2000, p. 46).

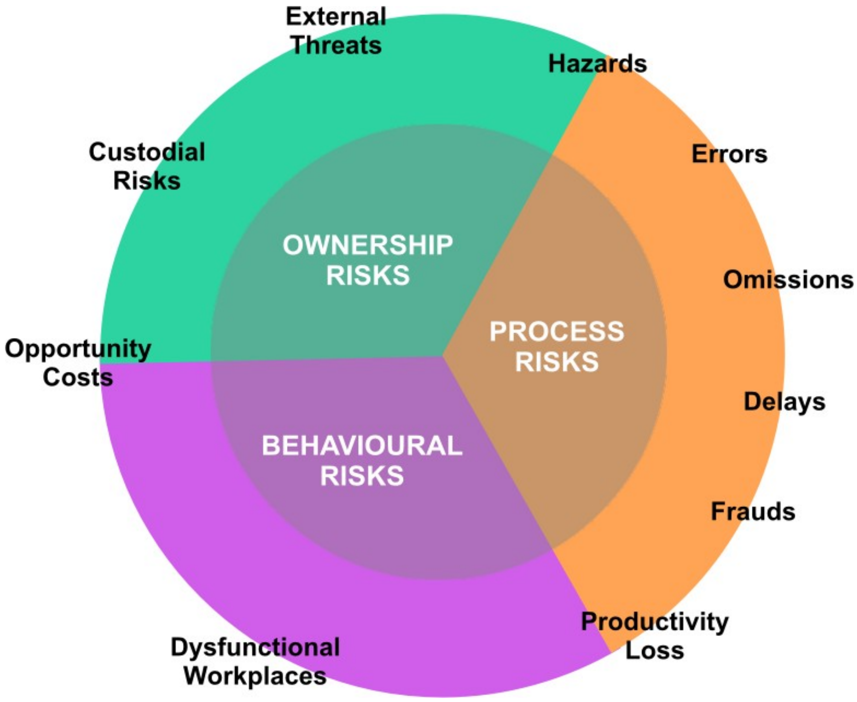
3.3.1 The Business Risk Model (McNamee, 2000)

The Business Risk Model comprises an inner section of risks, divided into Ownership, Behavioural and Process risks.

The inner sections are surrounded by a ‘ring’ of elements that are the components that make up each risk. This approach expands on the mere identification and listing of risks by providing what are, essentially, examples of what a risk element may be. The model itself is simple, yet it provides a powerful means of considering the various risks across the organisation, as

> a business risk framework can provide a common ground for managers, auditors, and other stakeholders to establish effective and efficient risk management for their organisation (McNamee 2000, p. 49)

Figure 3.30: A Business Risk Model (McNamee 2000, p. 48)



An examination of each risk and component follows, as it is necessary to understand the relevance and application of the Business Risk Model to Letter of Credit transactional risks.

a) Ownership Risks. These are "associated with acquiring, maintaining, and disposing of all assets, except human assets" (McNamee 2000, p. 51). McNamee makes the point that, as a number of these risks are insurable, risk transfer or risk sharing options should be pursued accordingly. Four elements make up the ownership risk in this model.

    i. External Threats. These are described as "forces outside the control of the organisation that can affect the organisation's business processes and goals" (McNamee 2000, p. 48). Examples of such threats provided by the author include: suppliers; competitors; government regulations; customer demands; financial markets; and economic, political, physical and environmental forces.

    ii. Custodial Risks. These are the risks that relate to owning and safeguarding assets. Examples provided by the author include: theft from storage; damage in handling or storing; and obsolescence.

iii. Hazards. These are shared with process risks because, according to McNamee, these are “associated with loss or impairment through fire and man-made disasters and accidental loss” (McNamee 2000, pp. 48-49).
iv. Opportunity Costs. These costs, McNamee argues, are shared with Behavioural Risks, because they “represent the cost of making less-than-optimum decisions about asset acquisition and disposition” (McNamee 2000, p. 48). Examples provided by the author include: the incorrect disposal of an asset; paying too much, selling the asset too soon or too late; and selling the asset too cheaply. Within this element the human influence on decision-making becomes obvious, with implications for employee selection and retention – the work force being the knowledge and skills base of the organisation.

b) Behavioural Risks. These are “associated with acquiring, maintaining and disposing of human assets” (McNamee 2000, p. 51). The author points out that these are probably the most difficult and varied risks to manage.
i. Dysfunctional work places. McNamee provides examples including: gender and racial harassment; employee theft and sabotage; occupational health and safety issues; and excessive pressure put on employees to perform. McNamee links the Dysfunctional work places to Process Risks by using the Productivity Loss element discussed below.
ii. Productivity losses. The author argues that productivity loss “arises from poor management practices or poor worker commitment” (McNamee 2000, p. 49). Examples given include: poor leadership; favouritism; and poor work structures and discipline.

c) Process Risks. These are “associated with putting assets to work to achieve objectives” (McNamee 2000, p. 51).
i. Productivity Loss. This is shared and interlinked with Behavioural Risks and Dysfunctional work places. Examples cited by the author include: scheduling and goal conflicts; poor process design and control; and inappropriate work rules.

ii. Errors, Omissions and Delays. These, according to the author, are risks "arising from random differences in human or machine activity in the process" (McNamee 2000, p. 49).

iii. Frauds. McNamee claims that these can arise from "intentional misrepresentations of suppliers, employees, and customers" (McNamee 2000, p. 49). Examples quoted include: bribery, kick-back schemes (secret commissions) and bid rigging.

As can be observed, the Business Risk Model provides a number of useful examples that crystallise the various common routine risk elements a business operation may confront. Some of these elements may be relevant to Letter of Credit transactions and documentary processes, whereas others may not. For example, it is difficult to see a link with Custodial Risks. Whilst the organisation has responsibility for safeguarding its stock, this is a generic responsibility and not only applicable to stock subject to Letter of Credit transactions. Stock obsolescence is also not particularly related to Letter of Credit business.

Opportunity Costs in the context of Custodial Risks do not appear to be relevant to Letter of Credit transactions either. If stock is sold cheaply this would most likely be due to buyers' market conditions and not the Letter of Credit *per se*. A seller would not sacrifice the price of a product just because there is a Letter of Credit involved – at most the seller would subsidise the bank charges on the establishment of the Letter of Credit. Market place price negotiations happen before the establishment of the Letter of Credit and it is therefore difficult to see how these may be linked. Hazards that may be caused by natural disasters are not directly related to the Letter of Credit in the context of the McNamee Business Risk Model. However, hazards related to a consignment that cause delays in shipping, etc., that result in documentary discrepancies would be a risk for the Letter of Credit transaction.

Missing from the model are specific references to the international trade risks concerning country (sovereign) risk, bank risk and foreign customer risk. Although McNamee cited financial markets, government regulations and customers as external risks, these are not given enough focus and prominence in the model.

There are other aspects of the Business Risk Model that are very relevant to Letter of Credit transactions, where there are opportunities for documentary mischief. Errors, Omissions and Delays are also other areas that could very much concern documentary processes subject to Letter of Credit payment terms.

It appears that although the Business Risk Model is designed within an internal audit risk management context, some elements are nevertheless relevant, others are not and some are missing.

A model specific to Letter of Credit transactions risks has not been discovered in this literature review. The closest opportunity to use an existing model appears to be the one offered by McNamee with the Business Risk Model. This model has been adapted to make it more relevant to the documentary processes related to Letter of Credit transaction – this adaptation, shown at Figure 3.31, is discussed below.

3.3.2 Export Letters of Credit Business Risk Model (adapted from McNamee 2000)

The Export Letter of Credit Business Risk Model operates within the context of the Letter of Credit trading environment. This is based on the code of practice, commonly referred to as the UCP 500[15], adhered to by banks in the examination of documentation tendered under a Letter of Credit transaction. Documentary compliance against the requirements of a Letter of Credit should result in payment to the exporter, whereas documentary non-compliance may result in payment delays or even non-payment, that is, a bad debt.

The model shows three major risk groups, inside the blue circle in Figure 3.31, and these are: Environmental Risk, Behavioural Risk and Process Risk.

[15] Detailed discussion on the operations of the UCP 500 is provided in Chapter 4 of this thesis.

Figure 3.31: Export Letters of Credit Business Risk Model (adapted from McNamee) (Bergami 2010, p. 168)

It should be remembered that some of these risks may occur in a foreign land, as this research is based on export transactions – additionally, these risks may potentially occur at pre-shipment, during shipment or post-shipment. Each group has a number of elements, shown within the white circle at Figure 3.31. These elements represent the likely risks that may eventuate within each risk group. These elements assist in the conceptualisation, understanding and explanation of the risk groups, as discussed below.

Environmental Risks

There are three primary elements that are considered under this heading, with a further one being shared with Behavioural and Process Risks, as detailed below. It should be noted that it is possible to reduce these environmental risks through export credit insurance, however, such insurance is subject to the insurer's willingness to assume the risk of payment default in the first place. Typically, each and every customer and country is subject to prior scrutiny by the insurer and premiums are calculated accordingly. Where the export credit insurer is unwilling to underwrite the risk, the exporter is given a negative signal about the credit risk in the particular country's environment – from a risk management point of view, this signal should not be ignored.

- Customer risk

  One of the reasons for wanting to trade under a Letter of Credit, from the exporter's point of view, is that the overseas buyer may be assessed as being an unacceptable financial risk. This may be due to a number of factors, including:

  - a lack of trading history between the exporter and the buyer. Lack of trading history will make it difficult, if not impossible, for the exporter to assess the credit risk of a potential buyer. Whilst credit references and checks may be sought from the foreign buyer, disclosure obligations vary between countries and, additionally, it may be difficult for the exporter to verify the authenticity of the information/documentation received. In cases where credit information is provided, payment arrangements outside the Letter of Credit are still regarded as 'unsecured sales' by the exporter. The primary reason for using the Letter of Credit is the ability of the exporter to replace the buyer's credit risk with that of their bank, because the bank issuing the Letter of Credit "guarantees payment to the exporter if all documents are presented in exact conformity with the terms of the Letter of Credit" (Nelson 2000, p. 91).
  - the amount of the transaction. A relationship between an exporter and a buyer may already exist and, therefore, a trading history is present; however, this may be cold comfort to the exporter where the business that is being considered is of relatively high value. Under these circumstances, the exporter's credit risk exposure, in an unsecured transaction, may be seen as unacceptably high, therefore, the exporter will seek to mitigate credit risk and reduce the possibility of non-payment by utilising the Letter of Credit. Under this circumstance, the exporter transfers the non-payment risk to the bank issuing the Letter of Credit. Where the documents comply to the Letter of Credit requirement, the bank issuing such Letter of Credit has an obligation to pay and this obligation is independent of whether the buyer pays their bank or not.

- the payment period. The buyer may seek payment terms that the exporter may be unwilling to accept in an unsecured transaction. The exporter's cash flow considerations may be more predictable under a secured payment term that has precise fund transfer dates. Additionally, the exporter may be able to discount the proceeds of a Letter of Credit thereby generating cash flows. The risks associated with longer payment periods are also considered in the next element, that is, Country Risk.

In choosing the Letter of Credit as the method of payment, the exporter is effectively using the buyer's bank to signal creditworthiness. Where the buyer is unable to secure a Letter of Credit from their bank, this should send a strong signal to the exporter that the foreign bank does not consider the buyer to be an acceptable credit risk. Under these circumstances, the exporter would be well advised to deal only on the basis of prepayment.

- Country Risk

  Whenever trade is conducted in another country, an assessment of the foreign trade business environment is necessary. Primarily, the exporter must be satisfied that the financial and regulatory environment in the foreign country will enable payment to be effected as agreed between the contracting parties. The country's socio-political environment and, therefore, its stability are, of course, primary concerns. In assessing these, exporters may resort to publicly available information, such as the OECD Country Risk Assessment grading or conduct more in-depth analysis of a particular market through other means. The more popular techniques that appear to be used by organisations to assess country risk include (Madura 2006):

  - Checklist approach. This approach uses both a macro and micro assessment to make a judgement on the level of country risk, based on political and financial factors. A scale needs to be developed for categorising risks and each factor is given a weight accordingly. A shortcoming of this approach is that the measurement of the factors and the weighting scheme derived are subjective.
  - Delphi technique. This approach involves collecting different independent opinions about a country's risk rating without the assessors discussing these.

Because this technique is based on subjective opinions, variations among assessors may occur and, consequently it may be difficult to reach agreement. This technique may be more useful for a larger corporation where the level of disagreement may be measured by the dispersion of opinions.

- Quantitative analysis. Models may be developed to measure variables, however, the selection of variables is, in itself, subjective. Quantitative analysis is useful as a component of the overall assessment approach, as it may not be able to predict future problems.
- Inspection visits. Probably the most expensive option to pursue, but this approach may assist in developing relationships with foreign buyers, obtaining a better appreciation of the country's business culture and clarifying opinions about a particular country. These may be regarded as the 'soft' considerations, that is, they rely on soft skills to establish the level of risk. On their own, country visits do not provide enough risk assessment information.
- Combination of techniques. Madura (2006) quotes a survey (unspecified) revealing that about half of the 193 organisation heavily involved in foreign business had "no formal method of assessing country risk … [because] there is no proven method to use. Consequently many … use a variety of techniques" (p. 481).

The financial regulations of a country may mandate the use of Letter of Credit for all imports, either absolutely or only for transactions above a certain value. Where government mandates exist, obviously then the Letter of Credit is the only viable trading option. Where mandates do not exist, the role of the exporter is to assess the acceptability or otherwise of a country's risk. This is connected to the risk that banks may pose in a particular country, particularly if that country operates on a centralised (government-owned) banking system. Country risk assessment is an important aspect of risk management as, according to the Belgian Export Credit Agency, "ninety percent of credit losses in overseas exports accrue from the country risk" (ONDD 2008).

- Bank Risk

Typically the exporter will deal with two banks in the Letter of Credit transaction: the issuing bank, in the foreign country and the advising bank in the exporter's own country. As it is difficult for an exporter to establish the genuineness of a Letter of Credit, the advising bank plays a fraud risk mitigation role. This is because the advising bank assumes certain liabilities when advising the Letter of Credit to the exporter, in accordance with the applicable rules (International Chamber of Commerce 1993, 2006)[16]. Basically, these rules allow a bank to decide whether, in the first place, it is willing to advise a Letter of Credit issued by another bank. Unwillingness to do so signals a potential problem with the issuing bank. A willingness to advise a Letter of Credit obliges the advising bank to authenticate such Letter of Credit before it is released to the exporter. Where authentication of the Letter of Credit is not possible, the advising bank has an obligation to advise the exporter of this situation and either refuse to advise the Letter of Credit or provide the advice with an explicit statement that the Letter of Credit has not been able to be authenticated. Therefore, under these circumstances, the exporter is able to assess whether the Letter of Credit is genuine, or not, and react accordingly. Documentary compliance is a separate issue from that of authenticity, because by necessity, the advice of the Letter of Credit must precede shipment, as the documents are produced, with data content to match the requirements of the Letter of Credit, once the goods are subsequently shipped. Fraud is further discussed under the Process Risk section below.

There may also be a third bank involved, if the Letter of Credit is subject to confirmation – this is discussed below.

It may be comparatively more difficult to assess a bank's standing in a foreign country. The issuing bank may not be acceptable to the exporter, simply because that country may be regarded by the exporter as an unacceptable credit risk. There may be government ownership of the banking system but if the country has poor, or no reserves, it may not be able to meet its payment commitments. In this situation, it may be a real case of the buyer wanting to pay but the bank being unable to do so

[16] See Article 7 (International Chamber of Commerce 1993) and Article 9 (International Chamber of Commerce 2006). The full text of these publications, for reference purposes, has been respectively reproduced in Appendix 1 and 2 at the end of this thesis.

due to lack of adequate funds. An exporter could rely on bank risk assessment provided by rating agencies, however, this may not provide the expected degree of risk ‘comfort’. This is because

> a financial entity is only rated if it pays an agency, such as Moody’s, or Standard and Poor’s to rate it [and] the European Union has described this as an inherent conflict of interest (Battersby 2009, p. 2).

Credit agencies have been the subject of much criticism as a result of the current global financial crisis. The Managing Director of Standard and Poor’s Australia, John Bailey, is on record as admitting that a “number of assumptions we used in our ratings analysis of many recent US mortgage-backed securities and related instruments did not hold up” (Battersby 2009, p. 2).

Added to this is a recent (May/June 2009) development that has many in banking circles concerned. Two Saudi Arabian banks: The International Banking Corporation and AWAL Bank, have “defaulted on their payment obligations, including those under export Letter of Credit involving Australian exporters” (Borton 2009). Although this is an unusual occurrence, it provides a clear example of bank risks in international trade transactions. Therefore, to overcome this problem, confirmation of a Letter of Credit may be an option for the exporter to consider. The idea behind the confirmation of a Letter of Credit is to provide the exporter with greater certainty as to the veracity of the payment undertaking initially provided by the foreign buyer’s bank, by obtaining an additional undertaking from the confirming bank. The analogy to this would be like obtaining a guarantee on a guarantee. The confirming bank must pay the exporter against compliant documents, regardless of whether the issuing bank reimburses the confirming bank or not. As any bank may be a confirming bank, there are three possibilities:

- The issuing bank may confirm its own credit. This should hardly be acceptable to an exporter. This is tantamount to stating: “trust me because I am telling you I am trustworthy”. The very fact that confirmation of a Letter of Credit is contemplated signals that there is doubt about the financial security of the issuer of the undertaking to pay, that is, the issuing bank. Therefore, in following prudent practices an exporter should never accept a Letter of Credit that is confirmed by an issuing bank, as this is ‘self-confirmation’.

- The advising bank. This is typically the exporter's own bank, or another bank in the exporter's country. There is no obligation for any bank to agree to confirm a Letter of Credit. Confirmation is voluntary and is usually agreed to by a bank after a due diligence check of the transaction and the parties involved, with a particular risk assessment focus on the issuing bank and the importing country. If the advising bank is unwilling to confirm a Letter of Credit then this signals a potential financial risk, as the bank's risk assessment is not positive. Under these circumstances the exporter should consider alternative payment arrangements, perhaps by full payment prior to shipment, as clean funds remitted to his bank account.
- The confirming bank. This could be a third independent bank. To mitigate country risk, this bank should not be another bank operating in the same country as the issuing bank. The confirming bank should instead be located in a country that is deemed by the exporter acceptable in terms of payment risk. After all, there is little point in having confirmation from a financially suspect source, even if that were to be in a different country. The idea is to avoid any possibility of non-payment, thereby avoiding bad debts.

The comments made earlier under customer risk, in relation to signalling theory, are also relevant here where the confirming bank is other than the issuing bank. If a bank, other than the issuing bank, is not willing to confirm the Letter of Credit, then the exporter receives a negative credit risk signal by that bank, and the exporter should explore alternate risk mitigation strategies, or accept the risk if this is within its risk appetite.

The bank in the exporter's own country is referred to as the advising bank. It is generally accepted that the exporter will be more familiar with its own banking structures and, therefore, find it easier to assess a bank's standing. It is more likely, though, that the exporter will be more interested in the bank's capacity to process Letter of Credit business adequately, rather than its financial standing. After all, the undertaking to pay is given by the issuing, not the advising bank, unless the advising bank confirms the Letter of Credit, in which case it transforms into the confirming bank (as discussed above).

The bank's processing abilities are discussed under the heading of Process Risks.

- Opportunity Costs. The asset disposal and related issues, as identified by McNamee (2000), do not really apply to the Letter of Credit, other than perhaps in the context of discounting proceeds against a future payment maturity. In this case, the exporter would know the cost of such action and would be able to evaluate this and decide on an appropriate course of action.

Behavioural Risks

There is one primary element considered under this heading, with a further two being shared with Environmental and Process Risks, as detailed below.

- Opportunity Costs. In the context of Behavioural Risks, McNamee (200) identified people's knowledge and skills. These are fundamental requirements to Letter of Credit processes, because even a minor error can give rise to the possibility of non-payment. Opportunity costs may be due to the organisation's internal business processes or those of external documentation producers that are engaged as part of the Letter of Credit processes. Examples of these parties include transport operators and their agents and permit issuing agencies, such as Australian Quarantine and Inspection Service or the Therapeutic Goods Administration. The important point here is that the exporter maintains the financial risk caused by documentary discrepancies, regardless of which party produces the error. This is a difficult risk to mitigate, particularly where third parties are involved and insurance for documentary errors is not routinely available. Sound business practices, standard operating procedures and the like, may assist, but given that Letter of Credit documentary data requirements are only limited by one's imagination, it is difficult to imagine a detailed procedure at every step. Therefore, people skills and knowledge gain increasing importance in these processes.
- Dysfunctional workplaces. McNamee (2000) provides examples that may be systemic in an organisation, such as gender or racial harassment or work-place violence, but it is not easily envisaged how these apply directly to the Letter of Credit transaction. However, excessive pressures to meet objectives may be closely related to Letter of Credit transactions, where meeting timelines is always critical, be it with shipment dates or documentation lodgement dead-lines. The same

comments made in relation to third parties' documentation producers also apply here. A dysfunctional work place may be the cause of Process Risks or it may be a symptom caused by Process Risks, so there is a possible inter-dependence of cause and effect between these risk elements.

- Productivity Loss. This is shared with Process Risks. Within the Behavioural Risk group, Productivity Loss, as identified by McNamee (2000), relates to poor management practices or poor worker commitment. It is certainly easy to imagine documentary discrepancies caused by a less than zealous employee or one who is not committed to the tasks assigned to them. Some documentary errors, such as missed shipment dates are not rectifiable, therefore, attention to detail and staff commitment are important risk management considerations in the context of the Letter of Credit transaction.

Process Risks

There are four primary elements considered under this heading, with a further two being shared with Environmental and Behavioural Risks, as detailed below.

- Hazards. This is shared with Environmental Risks. McNamee (2000) cites natural, man-made disasters and accidental loss as examples of hazards and these are relevant to Letter of Credit transactions in the context of the supply of goods and documentation to be tendered to the bank for payment. Hazards may occur prior to shipment (pre-shimpment) or after they have left the country of export (post-shipment).

  Pre-shipment hazards may be due to a number of factors, including:

  - product delays that result in missed shipment dead-lines. The exporter may avoid documentary discrepancies by having the Letter of Credit amended (through the proper procedures) to allow for an extended shipment window. The exporter may have to pay the relevant bank charges for this change, however, these charges are usually minimal.
  - goods damaged or lost en route to the port of export, resulting in either the transport document not being issued because the goods are not delivered to the carrier or the transport document being issued with a note indicating the consignment has been compromised in some way – for example, contents leaking – these documents are referred to as 'claused' transport documents.

Cargo insurance should provide relief against cargo loss and damage and, although most common events are covered by cargo insurance policies, some events are not. In the case of claused documents, the documentary risk is assumed by the exporter. It may be possible to recover loss from the carrier or insurer, but such claims are outside the Letter of Credit transaction, consequently the exporter is likely to suffer a loss under these circumstances.

Post-shipment hazards may include goods damaged or lost en route after they have left the country of export. In the majority of circumstances the exporter will not bear a loss, unless Incoterms 2000 'Delivered' terms are used[17], requiring the buyer to provide proof of delivery, as banks deal with documents only and not cargo, as per the stipulations of the UCP 500. Therefore, as long as the exporter can provide compliant documents, the risk of damage or loss en route is not their concern in the context of Letter of Credit payments.

- Errors, Omissions and Delays. McNamee (2000) claims that these risks are due to "random differences in human or machine activity in the process" (p. 49). In the context of the Letter of Credit and the focus of this thesis, these risk elements relate to data on documentation.

  Errors, as they relate to this method of payment, are simply data that are in conflict with the requirement of the Letter of Credit or amongst the documents themselves, thereby causing a discrepancy. There is a plethora of examples, such as incorrect goods descriptions, incorrect pricing, incorrect consignee details and so on. Where the discrepancies occur on documentation issued by the exporter, substitute documents may be easily provided but where third-party-issued documents are concerned, the matter may not be rectifiable, depending on the nature of the errors and the particular circumstances.

  Omissions are simply data that were required to be present on documents but were not included. Again, if the problem occurs on exporter-issued documentation the matter may be easily rectified but may not be so where third-party issued documents are concerned.

[17] These arrangements are outlined in greater detail in Chapter 4, as part of the discussion on the links between Incoterms 2000 'Delivered' terms and UCP 500 documentary requirements.

Delays. These are a potentially serious source of risk for the export Letter of Credit transaction. Some of these circumstances may be linked to hazards. For example, a delay in a ship reaching the export port, due to inclement weather en route, may result in a missed shipment date, through no fault of the exporter. In these circumstances most importers are reasonable and would readily agree to an amendment to the Letter of Credit and allow an extension of shipment time. However, where delays occur that are within the control of the exporter, risk avoidance may not be possible. For example, documents tendered to the bank outside the time limits allowed by the Letter of Credit, as the timely presentation of the documents is clearly the responsibility of the exporter.

- Frauds. These are identified by McNamee (2000) as including intentional misrepresentation. Certainly there has been a propensity for fraud to occur in international trade transactions, including Letter of Credit business. Fraud to do with cargo is outside the scope of the UCP 500, because, as mentioned earlier, banks only deal with documents and not goods. Whilst fraud to do with documents and their data content are issues of concern, these are more than likely to be of concern to the buyer instead of the exporter. The exporter is the party that produces, or causes to be produced, the requisite documents. It is presumed that the exporter is not in business with the primary intention of purposefully defrauding another party through documentary processes. False sales and shipping, identified as part of fraudulent activities (Lister 2007), could certainly play a part in a Letter of Credit transaction. A simple example of fraud, perpetrated by an unscrupulous exporter, may be to "exert pressure on the shipping agent to pre-date the bill of lading, thus ensuring that his documents comply with the terms of the Letter of Credit" (ICC International Maritime Bureau 2002, p. 13).Such requests, of course, ought to be denied, as

> If the ship's Master or local agent were to comply with any request to insert an incorrect date it is tantamount to the perpetration of fraud in that they are misrepresenting the date of receipt or shipment to the consignee or endorsee of the bill (Springall 2007, p. 19).

Furthermore, "the position taken by P&I Clubs[18] in connection with the issuance of bills of lading is clear, namely, that such contract will generally result in loss of

[18] P & I Clubs are Protection and Indemnity Clubs – "all operate on a mutual or non-profit basis aiming to call up only sufficient money in each year to meet costs, expenses and claims for that year. There are

P& I cover" (Springall 2007, p. 20), leaving the bill of lading issuer at considerable risk.

It should be noted that remedies may be pursued outside the Letter of Credit operations through legal means and that, additionally, banks may be able to avoid payments where fraud is implicated, but 'the fraud must also be proved not merely suspected" (Todd 2003, p. 76). The fraud exception rule principle is attributed to the *Sztejn v. Henry Schroder Banking Corporation* 31 NYS(2d)631 (1941) (Tyree 2002, pp. 526-527), and the scope of this rule was clarified in *United City Merchants (Investments)Ltd v. Royal Bank of Canada (The American Accord) [1983] A.C.*, where Lord Diplock stated:

> the exception for fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim *ex turpi causa nor oritur action* or, if plain English is to be preferred, 'fraud unravels all'. The courts will not allow their process to be used by a dishonest person to carry out a fraud (Tyree, p. 184).

It seems that, in Australia, "the concept of fraud may be somewhat wider" (Tyree 2002, p. 528), and include circumstances where the presentation of documents is known to be false. In *Contronic Distributors Pty Ltd v. Bank of New South Wales* [1984] 3 NSWLR 110

> it was held that the beneficiary of a commercial letter of credit may be restrained from presenting the letter of credit for payment or having payment made against it where the documents which are needed to require payment are to its knowledge false (Tyree 2002, p. 529) .

However, the perpetration of fraud is not limited to the actions of an unscrupulous seller. The exporter may also be subject to fraud where the Letter of Credit is received directly from the issuing bank and not through a local advising bank. This is because the exporter is not in a position to authenticate the Letter of Credit. After all, the exporter does not have access to the banking system's security processes that enable the verification of the party issuing the Letter of Credit (the issuing bank) and the documents issued by it. For example, in the case of a Letter of Credit transmitted electronically, security measures preclude the exporter from

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no shareholders and the shipowner members of the Association insure each other". (Seward 2002, p. 1). A "P&I Club operates as a mixture of an insurance company, a law firm and a loss adjuster" (Seward 2002, p. 2).

being able to use the bank's information technology systems to verify the *bona fides* of the payment instrument. In the case of a Letter of Credit issued on paper, the exporter does not have access to the processes by which signatures and other authentication means are used. The financial risk for the exporter in shipping goods against a Letter of Credit that is not authenticated is that the 'guarantee of payment' from the issuing bank cannot be verified and, therefore, once the goods have been shipped and the documents handed over for payment, the payment may never eventuate. Therefore, to avoid the possibility of fraud, an exporter should ensure that all Letters of Credit are advised through a local bank, to establish apparent authenticity. As an example of fraud, following extradition to Singapore, after three years in jail in Hong Kong, Ian Huang Yuan was "… charged with 16 counts of using fake documents and forged signatures … [and] using a forged LC [Letter of Credit] … in 2001" (Byrne 2007, p. 6). In an earlier 1999 case in the UK, a Letter of Credit scam reportedly swindled Barclays, Citibank and ABN Amro out of 13 million, 30 million and 16 million pounds, respectively (Honigsbaumand and Farrelly 1999).

In acknowledging the importance and the existence of fraud in Letter of Credit transactions, it should be noted that the focus of this thesis is not based on an examination of fraud.

- Productivity Loss. This is shared with Behavioural Risks. McNamee (2000) cites inappropriate work rules and missing controls as some of the examples for this risk element. In the context of the Letter of Credit transaction, productivity loss may be evidenced by the amount of resources required to correct documentary discrepancies. The cost of rectifying errors is not insignificant, as according to a 2001/02 UK survey, "the cost to exporters of discrepant documents under letters of credit is estimated at £113 million per year"(SITPRO Ltd. 2003, p. 2). Beyond productivity loss there is the risk of not getting paid. In an earlier report, in April 1985, a Euromoney Finance Report estimated total L/C business 'gone wrong' in Britain was five billion pounds annually (Moses 2003).

In summarising the risk management literature review, it appears that no specific model exists to deal with Letter of Credit risk and that an adaptation of the original McNamee model may be the closest that can be derived for this particular process.

The modified Export Letter of Credit Business Risk Model, explained above, will be utilised later in the thesis when discussing the Australian exporter survey results. In particular, this model will be used *inter alia* to identify the Letter of Credit transaction risks from the exporter's point view, the frequency of these risks and their risk magnitude, both in terms of potential financial losses as well as cost of rectifying errors.

3.4 Literature Review Summary

From the early notions of risk, the practice of risk management has developed holistically towards the notion of a whole-of-organisation approach that is commonly referred to as Enterprise Risk Management. A number of standards has appeared in the past two decades to assist industry and individuals in introducing a risk management culture across all layers of an organisation and also to introduce, implement and monitor risk management practices.

From the point of view of this thesis, the focus is on managing risks when dealing with Letter of Credit business for goods exported from Australia to ASEAN countries. To this end, a number of risk management models was discussed, ultimately resulting in an adaptation of McNamee's (2000) Business Risk Model – the Export Letter of Credit Business Risk Model – as the conceptual framework for the research in this thesis.

Letter of Credit literature highlights the continuing potential risk of non-payment, although it also claims that bad debts occur at very low rates, at less than one per cent. However, this may be cold comfort for those organisations falling into the one per cent bracket. Discrepancy rates are known to occur at high rates and the reasons offered in the literature include poor organisational practices and procedures, as well as lack of technical knowledge of Letter of Credit mechanics and operations.

Although there has been little empirical work done in this area, it is recognised in the literature that there is a need for greater investigation to expand upon the current body of knowledge that has little detail about the type and frequency of documentary discrepancies. The literature shows disagreement among authors as to the reasons for the use of the Letter of Credit and the real causes and practical outcomes of documentary discrepancies.

This research aims to fill gaps in current knowledge and provide information relevant to the areas currently in dispute among the various scholars. The research will also test the relevance and validity of the Export Letter of Credit Business Risk Model through empirical data.

The following chapter provides a detailed description and discussion of the Letter of Credit cycle, focusing on its operations and mechanics and the implications for the exporter.

4. Letter of Credit Operations

A Letter of Credit transaction comprises a number of complex and interwoven events, involving internal and external parties, mutually co-operating to the fullest extent possible, to ensure that the exporter (beneficiary) can meet the bank's documentary data requirements, in a timely manner, so as to obtain payment. In order to appreciate the documentary and associated risks relevant to this method of payment, it is necessary to understand the mechanics of a Letter of Credit transaction.

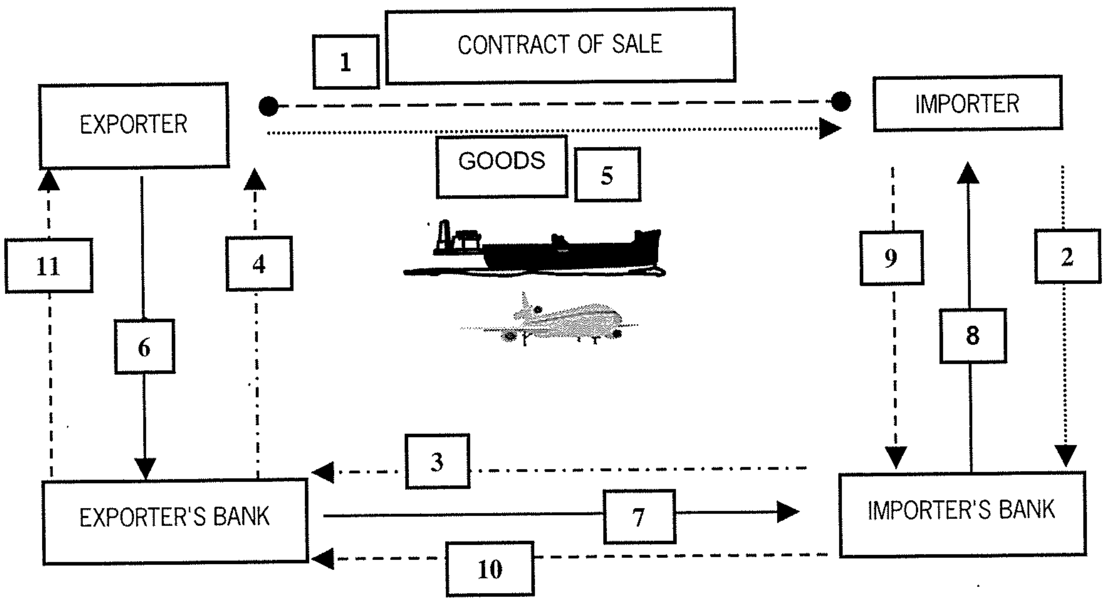
4.1 Letter of Credit Mechanics

The flows of documents, goods and funds for a deferred payment Letter of Credit transaction are shown at Figure 4.1. Unless otherwise indicated, standard irrevocable Letters of Credit are referred to in this Chapter, with the UCP 500 being the applicable rules.

The four parties to the Letter of Credit transaction, as shown in Figure 4.1, are known by different names, in accordance with the rules governing these transactions. The Exporter, the seller, is referred to as the **Beneficiary**, because he stands to gain (benefit) from the transaction. The Importer, the buyer, is referred to as the **Applicant**, because he applies for the Letter of Credit to be established. The Importer's Bank, is referred to as the **Issuing Bank** (or **Establishing Bank**), because they issue (establish) the payment undertaking (conditional guarantee) being the Letter of Credit. The term **Issuing Bank** will be used in this discussion. The Exporter's Bank, is referred to as the **Advising Bank**, because they receive, authenticate and advise the Letter of Credit to the Beneficiary. The Advising Bank is typically the foreign correspondent bank of the Issuing Bank and need not be the beneficiary's bank (this does not alter the generic flows shown in Figure 4.1). Furthermore, the Advising Bank may assume, by agreement, additional roles as provided for in the Letter of Credit, such as **Nominated Bank** and/or **Negotiating Bank** and/or **Paying Bank** and/or **Confirming Bank**. However, none of these roles waive, or alter, the basic requirements for documentary data compliance in a Letter of Credit transaction. For the purposes of the discussion of the flows shown in Figure 4.1, the Exporter's Bank's role will be considered to be that of the Advising Bank only.

It should be noted that the major difference between a deferred payment transaction and an immediate payment (at sight) transaction is the timing of the flow of funds. Unless specific alternative payment arrangements are in place, the flows shown in Figure 4.1 would not be affected by the change in payment time. Confirmation of the Letter of Credit is not included in Figure 4.1, as the involvement of a Confirming Bank may have little impact on documentary flows, especially if the Advising Bank also assumed the role of Confirming Bank, in which case no change to documentary flows would occur.

Figure 4.1: Typical deferred payment Letter of Credit flows (Bergami 2009a, p. 438)



Legend:

1. Contract of sale between the parties – L/C is the method of payment chosen
2. Importer lodges L/C application with issuing bank
3. Issuing bank issues L/C to advising bank
4. L/C advised to exporter
5. Goods despatched
6. Required documents lodged by exporter to the bank
7. Documents sent to issuing bank for acceptance
8. Documents released to importer
9. Funds transferred from importer on due date
10. Funds transferred from issuing bank
11. Funds transferred to exporter

L/C Application (2) L/C Transfer (3,4)

Documents (6,7,8) Funds (9,10,11)

Steps 1 through to 4, in Figure 4.1, mirror Steps 1, 2, 4, and 5 in Figure 3.27, discussed in Part III of Chapter 3. Whereas the discussion in Chapter 3 is in the context of the contracts arising from the use of Letter of Credit as the method of payment and the roles of the banks, the discussion in this chapter focuses on the operations of the Letter of Credit and its mechanics, mainly as viewed through the lens of an exporter.

Step 1

This represents the sales contract that specifies, *inter alia*, that the Letter of Credit is the payment method. It is generally accepted that the exporter will be the initiator of this method of payment as, unless it is a country's import requirement "an importer should only be thinking of opening a letter of credit if … his supplier insists upon it" (SITPRO Ltd. 2005). Implicit in the use of a Letter of Credit as the payment method are the risk considerations discussed in Chapter 3, particularly in relation to customer, country and bank risk. The contract of sale is typically referred to as the 'underlying contract' because, although the Letter of Credit rules uncouple the contract from this payment method, via the application of Article 3 of UCP 500, the conditions of trade expressed in the contract are what form the basis for the Letter of Credit application. Therefore, the contract influences the requirement for the types of documents and their data content. For example, the terms of delivery, 'Incoterms' (discussed later in this Chapter), stipulate the obligations of a seller, not merely in relation to the physical movement of goods, but also in relation to the documents to be tendered to the buyer. Therefore, the choice of Incoterms impacts the documentary requirements of a Letter of Credit transaction, both in terms of the number and type of documents and also their data content. The contract of sale will also stipulate what type of Letter of Credit is required, for example, confirmed, or not, and when and how payment is to be effected to the beneficiary. With a contract in place the Letter of Credit needs to be established next.

Step 2

The Applicant lodges a Letter of Credit establishment application with their bank. The application should mirror the contract of sale agreement with regards to issues such as product, price, currency, terms of delivery, payment maturity, etc., and, in accordance with Article 5 (b), "… must state precisely the document(s) against which payment, acceptance or negotiation is to be made" (International Chamber of Commerce 1993, p.

12) Any errors, omissions or delays in lodging the application with the bank may frustrate the timely supply of goods. The application is considered by the bank having regard to the credit risk the buyer poses and, if the bank decides to accept the application, it will seek some form of security prior to issuing the Letter of Credit. The amount and type of security required varies depending on the specific circumstances of any one transaction and any local laws and regulations that may apply in a specific country. The Applicant pays a fee for the Letter of Credit to be issued and this is typically based on a percentage of the total value, usually with a capped upper fee limit. As the fees vary from country to country, and bank to bank, it is not possible to state with certainty the level of these fees. The bank issuing the Letter of Credit becomes known as the Issuing Bank and, in this role, it arranges for the Letter of Credit to be notified to the Beneficiary.

Step 3

Although the Issuing Bank may advise the Beneficiary directly, typically this is not the case, rather the Letter of Credit is advised through a foreign correspondent. In as much as anything else this practice is followed to minimise the chances of frauds, as the beneficiary cannot conclusively authenticate the origin of a Letter of Credit, as they lack access to the banking world's security mechanisms.

Increasingly, Issuing Banks around the world are using electronic messages to advise the establishment of a Letter of Credit to their foreign correspondents. This is usually done through the Society for Worldwide Interbank Financial Telecommunication (SWIFT) a "member-owned cooperative through which the financial world conducts its business operations with speed, certainty and confidence" (S.W.I.F.T. SCRL 2009).

Regardless of the format by which the Letter of Credit is issued, before the beneficiary is advised, the Advising Bank must act in accordance with Article 7. The Advising Bank is under no obligation to advise the Letter of Credit, however, if it elects to do so, it

> shall take reasonable care to check the apparent authenticity of the [Letter of] Credit which it advises …[and if] it cannot establish such apparent authenticity it must inform … the bank from which the instructions appear to have been received that it has been unable to establish the authenticity of the [Letter of] Credit (International Chamber of Commerce 1993, pp. 12-13).

Where the Advising Bank elects to advise the Letter of Credit under these circumstances, it has an obligation to inform the Beneficiary that it has not been able to authenticate the Letter of Credit – this is necessary to signal to the beneficiary about potential problems.

Step 4

On receipt of the Letter of Credit from the Advising Bank, the Beneficiary should meticulously check this against the contract of sale for accuracy and consistency. Where discrepancies are found against the contract of sale, such as, for example, an incorrect payment period, selling price or delivery term, the beneficiary should seek an amendment prior to the despatch of the goods. The amendment flows are not shown in Figure 4.1, as these are the same as for the issue of the original Letter of Credit.

An amendment to a Letter of Credit is issued as a separate document to the original Letter of Credit, with the original payment instrument remaining unchanged. This is because, according to Article 9 (d), the Letter of Credit, once issued, can “neither be amended or cancelled without the agreement of the Issuing Bank, the Confirming Bank, if any, and the Beneficiary” (International Chamber of Commerce 1993, p. 15).

Usually, obtaining an amendment is not problematic, as long as the financial risk profile does not change, such as, for example, correcting the beneficiary’s name. However, in more substantial amendment requests involving a changed risk profile, such as an increase in value, or a changed payment period, the Issuing Bank may need to re-evaluate its position and may seek additional security before agreeing to issue the amendment. As in the case of the original Letter of Credit, there is no obligation on the bank to issue an amendment just because it has been asked for. Amendments are issued via the same Advising Bank as the original Letter of Credit. It should be noted that a Confirming Bank has no obligation to confirm an amendment and that specific rules apply to the acceptance of an amendment as far as the Beneficiary is concerned pursuant to Article 9 (d) (iii) and (iv), that sate in part:

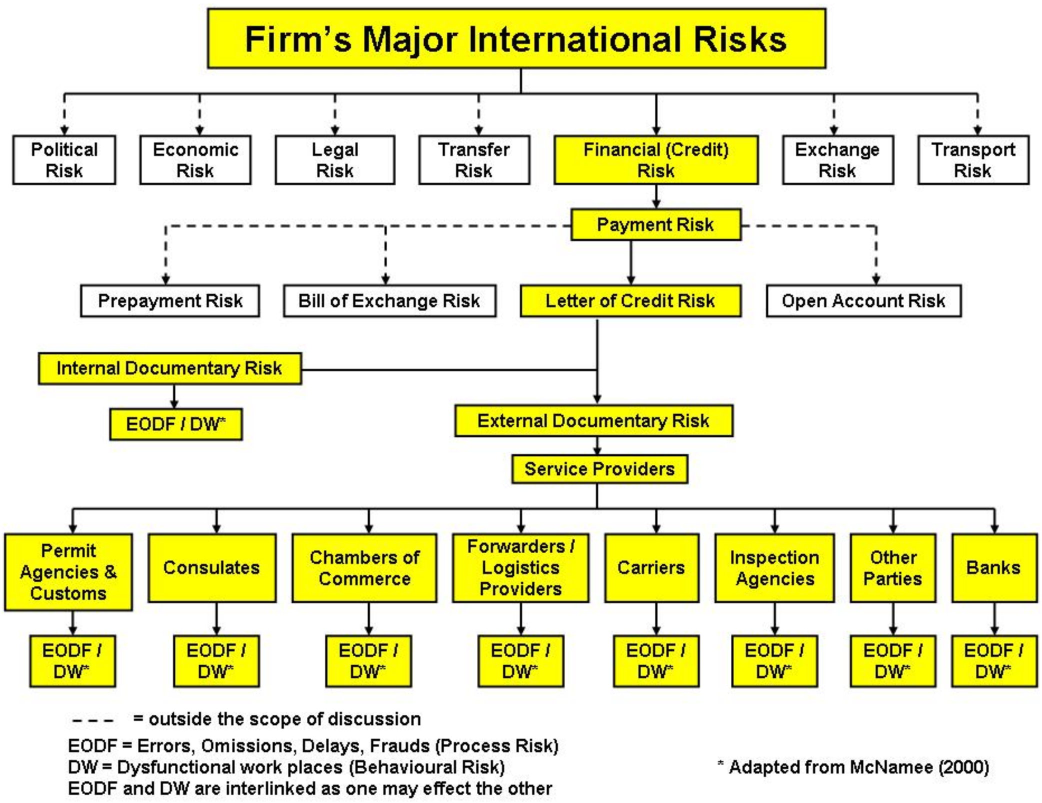
> The beneficiary “… should give notification of acceptance or rejection of amendments ... If the Beneficiary fails to give such notification, the tender of documents … will be deemed to be notification of acceptance … of such amendments ... Partial acceptance of amendments … in the same advice … is not allowed … and consequently will not be given any effect” (International Chamber of Commerce 1993, p. 16)

Once the Beneficiary is satisfied that the Letter of Credit is ‘workable’, that is, that all its terms and conditions can be met, they may proceed to arrange the despatch of the goods. From a risk management point of view, if the Letter of Credit requirements cannot be fulfilled, the Beneficiary should not proceed with the transaction, otherwise they may lose control of the goods and run the risk of non-payment.

Step 5

The necessary actions pertaining to Steps 5 and 6 are considered to be the most crucial to the Letter of Credit transaction, because it is only through the production and timely presentation of compliant documents that the payment is automatically triggered. In Letter of Credit operations Article 4 of the UCP 500 is very important to these steps, as it states, in part, that “all parties concerned deal with documents, and not with goods” (International Chamber of Commerce 1993, p. 11) The firm operating in an international environment is subject to a number of risks. The main risks that may be associated in operating internationally are shown at Figure 4.2. The yellow boxes in Figure 4.2 represent the risks associated with Letter of Credit transactions, as part of the overall financial (credit risk) to which the firm may be exposed.

Figure 4.2: Financial (credit) risk as part of the overall firm's international risks



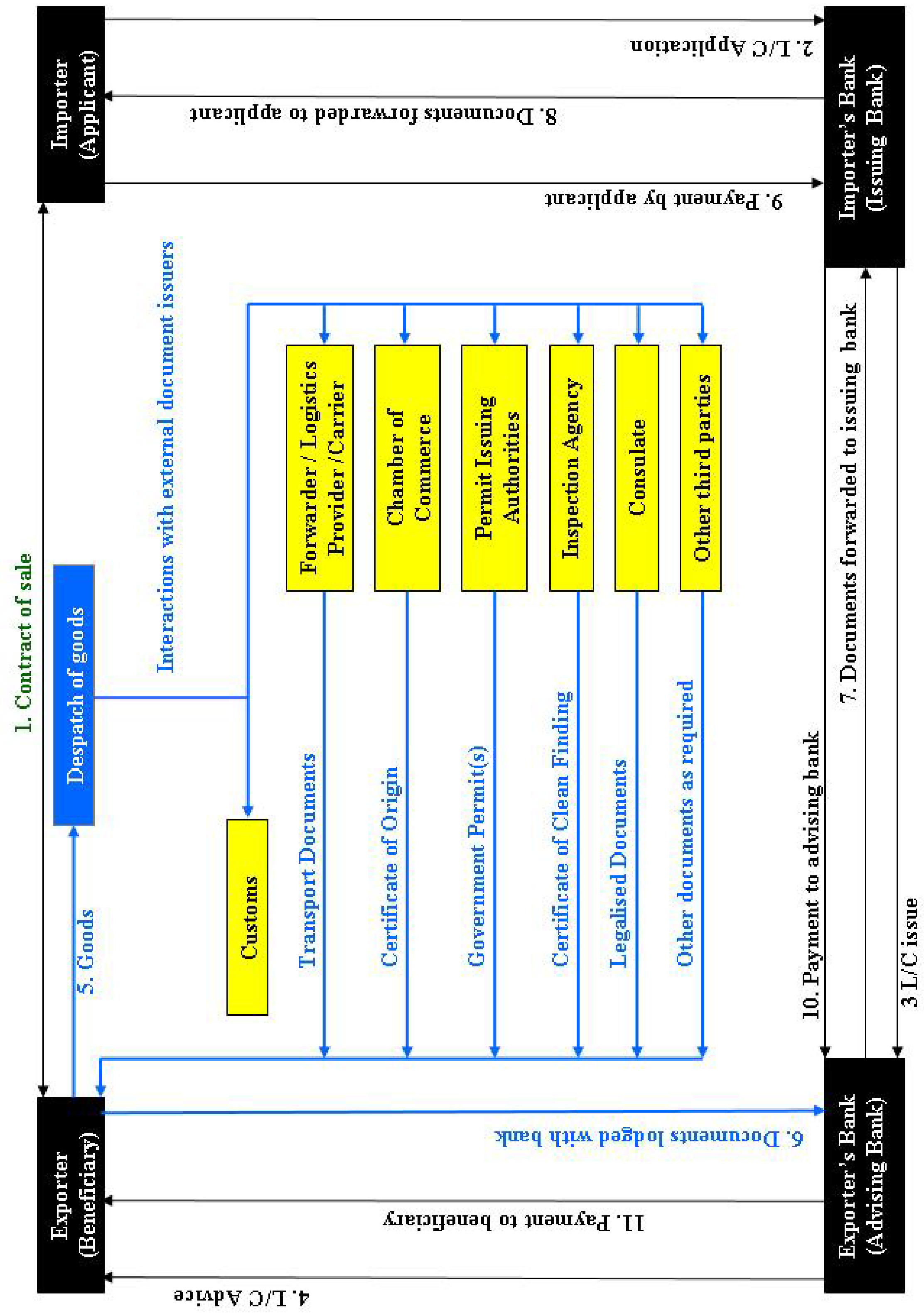
It can be observed that there are two types of documentary risk – internal and external. Documentary risk, as defined in this thesis, is understood to include electronic messages, where applicable. It is argued here that internal risks are within the exporting firm's internal control and this claim is supported by the ERM approach to risk management that is embedded in various principles and standards, such as the AS/NZS 4360: 2004, Risk Management Standard (Joint Technical Committee OB-007 Risk Management 2004). Therefore, internal documentation risks should be able to be managed through appropriate control mechanisms, such as policies and procedures and adequately skilled human resources. Internal documentation typically includes invoices, packing lists/slips, beneficiary's certificates, certificates of analysis/laboratory reports, and bills of exchange (drafts).

Additionally, there is a number of internally generated documents that are not part of the 'international documents set', therefore, these would not feature in the Letter of Credit. Nevertheless, in practice, the Beneficiary must produce these documents and send them to third parties, in order to obtain the usual requisite documents to satisfy the Letter of Credit. Examples of such documents may include: forwarding instructions, given to forwarders/logistics providers/carriers to obtain transport documents, or customs clearance declarations, in order to be able to export products legally.

These documents, therefore, are the precursors to third-party document production processes that are, obviously, outside the control of the Beneficiary, yet, the Beneficiary carries the financial risk of non-payment where non-compliant documents reach the bank, regardless of their source. Consequently, external documentary risk remains with the Beneficiary until such a time as the documents are accepted by the bank. For each external party with whom the beneficiary has to interact, there are potential process risks (errors, omissions, delays and fraud), as well as behavioural risks (dysfunctional work places). The more parties involved, obviously, the greater the risk exposure. As the amount and type of documents required by a Letter of Credit varies on a transaction-by-transaction basis, the level of documentary risk varies accordingly. The greater the quantity of documents, the greater the number of data fields to be completed and, consequently, a greater propensity for data mismatch.

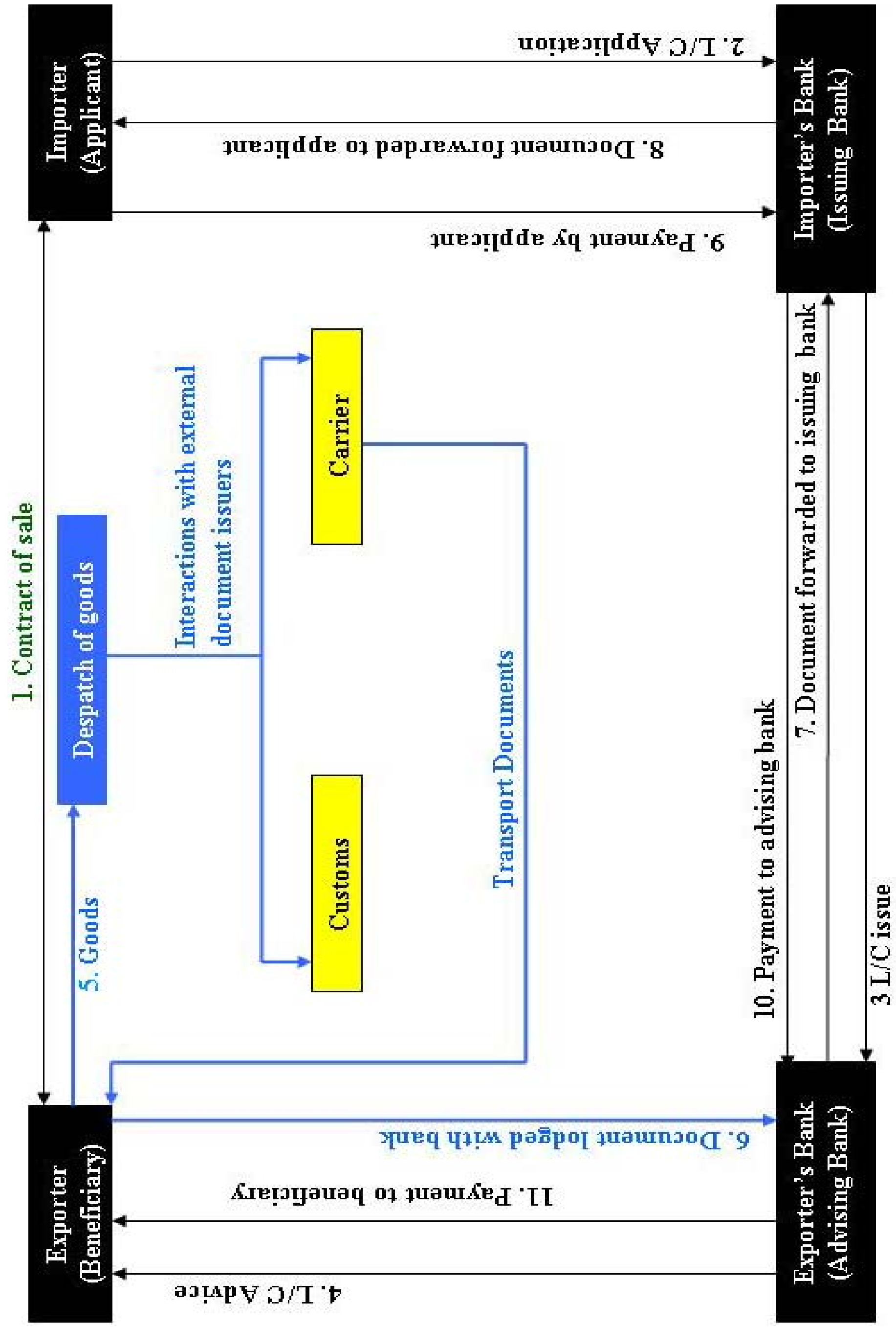
Figure 4.3 shows the typical documentary requirements for a complex Letter of Credit transaction (internal documents are not shown as these form part of internal risk).

Figure 4.3: Typical documentary requirements for a complex Letter of Credit transaction



The yellow boxes represent the external parties with whom the beneficiary may need to interact in relation to the despatch of the goods and the blue lines indicate the typical documents produced by these third parties. The variations in documentary requirements are exemplified by Figure 4.4 showing the simple requirements of a ‘light’ Letter of Credit (internal documents are not shown as these form part of internal risk)

Figure 4.4: Sample documentary requirements for a simple (‘light’) Letter of Credit transaction



The discussion will firstly concentrate on externally issued documents, as shown in Figure 4.3 and subsequently focus on internally issued documents.

The quantity of documents and their data content requirement is directly impacted by the choice of the terms of delivery – the Incoterms – agreed to in the contract of sale. These are relevant to the discussion here because the Incoterms are typically stated on the Letter of Credit, as they have a direct link to the pricing of the product and influence the data content of documents, indeed the relevant Incoterm "is deemed to be a requirement to be satisfied by a statement on the commercial invoice" (Collyer 1997, p. 64).

Devised by the International Chamber of Commerce in 1936 and recommended for use in international trade transactions by UN Commission on International Trade Law (UNCITRAL), the Incoterms are "a set of rules for the interpretation of the most commonly used trade terms in foreign trade" (International Chamber of Commerce 1990, p. 6). These terms are regularly up-dated, with the current version being the Incoterms 2000.

> Incoterms outline the rights, duties, obligations and responsibilities of the contracting parties in relation to:
>
> - the carriage of goods to the agreed point of delivery, including any government clearance responsibilities (e.g., customs),
> - the risks associated with the carriage of those goods and the apportionment of such risks,
> - the charges to be paid by each party in respect of the agreed actions to be taken, and
> - the packaging and marking of the goods and the documentation to be provided (Bergami 2006b, p. 362)

As a result of a contract of sale, it may be necessary to execute a number of subsidiary contracts, in accordance with the Incoterms 2000 chosen, to fulfil the contractual obligations. Examples of the most common subsidiary contracts are shown at Figure 4.5.

Incoterms 2000 work on a mutually exclusive principle for the allocation of responsibilities and tasks. That is, if the seller is responsible for an action then, obviously, the buyer will not be. The choice of Incoterms 2000 impacts on the quantity of documents the seller needs to provide to the buyer, their data content and the timing of the production of such documents.

Figure 4.5: Contract performance - subsidiary contracts (Bergami 2006a, p. 248)

There are thirteen Incoterms 2000, categorised into four groups, as shown in Table 4.1.

Table 4.1: Incoterms 2000 groups (International Chamber of Commerce 1999, p. 8)

Group	Name	Terms
E	Departure	**EXW –** Ex-Works (… named place)
F	Main Carriage Unpaid	**FCA –** Free Carrier (… named place)
		FAS – Free Alongside Ship (… named port of shipment)
		FOB – Free On Board (… named port of shipment)
C	Main Carriage Paid	**CFR –** Cost and Freight (… named port of destination)
		CIF – Cost Insurance and Freight (… named port of destination)
		CPT – Carriage Paid To (… named place of destination)
		CIP – Carriage and Insurance Paid To (… named place of destination)
D	Delivered	**DAF –** Delivered At Frontier (… named place)
		DES – Delivered Ex-Ship (… named port of destination)
		DEQ – Delivered Ex-Quay (… named port of destination)
		DDU – Delivered Duty Unpaid (… named place of destination)
		DDP – Delivered Duty Paid (… named place of destination)

Each of these terms places specific obligations on the seller in relation to, *inter alia*, the provision of documents to the buyer. The minimum documentary requirements under the relevant Incoterms 2000 are summarised in Table 4.2. Whilst the seller is not obliged to provide a transport document under FAS / FOB, in practice (especially for FOB transactions), to assist the buyer, the seller commonly provides these and, consequently, Letters of Credit will demand Bills of Lading for FAS / FOB consignments. The link between the Incoterms 2000 and the Letter of Credit can be evidenced in the data content of transport documents. The seller is not responsible to pay for freight charges under E and F terms. Consequently, the documents will show the goods having been sent on a 'freight collect' basis, that is, the carrier will be paid for the freight charges at the end of the journey. Under C and D terms, the carriage of the goods is arranged on a 'freight prepaid' basis, as the seller is responsible for these charges in accordance with the Incoterms 2000 stipulations and, consequently, the transport document will be noted likewise.

Table 4.2: Seller's minimum documentary requirements under Incoterms 2000

	Incoterms 2000												
Seller's documentary Obligation	**EXW**	**FCA**	**FAS**	**FOB**	**CFR**	**CIF**	**CPT**	**CIP**	**DAF**	**DES**	**DEQ**	**DDU**	**DDP**
Invoice	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Instructions to carrier/agent		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Transport document					✓	✓	✓	✓	✓	✓	✓	✓	✓
Insurance document						✓		✓					
Proof of delivery									✓	✓	✓	✓	✓

From a documentary risk perspective, the seller may be best served by use of Incoterms 2000 that require the least amount of involvement in the transaction. "The more documents that are required, the greater the risk of discrepancies" (Mehta 2004b), however, the preferred Incoterms 2000 choice is not always possible due to market situations.

Implicit in the obtaining of documents are background activities that, whilst not forming part of the Letter of Credit documentary requirements, have to be executed so that the goods may be exported. The logistics of these requirements that fall on the exporter should not be underestimated, as often there is a need to deal with several parties simultaneously to achieve timely outcomes, in what can be aptly described as a 'pressure cooker' environment. The Letter of Credit transaction has been referred to as a "a veritable juggling act for beneficiaries to ensure that the documents required for presentation are compliant" (Bazara 2006).

Externally issued documents

An example of the interlinked events that can impact on the timely flow of a consignment destined for a foreign country is provided by the export clearance requirements, the responsibility for which falls on the exporter, unless the term EXW is chosen in the contract of sale. To satisfy export clearance requirements in Australia, the exporter has to obtain an 'authority to deal', as per the requirements of Section 113 of the Customs Act 1901, that state in part:

> The owner of goods intended for export:
> (a) must ensure that the goods are entered for export; and
> (b) must not allow the goods: ….
> (ii) if the goods are other goods--to be loaded on the ship or aircraft in which they are to be exported;
> unless:
> iii) an authority to deal with them is in force.

An 'authority to deal' is typically the Customs Authority Number (CAN) issued by the Australian Border Protection and Customs Service (Customs), resulting from the prior lodgement of an export declaration. The CAN must be quoted to the carrier on lodgement of the cargo for export at a terminal (sea or air). Although forwarding instructions and CAN are required to export the product, for operational and control reasons, this information does not form part of the 'international documents set' and would, therefore, not feature in the Letter of Credit documentary requirements. Where the export clearance is not obtained in a timely manner, this may contribute to a late shipment, in breach of the Letter of Credit conditions. Delay, as a risk factor, is one of the process risk elements identified in the Export Letter of Credit Business Risk Model, shown at Figure 3.3.1.

Export customs clearance is not as easy a task as may initially be imagined and it can become quite complex and, depending on the nature of the product, the additional involvement of permit issuing authorities, such as the Australian Quarantine and Inspection Service (AQIS) or the Therapeutic Goods Administration (TGA) may be necessary. These authorities' involvement is mandated by specific regulations and/or legislation and may or may not result in the production of documents called for under the Letter of Credit. For example, meat for human consumption is typically subject to AQIS inspection and certification, as the AQIS certificate is required to be presented for import clearance. The Letter of Credit in this situation would demand the presentation of an AQIS certificate. However, prior to export clearance being granted, Customs must be advised of the details of the AQIS permit at the time of lodging the export declaration and this is done prior to the cargo being placed at the export terminal. Therefore, AQIS inspection and certificate issue is completed prior to permission to export being granted.

In a different situation, a pharmaceutical product may need export clearance by TGA but this may not result in the production of a document. Usually, pharmaceutical products are registered in the country of import through the Ministry of Health (or similar agency) under a specifically regulated process. Registration gives permission to import, stock, market and sell, without the need for individual consignment certification. The importer will usually hold an import permit and not be required to provide any additional documentation to their customs authority for clearance purposes, hence, the lack of documentary needs. In this circumstance, export permission may still be required and this is usually achieved by quoting a TGA export permit number to Customs, however, this is outside the scope of the Letter of Credit because there is no document requirement from the bank's point of view.

Aside from export customs clearance, other parties are potentially involved in the transaction, as shown in Figure 4.3. These external parties may be involved in a transaction regardless of whether a Letter of Credit is involved or not. The difference between a transaction that involves a Letter of Credit, versus one that does not, is not in the logistical steps and compliance with statutory documentation requirements. Rather, it is in the data contents on specified documents and the time frame allowed for the production and submission of these, in accordance with the Letter of Credit demands.

The issue of a Bill of Lading, for transport of goods by sea, results from information given to the carrier (or their agent) prior to the lodgement of the cargo at the export terminal. This information is usually provided via an Interim receipt – Forwarding Instruction, as shown at Figure 4.6. The yellow highlighted boxes represent data that are reproduced in the Bill of Lading. It should be noted that the document in Figure 4.6 is generated from commercial software using a method of production referred to as the 'aligned documentation system'. This system relies on the production of an in-house document, referred to as the Master Document, shown at Figure 4.7.

Figure 4.6: Sample Forwarding Instruction (produced using an aligned documentation system)

INTERIM RECEIPT - FORWARDING INSTRUCTION

SHIPPER (Will appear on Bill of Lading) ABN		SUPPLIER	
		EDN	AUTH/ENTRY No.
CONSIGNEE (If "order" state Notify Party)		VALUE FOR CUSTOMS	S.S. BOOKING REF.
		SHIPPING COMPANY	
NOTIFY PARTY (Subject to clause 15)		No. Copies of B/L required 0	Indicate who to make out B/L: SHIP CO / SHIPPER
VESSEL/AIRCRAFT	VOYAGE No	H/H, H/P, P/P, P/H	Number of Original Bs/L 0
PORT OF DISCHARGE	PLACE OF DELIVERY	PORT OF LOADING	PLACE OF RECEIPT

MARKS & NUMBERS	No OF PACKAGES	DESC. OF PACKAGES AND GOODS	GROSS MASS	CUBIC (m3)

THE ABOVE PARTICULARS DECLARED BY SHIPPER.

OTHER INFORMATION

FREIGHT PAYABLE AT

We certify that the cargo is in good order and condition and that the Quantities, Weights and Measurements shown herein are true and correct at the time of loading into the container or delivery to the carrier.

SHIPPER DATE

RECEIVED the above - mentioned cargo / container in apparent good order and condition subject to the terms, conditions and exceptions contained in the Container Bill of Lading issued by this Company on behalf of the owners.

DATE

SIGNED

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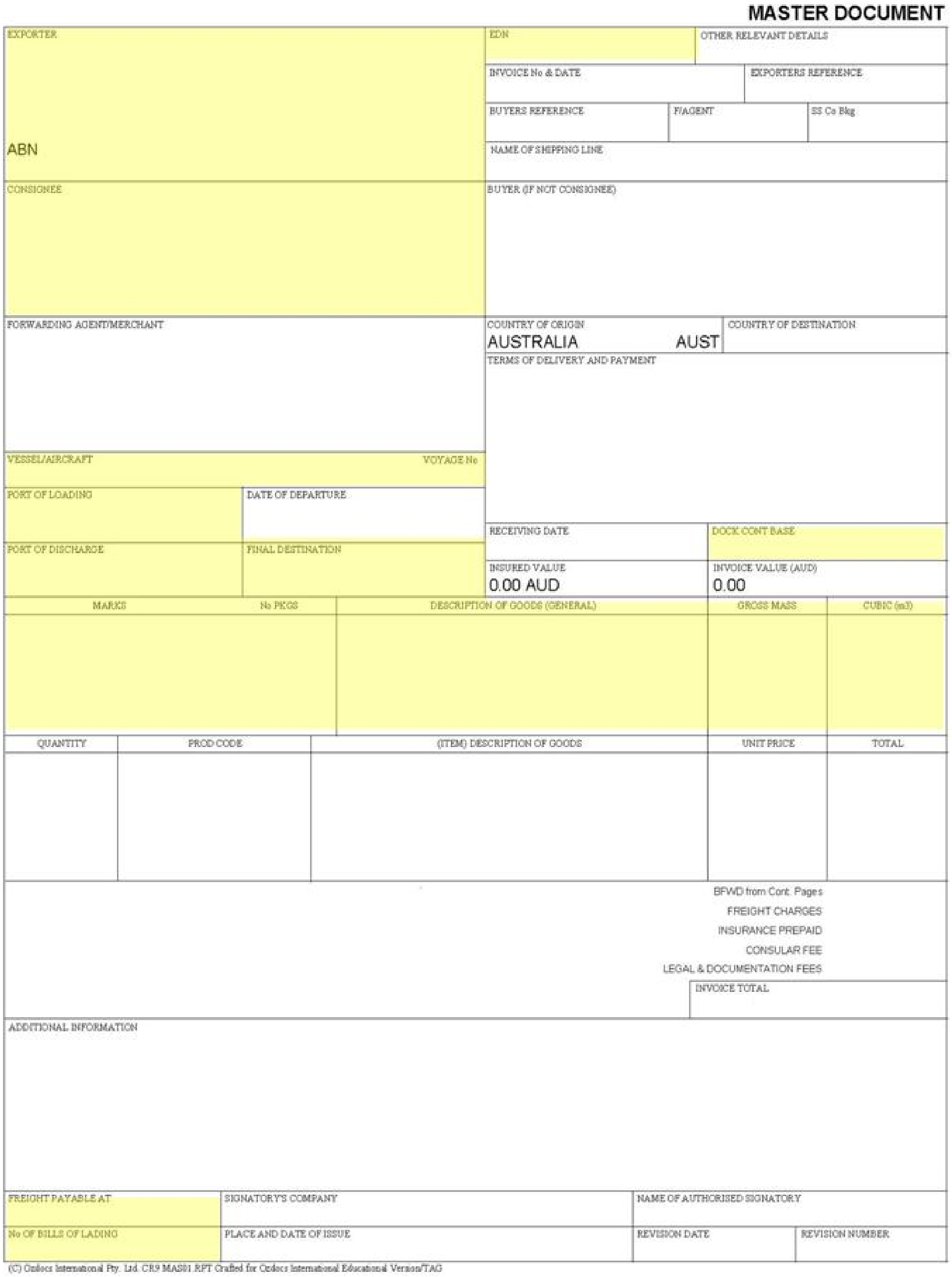
The data fields are populated in the Master Document and, as applicable, these data are then automatically transferred to other documents, thereby making document production more effective and efficient and potentially reducing errors through human intervention. A substantial proportion of data fields is shared across a number of documents and unless document production is automated in some form, the individual completing the documents will invariably be subjected to entering the same data across a number of documents. For example, the fields that are shared between the Master Document (Figure 4.7) and the Interim receipt-Forwarding Instruction (Figure 4.6) usually include: seller's (shipper's) details; consignee (and notify party) details; Export Declaration Number (Customs Authority Number); vessel and voyage number; place of receipt (dock/container base) and place of delivery (final destination); ports of loading and discharge; marks and numbers on the packages; details of the goods sold; number of packages, gross weight and volume; whether the goods travel as freight prepaid or freight collect, and the number of bills required. For the benefit of the reader those data fields are highlighted in yellow in Figure 4.7. Automation, therefore, provides a more expedient method of document production. However, efficiency gains may be compromised where information entered on the Master Document is incorrect, as the errors will be automatically carried on to the other documents, with potentially dire consequences. The means of internal document production, documentary errors and efforts to reduce these, particularly in relation to internal document production, are explored further in Chapter 6, when discussing the data gathered from the survey.

The Interim Receipt – Forwarding Instructions is the precursor document that results in the issue of the Bill of Lading (the transport document), shown at Figure 4.8. The process of obtaining the Bill of Lading is somewhat convoluted and this provides another example of where things may potentially not proceed according to plan, thereby giving rise to a number of process and behavioural risks that may jeopardise payment for the exporter.

The cargo is delivered to the export terminal, usually three to five days prior to the scheduled vessel departure date, in accordance with customary shipping practices around the globe. Two copies of the Interim Receipt – Forwarding Instructions accompany the consignment.

Figure 4.7: Sample Master Document (produced using an aligned documentation system)



MASTER DOCUMENT

EXPORTER ABN	EDN	OTHER RELEVANT DETAILS
	INVOICE No & DATE	EXPORTERS REFERENCE
	BUYERS REFERENCE / F/AGENT	SS Co Bkg
	NAME OF SHIPPING LINE	
CONSIGNEE	BUYER (IF NOT CONSIGNEE)	
FORWARDING AGENT/MERCHANT	COUNTRY OF ORIGIN AUSTRALIA AUST	COUNTRY OF DESTINATION
	TERMS OF DELIVERY AND PAYMENT	
VESSEL/AIRCRAFT VOYAGE No		
PORT OF LOADING / DATE OF DEPARTURE	RECEIVING DATE	DOCK CONT BASE
PORT OF DISCHARGE / FINAL DESTINATION	INSURED VALUE 0.00 AUD	INVOICE VALUE (AUD) 0.00

MARKS	No PKGS	DESCRIPTION OF GOODS (GENERAL)	GROSS MASS	CUBIC (m3)

QUANTITY	PROD CODE	(ITEM) DESCRIPTION OF GOODS	UNIT PRICE	TOTAL

BFWD from Cont. Pages
FREIGHT CHARGES
INSURANCE PREPAID
CONSULAR FEE
LEGAL & DOCUMENTATION FEES
INVOICE TOTAL

ADDITIONAL INFORMATION

FREIGHT PAYABLE AT	SIGNATORY'S COMPANY	NAME OF AUTHORISED SIGNATORY	
No OF BILLS OF LADING	PLACE AND DATE OF ISSUE	REVISION DATE	REVISION NUMBER

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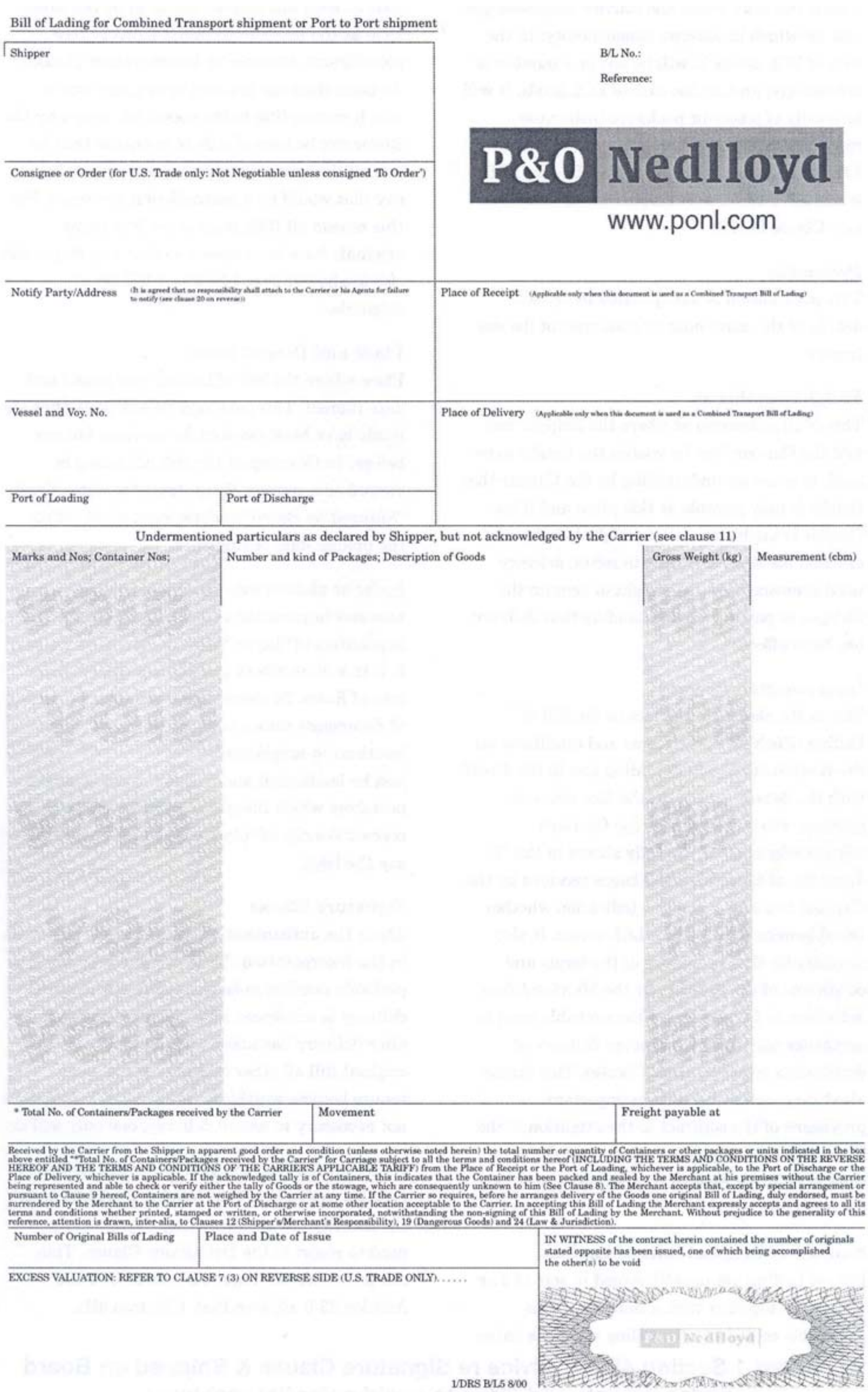
One copy is retained at the terminal and the information contained therein forms the basis for the subsequent population of the data fields on the Bill of Lading. The other copy of the Interim Receipt – Forwarding Instructions is signed at the terminal and retained by to the exporter. The signed Interim Receipt – Forwarding Instructions therefore is a receipt for the goods. The cargo is loaded on the vessel and once the vessel sails, the Bills of Lading are made available. The exporter surrenders the signed Interim Receipt – Forwarding Instructions to the carrier (or their agent) in exchange for a set of Bills of Lading. The exporter finally has the transport document.

Where the consignment is subject to a Letter of Credit, typically, the Issuing bank will make particular demands from the Beneficiary in relation to this document. In fact, the UCP 500 rules have specific articles that specifically address certain issues in relation to Bills of Lading. The reason for such high focus on this transport document is that it is negotiable and, depending on how it is issued by the carrier, possession of an original gives the holder the right to collect the goods at destination. As the Bill of Lading may be issued "To Order", meaning it can be handed over to third parties by endorsement (the handing over of the document to another party also hands over, to the document holder, the ability to collect the goods at destination), accountability and security relating to such documents become an obvious necessity. Endorsement is typically executed on the reverse of the Bill of Lading with the words "For and on behalf of" together with the Shipper's signature and the title of the signatory (Technical Officers of Global International Trade and Business Finance 2000).

The other type of sea transport document that is routinely used is the Non-Negotiable Sea Waybill (NNSW). This document does not carry negotiability and cannot therefore be transferred to third parties and it would, therefore, be nonsensical to issue this "To Order".

The interpretation of the UCP 500 requirement in relation to the Bill of Lading, the NNSW, the Charter Party Bill of Lading and the Multimodal transport document, covered respectively by Articles 23, 24, 25 and 26 of the UCP 500, has proven to be problematic for traders and bankers alike. So much so that the International Chamber of Commerce issued Position Paper No. 4 (Commission on Banking Technique and Practice 1994) to clarify how these are to be signed, to be acceptable to banks, in a Letter of Credit transaction. A sample Bill of Lading is provided at Figure 4.8. Position Paper No. 4 informs transport document issuers as to what banks consider acceptably signed documents. From the banker's perspective the Bill of Lading must appear to have been signed (executed) by a party authorised to do so and where this party is not the carrier or the Master, the identity and the capacity of the signatory must be evidenced on the transport document. This is required, *inter alia*, to minimise opportunities for fraudulent documentary activities.

Figure 4.8: Sample Bill of Lading (Richardson 2003, p. 49)


Bill of Lading for Combined Transport shipment or Port to Port shipment

Shipper

B/L No.:

Reference:

P&O Nedlloyd

www.ponl.com

Consignee or Order (for U.S. Trade only: Not Negotiable unless consigned 'To Order')

Notify Party/Address (It is agreed that no responsibility shall attach to the Carrier or his Agents for failure to notify (see clause 20 on reverse))

Place of Receipt (Applicable only when this document is used as a Combined Transport Bill of Lading)

Vessel and Voy. No.

Place of Delivery (Applicable only when this document is used as a Combined Transport Bill of Lading)

Port of Loading

Port of Discharge

Undermentioned particulars as declared by Shipper, but not acknowledged by the Carrier (see clause 11)

Marks and Nos; Container Nos;	Number and kind of Packages; Description of Goods	Gross Weight (kg)	Measurement (cbm)

* Total No. of Containers/Packages received by the Carrier	Movement	Freight payable at

Received by the Carrier from the Shipper in apparent good order and condition (unless otherwise noted herein) the total number or quantity of Containers or other packages or units indicated in the box above entitled "*Total No. of Containers/Packages received by the Carrier" for Carriage subject to all the terms and conditions hereof (INCLUDING THE TERMS AND CONDITIONS ON THE REVERSE HEREOF AND THE TERMS AND CONDITIONS OF THE CARRIER'S APPLICABLE TARIFF) from the Place of Receipt or the Port of Loading, whichever is applicable, to the Port of Discharge or the Place of Delivery, whichever is applicable. If the acknowledged tally is of Containers, this indicates that the Container has been packed and sealed by the Merchant at his premises without the Carrier being represented and able to check or verify either the tally of Goods or the stowage, which are consequently unknown to him (See Clause 8). The Merchant accepts that, except by special arrangement or pursuant to Clause 9 hereof, Containers are not weighed by the Carrier at any time. If the Carrier so requires, before he arranges delivery of the Goods one original Bill of Lading, duly endorsed, must be surrendered by the Merchant to the Carrier at the Port of Discharge or at some other location acceptable to the Carrier. In accepting this Bill of Lading the Merchant expressly accepts and agrees to all its terms and conditions whether printed, stamped or written, or otherwise incorporated, notwithstanding the non-signing of this Bill of Lading by the Merchant. Without prejudice to the generality of this reference, attention is drawn, inter-alia, to Clauses 12 (Shipper's/Merchant's Responsibility), 19 (Dangerous Goods) and 24 (Law & Jurisdiction).

Number of Original Bills of Lading	Place and Date of Issue	IN WITNESS of the contract herein contained the number of originals stated opposite has been issued, one of which being accomplished the other(s) to be void

EXCESS VALUATION: REFER TO CLAUSE 7 (3) ON REVERSE SIDE (U.S. TRADE ONLY)......

P&O Nedlloyd

1/DRS B/L5 8/00

The requirements for an acceptable signature on a Bill of Lading, or a NNSW, may be summarised as follows:

- the name of the carrier must appear on the front of the transport document, that is, the side that shows the details of the goods, vessel and voyage; and
- where the carrier signs the document, and is so identified, the word ‘carrier’ need not appear in the signature box; or
- where the document is signed by a party acting as an agent of the carrier, that party must be named and the principal indicated by any one of the means shown in Table 4.3; or
- where the document is signed by the Master, the name of the Master need not be quoted, however, where the document is signed by an agent for, or on behalf of the Master, then the identity of the agent and their role, must be disclosed together with the name of the Master, such as: ABC Co. Ltd. as agents for (or ‘on behalf of’) John Doe, Master, signature.

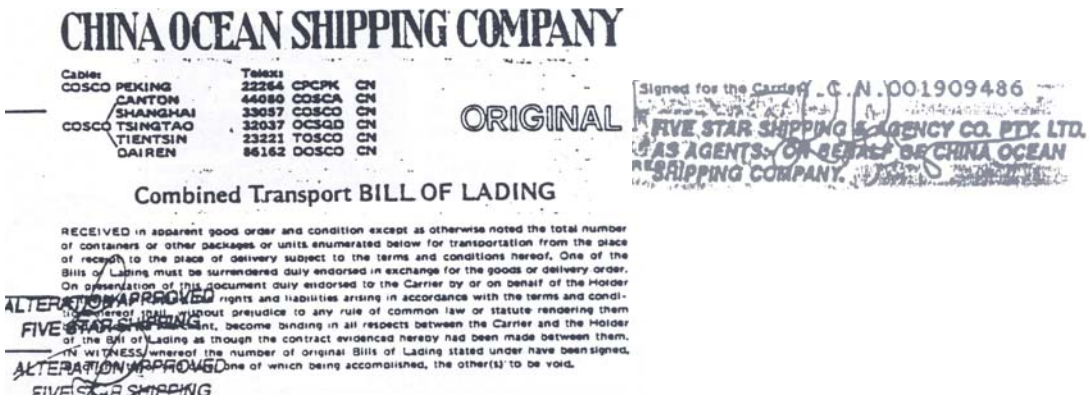
Table 4.3: Signature requirements on maritime transport documents to satisfy banking requirements under a Letter of Credit transaction

<table>
<tr><th>Where the word carrier has not been used in the front of the transport document</th><th>Where the word carrier has been used in the front of the transport document any of the following are acceptable</th></tr>
<tr><td rowspan="4">ABC Co. Ltd. as agents for (or ‘on behalf of’) XYZ Shipping, carrier (signature)</td><td>❶ ABC Co. Ltd. as agents for (or ‘on behalf of’) XYZ Shipping, carrier (signature)</td></tr>
<tr><td>❷ ABC Co. Ltd. as agents for (or ‘on behalf of’) XYZ Shipping, (signature)</td></tr>
<tr><td>❸ ABC Co. Ltd. as agents for (or ‘on behalf of’) the above named carrier (signature)</td></tr>
<tr><td>❹ ABC Co. Ltd. as agents for (or ‘on behalf of’) the carrier (signature)</td></tr>
</table>

A few months prior to the issue of Position Paper No. 4, Australian banks clarified their maritime transport document signature authentication requirements by providing exemplars to their customer base. Extracts of these are reproduced in Figure 4.9.

Figure 4.9: Sample Bill of Lading signatures

Exhibit 1 - acceptable


CHINA OCEAN SHIPPING COMPANY

Cables: COSCO PEKING, CANTON, SHANGHAI, COSCO TSINGTAO, TIENTSIN, DAIREN

Telexs: 22264 CPCPK CN; 44080 COSCA CN; 33057 COSCO CN; 32037 OCSQD CN; 23221 TOSCO CN; 86162 DOSCO CN

ORIGINAL

Combined Transport BILL OF LADING

RECEIVED in apparent good order and condition except as otherwise noted the total number of containers or other packages or units enumerated below for transportation from the place of receipt to the place of delivery subject to the terms and conditions hereof. One of the Bills of Lading must be surrendered duly endorsed in exchange for the goods or delivery order. On presentation of this document duly endorsed to the Carrier by or on behalf of the Holder ... rights and liabilities arising in accordance with the terms and conditions hereof shall, without prejudice to any rule of common law or statute rendering them binding on the Merchant, become binding in all respects between the Carrier and the Holder of the Bill of Lading as though the contract evidenced hereby had been made between them.

IN WITNESS whereof the number of original Bills of Lading stated under have been signed, one of which being accomplished, the other(s) to be void.

ALTERATION APPROVED FIVE STAR SHIPPING

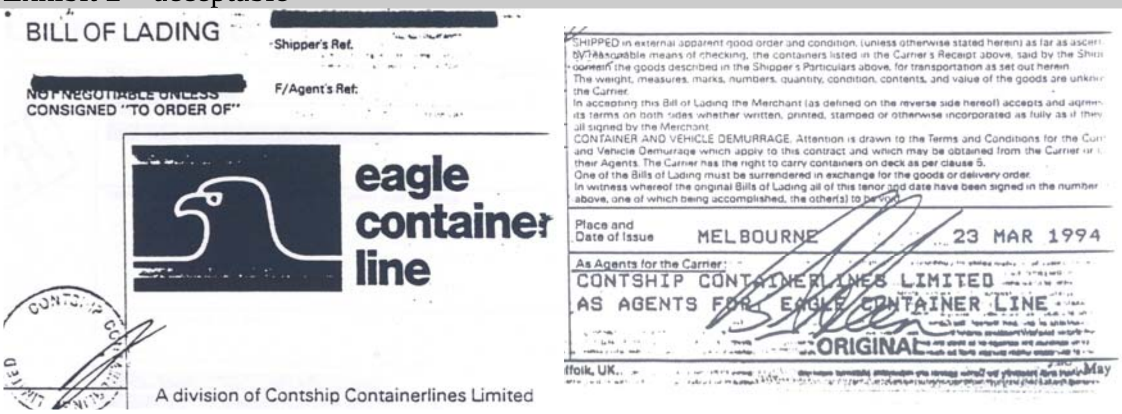
ALTERATION APPROVED FIVE STAR SHIPPING

Signed for the Carrier A.C.N. 001909486

FIVE STAR SHIPPING & AGENCY CO. PTY. LTD.

AS AGENTS ON BEHALF OF CHINA OCEAN SHIPPING COMPANY.

Exhibit 2 – acceptable


BILL OF LADING [redacted]

Shipper's Ref.

F/Agent's Ref.

[redacted]

CONSIGNED "TO ORDER OF"

eagle container line

A division of Contship Containerlines Limited

SHIPPED in external apparent good order and condition (unless otherwise stated herein) as far as ascertained by reasonable means of checking, the containers listed in the Carrier's Receipt above, said by the Shipper to contain the goods described in the Shipper's Particulars above, for transportation as set out herein.

The weight, measures, marks, numbers, quantity, condition, contents, and value of the goods are unknown to the Carrier.

In accepting this Bill of Lading the Merchant (as defined on the reverse side hereof) accepts and agrees to all its terms on both sides whether written, printed, stamped or otherwise incorporated as fully as if they were all signed by the Merchant.

CONTAINER AND VEHICLE DEMURRAGE. Attention is drawn to the Terms and Conditions for the Container and Vehicle Demurrage which apply to this contract and which may be obtained from the Carrier or their Agents. The Carrier has the right to carry containers on deck as per clause 5.

One of the Bills of Lading must be surrendered in exchange for the goods or delivery order.

In witness whereof the original Bills of Lading all of this tenor and date have been signed in the number above, one of which being accomplished, the other(s) to be void.

Place and Date of Issue MELBOURNE 23 MAR 1994

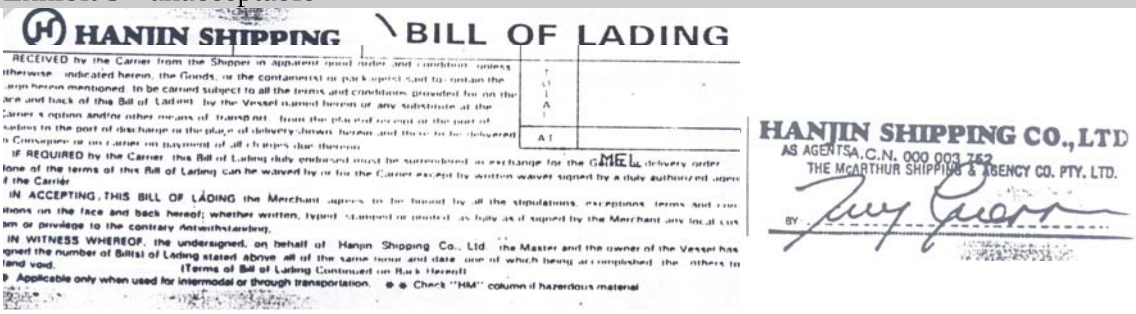
As Agents for the Carrier:

CONTSHIP CONTAINERLINES LIMITED

AS AGENTS FOR EAGLE CONTAINER LINE

ORIGINAL

Exhibit 3 - unacceptable


HANJIN SHIPPING BILL OF LADING

RECEIVED by the Carrier from the Shipper in apparent good order and condition unless otherwise indicated herein, the Goods, or the container(s) or package(s) said to contain the cargo herein mentioned, to be carried subject to all the terms and conditions provided for on the face and back of this Bill of Lading by the Vessel named herein or any substitute at the Carrier's option and/or other means of transport, from the place of receipt or the port of loading to the port of discharge or the place of delivery shown herein and there to be delivered unto order or assigns.

IF REQUIRED by the Carrier, this Bill of Lading duly endorsed must be surrendered in exchange for the Goods or delivery order.

IN ACCEPTING THIS BILL OF LADING the Merchant agrees to be bound by all the stipulations, exceptions, terms and conditions on the face and back hereof, whether written, typed, stamped or printed, as fully as if signed by the Merchant, any local custom or privilege to the contrary notwithstanding.

IN WITNESS WHEREOF, the undersigned, on behalf of Hanjin Shipping Co., Ltd., the Master and the owner of the Vessel has signed the number of Bill(s) of Lading stated above all of this tenor and date, one of which being accomplished, the others to stand void.

(Terms of Bill of Lading Continued on Back Hereof)

Applicable only when used for intermodal or through transportation. Check "HM" column if hazardous material

MEL

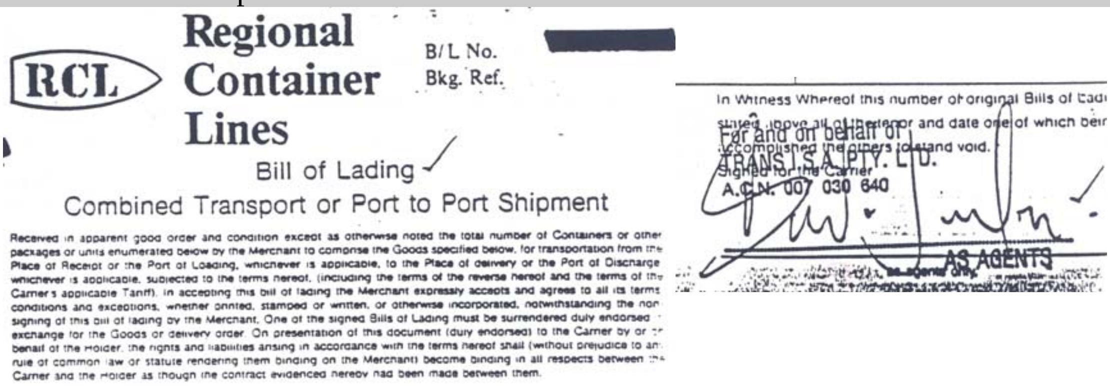
HANJIN SHIPPING CO., LTD

AS AGENTS A.C.N. 000 003 752

THE McARTHUR SHIPPING & AGENCY CO. PTY. LTD.

BY

Exhibit 4 - unacceptable


RCL Regional Container Lines

B/L No. [redacted]

Bkg. Ref.

Bill of Lading

Combined Transport or Port to Port Shipment

Received in apparent good order and condition except as otherwise noted the total number of Containers or other packages or units enumerated below by the Merchant to comprise the Goods specified below, for transportation from the Place of Receipt or the Port of Loading, whichever is applicable, to the Place of delivery or the Port of Discharge whichever is applicable, subject to the terms hereof, (including the terms of the reverse hereof and the terms of the Carrier's applicable Tariff). In accepting this bill of lading the Merchant expressly accepts and agrees to all its terms conditions and exceptions, whether printed, stamped or written, or otherwise incorporated, notwithstanding the non signing of this bill of lading by the Merchant. One of the signed Bills of Lading must be surrendered duly endorsed in exchange for the Goods or delivery order. On presentation of this document (duly endorsed) to the Carrier by or on behalf of the Holder, the rights and liabilities arising in accordance with the terms hereof shall (without prejudice to any rule of common law or statute rendering them binding on the Merchant) become binding in all respects between the Carrier and the Holder as though the contract evidenced hereby had been made between them.

In Witness Whereof this number of original Bills of Lading stated above all of this tenor and date one of which being accomplished the others to stand void.

For and on behalf of TRANS ISA PTY. LTD.

Signed for the Carrier

A.C.N. 007 030 640

AS AGENTS

It can be observed that Exhibits 1 and 2 are acceptable because these are signed in accordance with option 2, shown in Table 4.3. Exhibit 3 does not comply because the signature of The McArthur Shipping and Agency Co. Pty. Ltd. fails to identify the role of this organisation in relation to Hanjin Shipping Co., Ltd., that is, the words ‘as agents for’, or ‘on behalf of’ have not been used. Therefore, the authentication of the Bill of Lading fails to meet any of the four options outlined in Table 4.3. Exhibit 4 also fails to meet the authentication requirements, because the signature has been executed as for and on behalf of Trans I.S.A. Pty. Ltd as agents but without disclosing the identity of their principal that, in this case, should have been Regional Container Lines.

As can be observed from Table 4.3, and Figure 4.9, the requirements for signature are quite prescriptive and pedantic, yet the authenticity of signatures is not actually checked by banks. That is, a bank would not contact a carrier, or their agent, to establish the *bona fides* of the signatory of the document, unless some obvious unauthorised alterations appeared on the face of the document that suggested possible fraud or some other non-compliance issue was detected. Where fraud is alleged, the bank has the right to refuse payment, a principle known as the fraud exception rule.

The signature requirements present with a peculiar arrangement for, on the one hand, banks demand exactness in the execution of a signature on a document and, on the other hand, they do not establish the authenticity of the signatory. The reason for this circumstance is that Article 13 of the UCP 500 only requires banks to check documents “to ascertain whether they appear, on their face’ to be in compliance with the terms and conditions of the Credit” (International Chamber of Commerce 1993, p. 19). The bank’s exoneration from liability in the documentation checking process is further enhanced by the application of Article 15, of the UCP 500, that states:

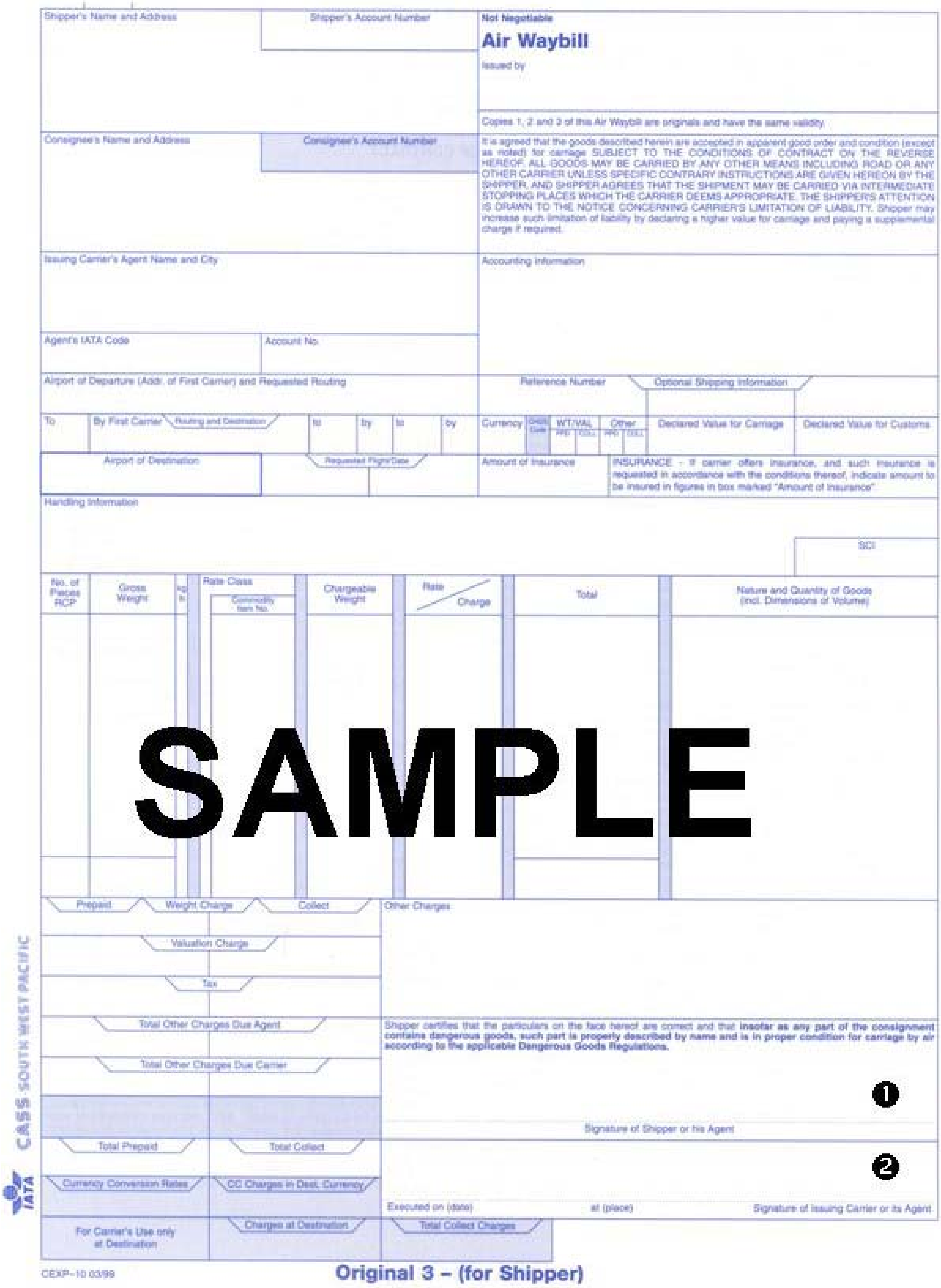
> Banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document(s), or for the general and/or particular conditions stipulated in the document(s) or superimposed thereon; nor do they assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods represented by any document(s), or for the good faith or acts and/or omissions, solvency, performance, or standing of the consignors, the carriers, the forwarders, the consignees or the insurers of the goods, or any other person whomsoever (International Chamber of Commerce 1993, p. 21).

Essentially banks check documents as presented without necessarily probing further. It has been argued that the bank is not in a position to verify the authenticity of each and every document it checks for at least two reasons. The first reason is that it may be difficult to do checks for privacy reasons and how these checks may be substantiated by evidentiary rules. The second reason is that it would be difficult, in practice, to check the authenticity of foreign issued documents and, in any case, it would take too long to perform checks on each transaction. This could place the bank in an awkward position vis-a-vis the maximum documentary check periods allowed under the UCP 500, Article 13 b, that is, seven clear bank working days from receipt of documents – this period applies to each bank involved in the transaction, a point that will be discussed later in the chapter.

What would the bank's position be if, for example, an authenticating request was made, but a reply not received within the allowable time frame? The document could, in fact, be perfectly legitimate, and should the bank refuse acceptance, it may face a challenge through legal avenues. The question of trust, among all parties involved in a Letter of Credit transaction, remains an essential element of the equation. Additionally, delays in document availability may have serious business consequences, including: missed delivery dead-lines; missed seasonal demands; increase in items costs through additional storage and demurrage charges; and causing unnecessary build up of pipeline inventories. Hence, it seems that the most expedient way to deal with these uncertainties, at least from the bank's perspective, is to be exonerated from these tasks – the net effects of Articles 13 and 15. It should be noted that these Articles do not apply only to maritime transport documents but to any and all documents tendered by the Beneficiary to a bank in a Letter of Credit transaction.

The clarification required in relation to transport documents for maritime traffic apparently was not necessary for air traffic. This is mainly due to the differences in how Air Waybills are issued and also their status at law, as these documents are non-negotiable. A sample Air Waybill is shown at Figure 4.10. The Air Waybill is issued in a set, usually comprising nine documents, three of which are considered 'originals', with the rest being copies. What differentiates originals from copies is that the originals have the conditions of carriage in the reverse, whereas copies do not. There are three originals - one each for the Issuing Carrier, the Shipper (Beneficiary) and the Consignee (Buyer).

Figure 4.10: Sample Air Waybill


Shipper's Name and Address
Shipper's Account Number
Not Negotiable
Air Waybill
Issued by
Copies 1, 2 and 3 of this Air Waybill are originals and have the same validity.
Consignee's Name and Address
Consignee's Account Number
It is agreed that the goods described herein are accepted in apparent good order and condition (except as noted) for carriage SUBJECT TO THE CONDITIONS OF CONTRACT ON THE REVERSE HEREOF. ALL GOODS MAY BE CARRIED BY ANY OTHER MEANS INCLUDING ROAD OR ANY OTHER CARRIER UNLESS SPECIFIC CONTRARY INSTRUCTIONS ARE GIVEN HEREON BY THE SHIPPER, AND SHIPPER AGREES THAT THE SHIPMENT MAY BE CARRIED VIA INTERMEDIATE STOPPING PLACES WHICH THE CARRIER DEEMS APPROPRIATE. THE SHIPPER'S ATTENTION IS DRAWN TO THE NOTICE CONCERNING CARRIER'S LIMITATION OF LIABILITY. Shipper may increase such limitation of liability by declaring a higher value for carriage and paying a supplemental charge if required.
Issuing Carrier's Agent Name and City
Accounting Information
Agent's IATA Code
Account No.
Airport of Departure (Addr. of First Carrier) and Requested Routing
Reference Number
Optional Shipping Information
To
By First Carrier
Routing and Destination
to
by
to
by
Currency
CHGS Code
WT/VAL
PPD
COLL
Other
PPD
COLL
Declared Value for Carriage
Declared Value for Customs
Airport of Destination
Requested Flight/Date
Amount of Insurance
INSURANCE - If carrier offers insurance, and such insurance is requested in accordance with the conditions thereof, indicate amount to be insured in figures in box marked "Amount of Insurance".
Handling Information
SCI
No. of Pieces RCP
Gross Weight
kg lb
Rate Class
Commodity Item No.
Chargeable Weight
Rate
Charge
Total
Nature and Quantity of Goods (incl. Dimensions or Volume)
SAMPLE
Prepaid
Weight Charge
Collect
Other Charges
Valuation Charge
Tax
Total Other Charges Due Agent
Shipper certifies that the particulars on the face hereof are correct and that **insofar as any part of the consignment contains dangerous goods, such part is properly described by name and is in proper condition for carriage by air according to the applicable Dangerous Goods Regulations.**
Total Other Charges Due Carrier
❶
Signature of Shipper or his Agent
Total Prepaid
Total Collect
❷
Currency Conversion Rates
CC Charges in Dest. Currency
Executed on (date)
at (place)
Signature of Issuing Carrier or its Agent
For Carrier's Use only at Destination
Charges at Destination
Total Collect Charges
CASS SOUTH WEST PACIFIC
IATA
CEXP-10 03/99
Original 3 – (for Shipper)

It should be noted that the Air Waybill requires two signatures, and these are shown as numbers ❶ and ❷, respectively, in Figure 4.10. Original 3 is the document released to the Beneficiary (Shipper). The Air Waybill may be signed by the Shipper, or its agent, at ❶, and by the carrier, or its agent, at ❷. In practice, the Freight Forwarder is the entity that acts as agent for both the Shipper (Beneficiary), and the carrier and may, therefore, execute the Air Waybill as an agent for both parties simultaneously.

Of course, instructions for carriage need to be given by the Shipper (Beneficiary) to the carrier (or their agent.), just as in the case of maritime movement. A sample of a Shipper's Letter of Instruction (SLI) is provided at Figure 4.11. The yellow shaded boxes represent the information that is shared between the SLI and the Air Waybill. It should be noted that, because of the speed of air traffic, it is a requirement of the airline cargo industry that export documentation accompany the goods, even in a Letter of Credit situation. This is to enable prompt customs clearance of the cargo at the destination airport. The SLI details the amount and type of documents that accompany the consignment.

The process to obtain an Air Waybill is far less complicated than that pertaining to Bills of Lading. When the cargo is received at the export terminal, or earlier, at the freight forwarder's premises and it is accepted for carriage, the Air Waybill is issued and the relevant copy is made available immediately to the Shipper (Beneficiary). Therefore, unlike maritime transport, the Air Waybill is always available prior to the departure of the goods, and, if it issued by the Forwarder, it is available even before the cargo reaches the carrier.

For both the Bill of Lading and the Air Waybill, the data contents on documents are a shared responsibility between the Beneficiary (Exporter), who gives instructions, and the issuer of the relevant transport document who interprets those instructions and acts according to their understanding of such instructions. However, it can be observed by comparing Figures 4.6 with 4.8, and 4.10 with 4.11 that there is a number of fields that are completed by the carrier (or its agent), in the normal course of their business and, therefore, the data for fields are not provided by the Beneficiary (Exporter). It must be re-iterated that the Beneficiary (Exporter) retains the financial risk caused by documentary discrepancies, regardless of their production source, until such time as the documents are accepted by the bank.

Figure 4.11: Sample Shippers Letter of Instruction (produced using an aligned documentation system)

SHIPPERS LETTER OF INSTRUCTION

EXPORTER

ABN

EDN

OTHER RELEVANT DETAILS

INVOICE No & DATE

EXPORTERS REFERENCE

BUYERS REFERENCE

F/AGENT

NAME OF SHIPPING LINE

CONSIGNEE

BUYER

FORWARDING AGENT/MERCHANT

COUNTRY OF ORIGIN CODE

AUSTRALIA AUST

COUNTRY OF DESTINATION CODE

TERMS OF DELIVERY AND PAYMENTS

VESSEL/AIRCRAFT

VOYAGE No

PORT OF LOADING

DATE OF DEPARTURE

PORT OF DISCHARGE

FINAL DESTINATION

INSURED VALUE

0.00 AUD

INVOICE VALUE (AUD)

0.00

MARKS	No PKGS	DESCRIPTION OF GOODS (GENERAL)	GROSS MASS	CUBIC (m3)

INSTRUCTIONS OF FREIGHTING

FREIGHT CHARGES

FREIGHT PREPAID [ ]

FREIGHT COLLECT [ ]

(if service available)

OTHER CHARGES 1

[ ]

[ ]

(if service available)

DECLARED VALUE FOR CUSTOMS

SPECIAL INSTRUCTIONS

(INCLUDING DOCUMENTATION TO ACCOMPANY AIRWAY BILL)

HAZARDOUS CARGO

[ ] Yes [ ] No

No. of copies

ATTACHED HEREWITH KINDLY FIND THE FOLLOWING DOCUMENTS:

[ ] COMMERCIAL INVOICE

[ ] CUSTOMS INVOICE / CERTIFICATE

[ ] PACKING LIST

[ ] CERTIFICATE OF ORIGIN

[ ] BILL OF LADING / AIRWAY BILL

[ ] INSURANCE/CERT/POLICY/DECLARATION

[ ] CONSULAR INVOICE

[ ] DUPLICATE DOCUMENTS ATTACHED

SPECIAL INSTRUCTIONS (Applicable when box ticked)

[ ] OTHER CHARGES 2

[ ] HAZARDOUS GOODS

HANDLING INFORMATION & REMARKS

Received the above mentioned containers in apparent good order.	You are hereby requested and authorised upon receipt of the consignment described herein to prepare and sign the Airway Bill and other necessary documents on our behalf and dispatch the consignment in accordance with your condition of Contract.
NAME OF TRANSPORT COMPANY	SIGNATORY'S COMPANY
PLACE & DATE OF ISSUE	NAME OF AUTHORITY SIGNATORY
SIGNATURE1	SIGNATURE2

In the context of the Export Letter of Credit Business Risk Model, shown at Figure 3.31, the following Process Risk elements may apply to the process of transport documentation issue, as discussed above. **Hazards** may result from the improper handling of cargo either prior to handover at the export terminal or, subsequently, but prior to the cargo being successfully placed on board the vessel or the aircraft. Hazards reflect physical damage and whilst other remedies may be available outside the Letter of Credit mechanism, the Beneficiary, in the first instance, may be unable to fulfil the Letter of Credit requirement. As an example, if cargo is damaged, the transport document may be superimposed with a clause indicating that the consignment has been compromised in some way. Letters of Credit typically request clean, that is, non-claused transport documents, in accordance with Article 32 of the UCP 500, therefore, the beneficiary would be in breach of such demands, by being unable to provide a clean transport document. It is immaterial to the banker whether the risk in transit had already transferred to the Applicant (Buyer), as per the Incoterms 2000, or whether the consignment was subject to insurance coverage. The point is that the banker is looking for documentary compliance, based on the Letter of Credit demand alone, for the payment to be triggered.

Errors and/or **omissions** may be caused by either improper instructions issued by the Beneficiary (Shipper) or misinterpretation of these instructions by the carrier (or its agent) or by the carrier (or their agent) without causative factors from the Beneficiary (Shipper), resulting in documentary non-compliance against the Letter of Credit stipulations. Transport documents, for example, must specify where freight is payable, as per Article 33 of the UCP 500 and consistency with the applicable Incoterms 2000 is also required – failure to satisfy either of these two requirements results in a documentary discrepancy.

Delays could also be caused by a number of factors, including the failure of the Beneficiary to obtain the necessary export approvals in a timely manner with consequential repercussions for delivery of the cargo or by the carrier through the late arrival of a ship, both factors potentially resulting in missed shipping dead-lines, in breach of the Letter of Credit demands.

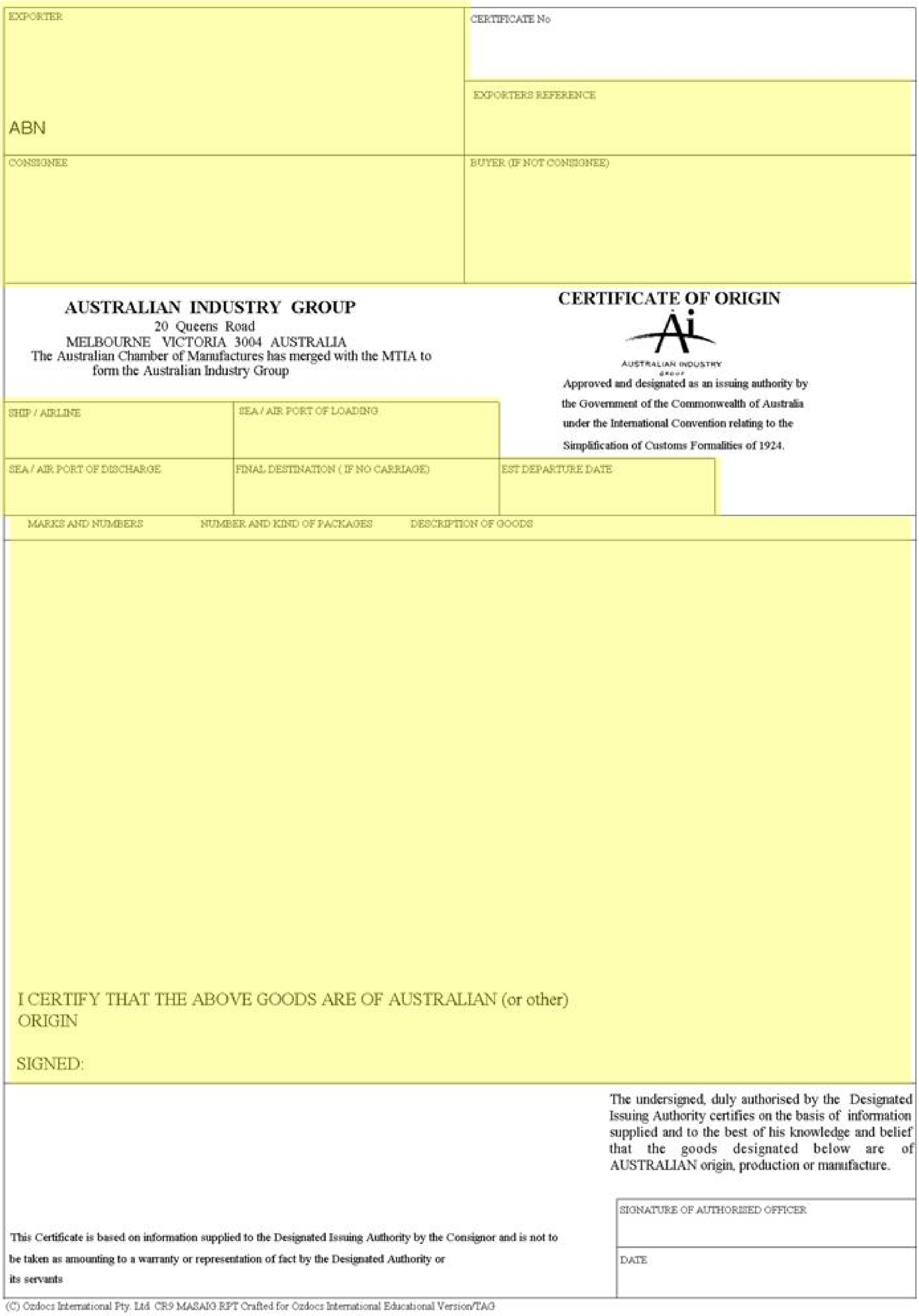
Frauds are always a possibility in any transaction, but it is presumed in this thesis that the Beneficiary (Exporter) is not engaging in international trade activities with the intention and purpose of defrauding other parties. Consequently, although it is acknowledged that fraudulent activities with documentation are a fact of life, they are not considered in detail in this thesis.

Productivity Losses are consequential, rather than causative. Therefore, the elements of risk discussed above are likely to cause productivity losses. Certainly documentation errors contribute to productivity losses through the process of correcting mistakes. As an example, in the UK it has been estimated that "the cost of documentary discrepancies is in the order of £ 113 million per annum" (SITPRO Ltd. 2003, p. 2).

Dysfunctional work places, as part of Behavioural Risks, may also be a contributing factor and it may be argued that Process Risks and Behavioural Risks are interlinked, as one has the propensity to affect the other. In other words, if processes are not robust enough this may cause dysfunction in the work place, but if people are dysfunctional in the discharge of their duties this may contribute to process risks and, consequently, hazards, errors, omission, delays and productivity losses.

Other externally issued documents, as identified in Figure 4.3, are also subject to documentary data accuracy challenges to varying degrees. A Certificate of Origin, although 'officially' issued by an organisation with delegated authority from the Australian Government, in reality, has almost all of the data on the appropriate form provided to it by the exporter. A sample Certificate of Origin is shown at Figure 4.12, with the yellow shaded boxes representing the data provided by the exporter. It can be observed that the issuing authority's role, in relation to this document, under normal circumstances, is limited to its assignment of a certificate number, execution by signature and date. Prior to obtaining such a certificate, the exporter needs to lodge a deed of declaration, as required by the issuing authority, providing details of export products, their origin and customs classification. The issuing authority checks the details on the Certificate of Origin form submitted to it, against its database, before proceeding to execute the document. Unless the issuing authority has cause to demand changes in the document provided by the exporter, it has limited opportunity to contribute towards documentary risks, and probably the only concern would be a delay in the processing of the Certificate of Origin. Where changes are required, however, this may cause problems and this is considered later in this chapter in the context of documentary compliance related to commercial invoices.

Figure 4.12: Sample Certificate of Origin (produced using an aligned documentation system)



EXPORTER

ABN

CERTIFICATE No

EXPORTERS REFERENCE

CONSIGNEE

BUYER (IF NOT CONSIGNEE)

AUSTRALIAN INDUSTRY GROUP
20 Queens Road
MELBOURNE VICTORIA 3004 AUSTRALIA
The Australian Chamber of Manufactures has merged with the MTIA to form the Australian Industry Group

CERTIFICATE OF ORIGIN

AUSTRALIAN INDUSTRY GROUP

Approved and designated as an issuing authority by the Government of the Commonwealth of Australia under the International Convention relating to the Simplification of Customs Formalities of 1924.

SHIP / AIRLINE	SEA / AIR PORT OF LOADING	
SEA / AIR PORT OF DISCHARGE	FINAL DESTINATION (IF NO CARRIAGE)	EST DEPARTURE DATE

MARKS AND NUMBERS | NUMBER AND KIND OF PACKAGES | DESCRIPTION OF GOODS

I CERTIFY THAT THE ABOVE GOODS ARE OF AUSTRALIAN (or other) ORIGIN

SIGNED:

The undersigned, duly authorised by the Designated Issuing Authority certifies on the basis of information supplied and to the best of his knowledge and belief that the goods designated below are of AUSTRALIAN origin, production or manufacture.

SIGNATURE OF AUTHORISED OFFICER

DATE

This Certificate is based on information supplied to the Designated Issuing Authority by the Consignor and is not to be taken as amounting to a warranty or representation of fact by the Designated Authority or its servants

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Permit Issuing Agencies are not usually a high level concern, in the context of documentary data acceptability but timely availability may be a problem. Increasingly, Permit Issuing Authorities are transmitting certificates electronically, directly to the importing government authorities, instead of issuing these to traders. As these documents phase in, they will cease to be of concern in future Letter of Credit business.

Inspection Agencies are third party independent surveyors, who are contracted to conduct pre-shipment inspection of export consignments. According to the Agreement on Preshipment Inspection (World Trade Organisation 1994), Article 1.3 states in part:

> preshipment inspection activities are all activities relating to the verification of the quality, the quantity, the price, including currency exchange rate and financial terms, and/or the customs classification of goods to be exported.

Preshipment inspections usually occur as a result of importing government requirements, to combat underdeclaration of customs values for imported products that results in loss of duty revenue collection. However, these inspections may also be commercially arranged, as a risk mitigation strategy, such as, for example, where an importer sources product from a new exporter. The detail of the inspection is arranged on a case-by-case basis and may simply involve a visual (physical inspection) of the goods, or it may involve random sampling of products in a consignment for independent testing. The documentary requirements of a Letter of Credit would, therefore, reflect the amount and type of document accordingly. To simplify matters, the discussion in this chapter is limited to visual inspection, therefore, minimal documentation requirement.

Under each of the thirteen Incoterms 2000 the buyer is responsible for preshipment inspection costs, even where such inspections are “mandated by the authorities of the country of export” (International Chamber of Commerce 1999, pp. 31,45,53, 63, 71, 79, 87, 95, 101, 109, 117, 125), as obviously the exporter has no interest, or need, for preshipment inspection. Once the cargo has been inspected, if all is in order, the inspection agency issues what is commonly referred to as a Clean Report of Findings, and in the case of a Letter of Credit transaction, typically the documentary demands will consist of an original commercial invoice and packing list/slip duly signed under seal by the inspection agency. Failure to obtain these documents would not enable the exporter to meet the Letter of Credit demands.

Preshipment inspections require co-ordination between the exporter and the inspection agency in relation to the timing of the inspection and the documentation (with specific data content) required by them. The exporter's logistics flows may need to be altered to allow adequate time for the inspection and from a documentary perspective the commercial invoice and packing lsit/slip may need to be issued earlier than would otherwise be the case. Any errors on these documents would be difficult to rectify post their issue. For example, if errors on the documents were not detected until after their lodgement with the bank, the exporter would not simply be able to issue new commercial invoices or packing lists/slips, because these would need to be authorised by the inspection agency. Alterations and amendments would also need authorisation. Depending on the materiality of the changes required this may, or may not, be possible, within the allowed presentation period stipulated in the Letter of Credit. At the time of writing, two ASEAN countries mandate pre-shipment inspection of consignments: Cambodia and Indonesia (only for some steel and waste products). However, it must be remembered that pre-shipment inspection may be more widespread, as buyers may use this process to safeguard against the possibility of goods being dispatched that may not conform to the contract of sale. In the context of the Export Letter of Credit Risk Model shown at Figure 3.31 pre-shipment inspection processes risk may include errors, omissions and delays and these may influence, or be influenced by, dysfunctional work places as behavioural risks.

In relation to Consulates, or Embassies, their involvement is usually limited to the 'legalisation' or 'visa' of documents. Typically this is achieved by the relevant authority singing the document presented to it under seal. As their involvement typically does not require the production of any data on the documents, aside from the signature under seal, there is minimal if any documentary data risk in this process. However, the timing it takes to have these processes completed may present problems, particularly as there are usually no minimum service standards for turnaround of documents. The situation is compounded if the document to be legalised by a Consulate, or Embassy, firstly needs to be endorsed by another third party, such as a Chamber of Commerce – for example, a Certificate of Origin. Delays are likely to be the process risk of greatest concern in this situation, as the inability to retrieve processed documents from a Consulate or Embassy, may prevent the exporter lodging the documents with the bank on time. It is not difficult, therefore, to imagine that there is a greater propensity for risk when exporters work within this 'pressure cooker environment' of dealing with a number of parties against tight dead-lines.

Depending on the Letter of Credit transaction in question, other third party documents may be required. The types and quantity of documents required could take any form and, therefore, it is not possible or feasible to provide an exhaustive list. Examples of such documents may be independent reports or certification from accredited parties, such as a laboratory report from a NATA laboratory (National Association of Testing Laboratories) or public places, for example, a weight note from a Public Weighbridge. The risk elements identified above are equally applicable to this category of documents, as they are likely to provide the same risk profile.

Having considered the externally issued documents, internal documents that are produced and issued by the exporter, are discussed next. To avoid unnecessary over-complication the discussion is limited to the most common exporter produced documents.

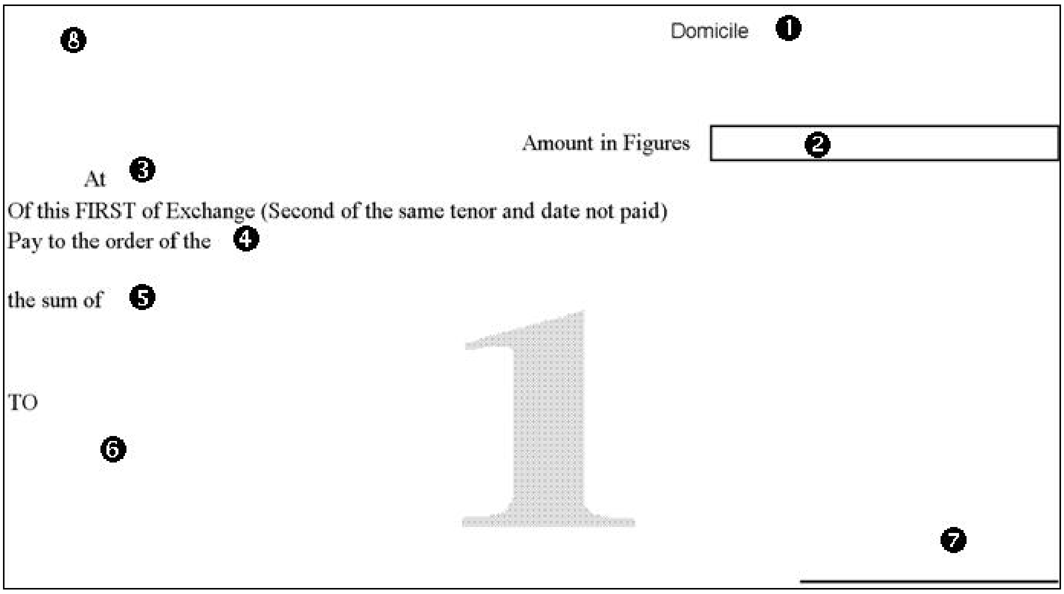
Internally issued documents

The most common documents that an exporter is required to produce in a typical Letter of Credit transaction are (in order of discussion): the Bill of Exchange, the Commercial Invoice, the Packing List and, where the sale is either on a CIF/CIP basis, an Insurance Certificate.

The Bill of Exchange, shown at Figure 4.13, is used as the mechanism by which the documents are 'sold and bought' by relevant parties to the Letter of Credit. Therefore, the Bill of Exchange "is the instrument used to demand payment" (Credit Management World 2006). This is a simple document, requiring the population of a maximum of eight data fields. Being internally generated, the exporter should, in theory, achieve faultless production but in reality discrepancies do occur.

Any flawed internal document production is the result of "incorrect or inadequate internal procedures and policies … [and]… lack of requisite resources" (Mehta 2004b, p. 2), that are not limited to technology but also include human error. The lack of adequate internal controls and human skills contribute to the behavioural and process risks identified in the Export Letter of Credit Business Model at Figure 3.31. Of relevance to internal document production are elements such as errors, omissions, delays and productivity losses that contribute to a dysfunctional work place. Bills of Exchange and other internally produced documents are discussed in greater detail in Chapter 6, in the context of the survey data analysis.

Figure 4.13: Sample Bill of Exchange



The Commercial Invoice, shown at Figure 4.14, is probably the most fundamental and important document in any business transaction but particularly so in a Letter of Credit transaction. This document has 44 data fields that may require completion.

The data shown on a Commercial Invoice are a combination of general commercial requirements, internal processing needs and convenience of the exporting firm, regulatory compliance and Letter of Credit demands. This document is subject to specific requirements under Article 37 of the UCP 500 that sates, in part, that "Commercial Invoices must appear on their face to be issued by the Beneficiary … and must be made out in the name of the Applicant" (International Chamber of Commerce 1993, p. 44). There are further requirements imposed on the Commercial Invoice, as per Article 37(c):

> The description of the goods in commercial invoice must correspond with the description in the Credit. In all other documents, the goods may be described in general terms not inconsistent with the description of the goods in the Credit (International Chamber of Commerce 1993, p. 44)

The prescriptive requirements for exact data match between the Commercial Invoice, and the description of the goods on the Letter of Credit, have been the subject of debate in the past.

Figure 4.14: Sample Commercial Invoice (produced using an aligned documentation system)

COMMERCIAL INVOICE

EXPORTER

ABN

EDN

OTHER RELEVANT DETAILS

INVOICE No & DATE

EXPORTERS REFERENCE

BUYERS REFERENCE

F/AGENT

SS Co Bkg

NAME OF SHIPPING LINE

CONSIGNEE

BUYER (IF NOT CONSIGNEE)

FORWARDING AGENT/MERCHANT

COUNTRY OF ORIGIN AND CODE

COUNTRY OF DESTINATION AND CODE

TERMS OF DELIVERY AND PAYMENT

VESSEL/AIRCRAFT

VOYAGE No

PORT OF LOADING

DATE OF DEPARTURE

RECEIVING DATE

DOCK CONT BASE

PORT OF DISCHARGE

FINAL DESTINATION

INSURED VALUE

INVOICE VALUE (AUD)

MARKS	No PKGS	DESCRIPTION OF GOODS (GENERAL)	GROSS MASS	CUBIC (m3)

QUANTITY	PROD CODE	(ITEM) DESCRIPTION OF GOODS	UNIT PRICE	TOTAL

BFWD from Cont. Pages

FREIGHT CHARGES

INSURANCE PREPAID

CONSULAR FEE

LEGAL & DOCUMENTATION FEES

INVOICE TOTAL

ADDITIONAL INFORMATION

SIGNATORY'S COMPANY

NAME OF AUTHORISED SIGNATORY

PLACE & DATE OF ISSUE

SIGNATURE

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As the doctrine of strict compliance is applied by banks through their documentary checking processes, attention to minute detail by the document producer is essential.

Data accuracy seems like a simple task but there are challenges in meeting the Letter of Credit requirements, partially due to the interpretations of the UCP 500 as applied by bankers. A few examples, outlined below, drawn from the Official Opinions of the International Chamber of Commerce Banking Commission, highlight the difficulties encountered in documentary data compliance and the pedantic nature of documentary scrutiny.

- Description of the goods on the Letter of Credit (Collyer 1997, p. 31) :
  Clock Movement
  'O.K.' BRAND QUARTZ CLOCK MOVEMENT WITH SWITCH
  Description of the goods on the invoice:
  'O.K.' BRAND QUARTZ CLOCK MOVEMENT WITH SWITCH
  The missing description '*Clock Movement*' was queried by the bank as a possible discrepancy, even though the same words appear again as part of the main description. The conclusion was that no discrepancy existed on the invoice, as the first incidence of the words '*Clock Movement*' was unimportant, as the wording on the invoice already included those words.
- Description (partial) of the goods on the Letter of Credit (Collyer 1997, pp. 62-63)
  'F.O.B. Shimonoseki'. (Shimonoseki is a seaport in Japan)
  Description (partial) of the goods on the invoice:
  'F.O.B. Japan'. The invoice also additionally showed *F.O.B. Shimonoseki* in the port of loading data field (this is separate from the description of the goods data field).
  The Issuing Bank rejected the documents claiming a discrepancy against Article 37(c) of the UCP 500 – this is a classic example of the doctrine of strict compliance approach to documentary checks. The decision of the banking Commission in this case was not unanimous. The minority supported the view of the Issuing Bank, rejecting the invoice description because of the implications of the Incoterms – stated as "F.O.B. Japan", claiming this caused uncertainty as what costs had actually been met by the seller, given that Japan is not a port but

a country. Their concern was the buyer may be forced to meet additional costs to what was originally agreed because the invoice was not specific as to the port of departure. The majority, however, did not uphold the view of the Issuing Bank as, despite a seeming discrepancy, the Bill of Lading did show ‘Port of loading: Shimonoseki, Japan’ and the invoice also showed ‘Shimonoseki, Japan’ as the place where goods were shipped from. Therefore, it was considered that the buyer would not, in fact, be subjected to extra costs. This is an interesting outcome as it indicates a ‘softer approach’ to the decision, favouring the doctrine of materiality over the doctrine of strict compliance. It is this very tension between the applications of these two doctrines that may potentially deliver different decisions on documentary compliance and this makes the documentary production task of the Beneficiary very difficult indeed.

- Description of the goods on the Letter of Credit (ICC Banking Commission 2002, p. R456):

  'Single core copper conductor PVC insulated cable 450-750 volts to BS6004.1975'

  Description of the goods on the invoice:

  'Single core copper conductor PVC insulated cable 450/750 volts to BS 6004/1975 - Eurocab Brand on reels each 85 yards'

  The documents were rejected by the bank claiming a discrepancy in the description of the goods on the invoice. The decision was that a discrepancy did not exist, as the invoice may display additional data as long as this does not change the nature of the goods.

In another case (ICC Banking Commission 2005, p. R584 / TA564rev), the Issuing Bank claimed a discrepancy against an invoice. The summary of the case is as follows. The Letter of Credit description was the description of goods as ‘*Men's suede jackets, plain suede fabric*’. The commercial invoices showed the goods description as ‘*Men's suede jackets (imitation suede with 100 per cent polyester knitted backing) plain suede fabric*’. The beneficiary explained that the extra information on the invoice was inserted at the request of the local Chamber of Commerce, who would not otherwise issue the Certificate of Origin (another document demanded by the Letter of Credit). The beneficiary further provided a “statement endorsed by the Camber of Commerce …

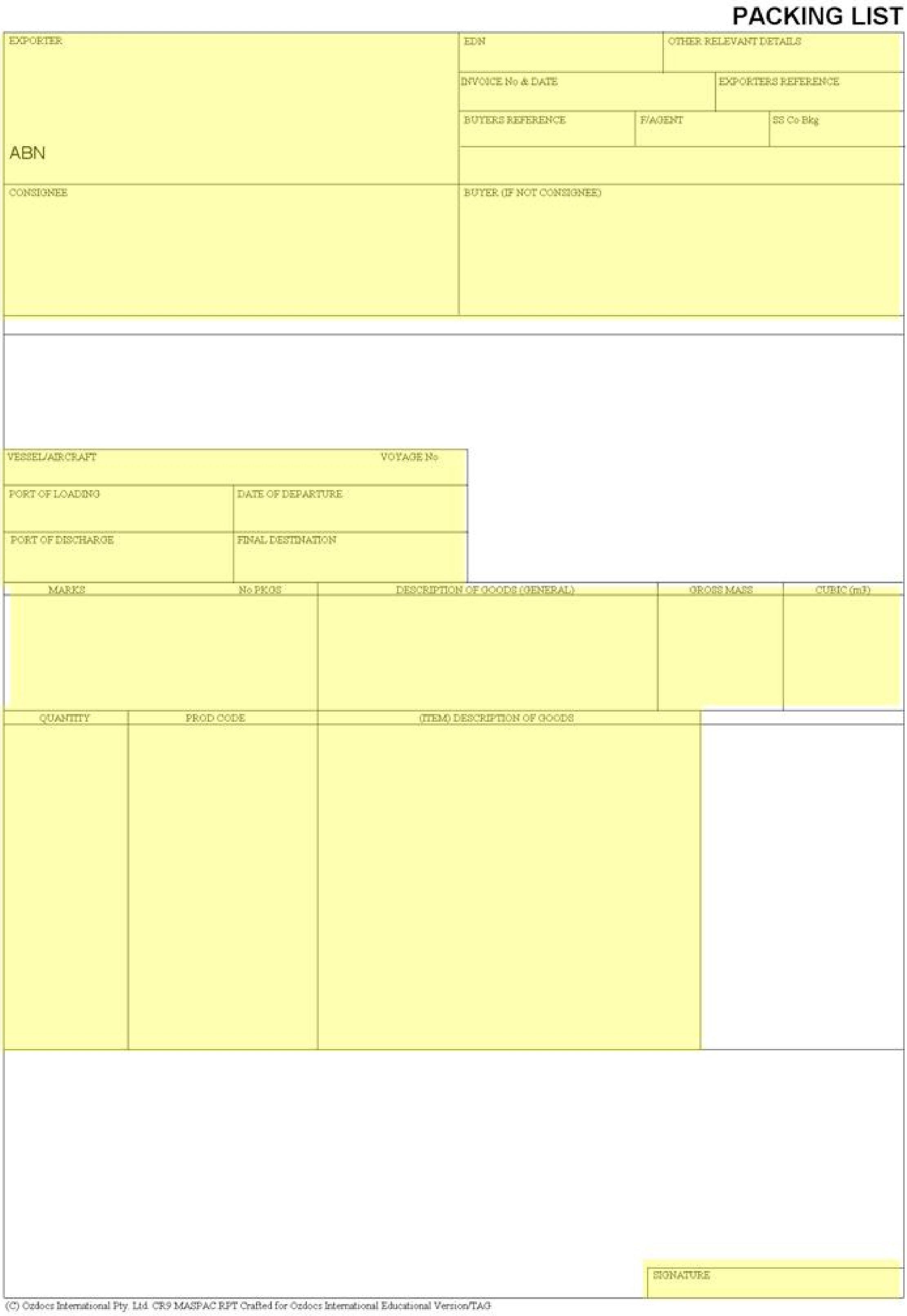
together with a certificate of origin, to the issuing bank as proof for the consistency between the description of goods and the wording in brackets". The Banking Commission's decision was as follows:

> The addition of the words "(imitation suede with 100 per cent polyester knitted backing)" is not part of the description of the goods in the credit. The word "imitation" indicates a different category or classification of the goods, which is not apparent in the goods description within the credit. The addition of the word "imitation" is grounds for refusal on the basis that the goods description in the invoice does not correspond with that in the credit (ICC Banking Commission 2005, p. R584 / TA564rev).

The decision in this case appears consistent with the one above it, that is, different data content on the Commercial Invoice are allowed, except where these change the nature of the product. It is immaterial that the additional information is required to satisfy third party document issuers, even though, seemingly, the correct product was shipped as claimed by both the Beneficiary and the Chamber of Commerce. The bank's role is to check required documents for their compliance against the Letter of Credit and not unrequested extrinsic documents. In this situation, the Beneficiary should have sought an amendment to the Letter of Credit, upon receipt and prior to shipment, to avoid rejection of documents. This case highlights, once again, the difficulties the exporter faces, at times, in meeting the requirement of a Letter of Credit, as external parties may make separate demands that run contrary to the payment instrument.

The Packing List, shown at Figure 4.15, is a standard commercial requirement, with the yellow shading representing shared data fields with the Commercial Invoice. It should be noted that additional information may be required to be shown on the Packing List. This document details how the goods are packed, together with the weight and dimensions. Insurers and carriers rely on Packing Lists in the event of cargo claims, to verify aspects of a consignment. Some countries require this document as part of the import clearance process. Letters of Credit routinely demand this document. Except for prices of the goods within a consignment, the Packing List mirrors the details of the Commercial Invoice and, additionally, provides container and seal numbers (if applicable), weights and volumes. When compared to non-generated document production, Packing Lists generated through an automated system have diminished opportunity for data errors, as a large amount of data fields are shared with other documents, enabling system-generated automatic population of such fields.

Figure 4.15: Sample Packing List (produced using an aligned documentation system)


PACKING LIST

EXPORTER

ABN

EDN

OTHER RELEVANT DETAILS

INVOICE No & DATE

EXPORTERS REFERENCE

BUYERS REFERENCE

F/AGENT

SS Co Bkg

CONSIGNEE

BUYER (IF NOT CONSIGNEE)

VESSEL/AIRCRAFT

VOYAGE No

PORT OF LOADING

DATE OF DEPARTURE

PORT OF DISCHARGE

FINAL DESTINATION

MARKS	No PKGS	DESCRIPTION OF GOODS (GENERAL)	GROSS MASS	CUBIC (m3)

QUANTITY	PROD CODE	(ITEM) DESCRIPTION OF GOODS

SIGNATURE

Just like Commercial Invoices, Packing Lists have been the subject of compliance disputes. Some examples are provided below to illustrate the documentary compliance problems that have arisen in the past.

- A Letter of Credit required a "Packing List in 3 copies showing weight and measurement of each package" (ICC Banking Commission 2002, p. R248). The Packing List presented to the bank did not indicate the weight and measurement of each package, rather it only showed the total weight and measurement of the consignment as a whole. Not surprisingly, the decision that the Packing List was discrepant was upheld by the Banking Commission. In the context of the export Letter of Credit Business Risk Model, shown at Figure 3.31, this transaction highlights a process error, possibly contributed to by improper internal controls, or behavioural risks, such as inadequate understanding of the Letter of Credit compliance processes.
- A Letter of Credit required a Packing List, without further qualification and when this was presented a discrepancy was claimed on the basis that the name of the vessel shown on this document was different to that shown on the transport document. The Packing List showed *Irtysh*, whereas the transport document showed this as *Irtish*. The Banking Commission decided that “the name of the vessel being spelled differently by one letter would not constitute grounds for refusal” (ICC Banking Commission 2002, p. R431). This case indicates the pedantic nature of the documentary checking procedures of banks, contributing difficulty to documentary compliance – an issue that will be discussed later in this chapter.
- A Letter of Credit required a Packing List, without further qualification, and when this was presented a discrepancy was claimed on the basis that the document was not dated. The Banking Commission held there was no discrepancy, because the Letter of Credit did not specifically request the document to be dated and, in accordance with Article 21 of UCP 500, any specific information that is to appear on a document must be specified in the Letter of Credit (ICC Banking Commission 2002, p. R447). In this case, at least, the lack of exact requirements seems to have worked in the favour of the Beneficiary.

The above examples continue to highlight the pedantic nature of Letter of Credit transactions in the context of the all important documentary compliance.

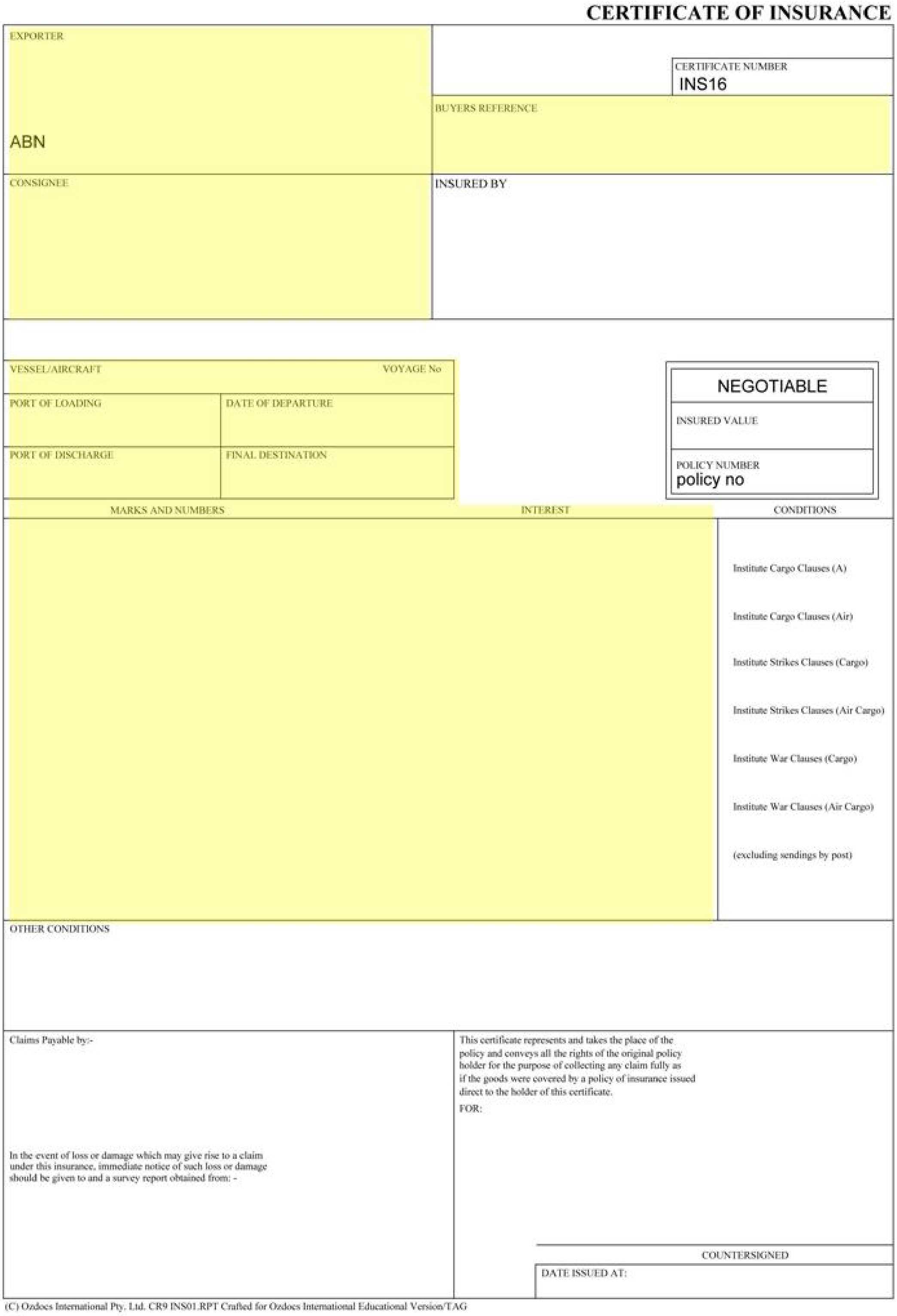
The question of cargo insurance also presents some documentary compliance challenges. It should be noted that the discussion in this section is limited to CIF and CIP Incoterms 2000 contracts, where the Beneficiary must provide evidence of insurance. This evidence is usually in the form of either an Insurance policy or certificate, with the certificate being the most common option. A sample Certificate of Insurance is shown at Figure 4.16 - the yellow shaded areas represent the data fields shared with the Commercial Invoice. Policy and certificate numbers, identify of the insurers, signature and date, as well as value and conditions are all critical fields that cannot remain blank.

UCP 500 Articles 34, 35 and 36 specifically relate to insurance provisions. The focus of the requirements is on the signature, the currency, the insured value and that, importantly, insurance begins prior to the start of the journey – as insurance cannot be retrospectively applied. The examples of disputes over insurance cover, provided below, are helpful to contextualise the documentary compliance risk in a Letter of Credit transaction.

- A Letter of Credit required the provision of an Insurance Certificate. The bank claimed a discrepancy because this document did not show, like the Bill of Lading did, the voyage number alongside the vessel name. The decision of the Banking Commission was that the inclusion of the voyage number was not necessary, because Bills of Lading did not always show this information, therefore, there was no discrepancy (ICC Banking Commission 2002, p. R389).
- A Letter of Credit stipulated the following "*Insurance Policy/Certificate covering Marine Institute Cargo Clauses (A), Institute War Clauses (Cargo) and Institute Strike Clauses (Cargo) for full invoice value plus 10 percent*". The certificate of Insurance presented contained the clauses above and additionally stated "*- Institute Radioactive Contamination Exclusion Clause; -Institute Cyber Attack Exclusion Clause if applicable*". The bank rejected the document, claiming these exclusions contravened the insurance requirement of the Letter of Credit. The Banking Commission did not find a discrepancy because the first exclusion was not directly related to one of the required risks to be covered and

the second exclusion was qualified by ‘if applicable’ and could be disregarded (ICC Banking Commission 2002, p. R417).

Figure 4.16: Sample Certificate of Insurance (produced using an aligned documentation system)



CERTIFICATE OF INSURANCE

EXPORTER

ABN

CERTIFICATE NUMBER
INS16

BUYERS REFERENCE

CONSIGNEE

INSURED BY

VESSEL/AIRCRAFT | VOYAGE No

PORT OF LOADING | DATE OF DEPARTURE

PORT OF DISCHARGE | FINAL DESTINATION

NEGOTIABLE

INSURED VALUE

POLICY NUMBER
policy no

MARKS AND NUMBERS | INTEREST | CONDITIONS

Institute Cargo Clauses (A)

Institute Cargo Clauses (Air)

Institute Strikes Clauses (Cargo)

Institute Strikes Clauses (Air Cargo)

Institute War Clauses (Cargo)

Institute War Clauses (Air Cargo)

(excluding sendings by post)

OTHER CONDITIONS

Claims Payable by:-

This certificate represents and takes the place of the policy and conveys all the rights of the original policy holder for the purpose of collecting any claim fully as if the goods were covered by a policy of insurance issued direct to the holder of this certificate.

FOR:

In the event of loss or damage which may give rise to a claim under this insurance, immediate notice of such loss or damage should be given to and a survey report obtained from: -

COUNTERSIGNED

DATE ISSUED AT:

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- The Letter of Credit required a "*Certificate of Insurance (cover note issued by broker not authorised)*". A Certificate of Insurance was issued and signed under the authority of the Underwriters by a company being Insurance Brokers. The Banking Commission ruled that this document was acceptable as the brokers were authorised to issue insurance on behalf of the Underwriters and had effected the insurance.

It can be noted from the above examples that Insurance Certificates do not generally appear to have caused as many concerns as Commercial Invoices.

Viewed from the beneficiary's perspective, regardless of the production source, documentary compliance is not an easy task and Letter of Credit transactions are certainly not suitable for inexperienced employees. The issue of documentary compliance, central to the triggering of the payment under a Letter of Credit, has been explained by one US court as "compliance with the terms of the credit is not like pitching horseshoes. No points are awarded for being close" (Ronner 1995, pp. 630-631), indeed in *Bank of Nova Scotia v. Angelica-Whitewear Ltd.*, [1987] 1 S.C.R. 59 at 37, Ledain, J. stated that "the rule *de minimis non curat lex* (the law does not concern itself with trifling matters) does not apply in commercial credit transactions". The implication of this statement is that the doctrine of strict compliance should be followed by banks in Letter of Credit transactions.

Having discussed the main issues of document production and data accuracy pre- and post-shipment, the next step for the Beneficiary in the Letter of Credit flow is the lodgement of the documents with the bank.

Step 6

The documents required by the Letter of Credit must be lodged with the bank within the presentation period allowed for in the particular Letter of Credit that, unless stated otherwise, is a maximum of twenty-one days after the date of shipment, in accordance with Article 43(a) of the UCP 500. All required documents are to be lodged in one presentation and this may be at the counters of any bank in the country of the beneficiary, unless the Letter of Credit stipulates otherwise.

Upon lodgement the bank receiving the documents must check these in accordance with the requirements of Article 13 of the UCP 500. There is a maximum time period for **each bank** in which to perform this task and, in accordance with Article 13 (b), this is “not to exceed seven banking days following the day of receipt of the documents” (International Chamber of Commerce 1993, p. 19)[19]. The bank must disclose its acceptance of the documents, or otherwise, within this period, otherwise, by virtue of Article 14(e) of the UCP 500, it is “precluded from claiming that the documents are not in compliance with the terms and conditions of the Credit” (International Chamber of Commerce 1993, p. 21). According to banking industry sources in Australia, documentary checks, against a set of export documents, are usually completed within two days of receipt. It should be noted that the UCP 500 imposes time limits for banks to signal their acceptance of documents but do not, and cannot, impose time limits for resolving disputes, as legal action cannot be precluded.

Documents presented to the Advising Bank[20] are offered (tendered) and, therefore, subject to the legal principles of offer and acceptance, that is, their ownership remains with the presenter (Beneficiary) until such a time as they are accepted. The bank’s obligation in respect of documentary scrutiny is as outlined in Article 13 of the UCP 500 (International Chamber of Commerce 1993, p. 19) that states, in part

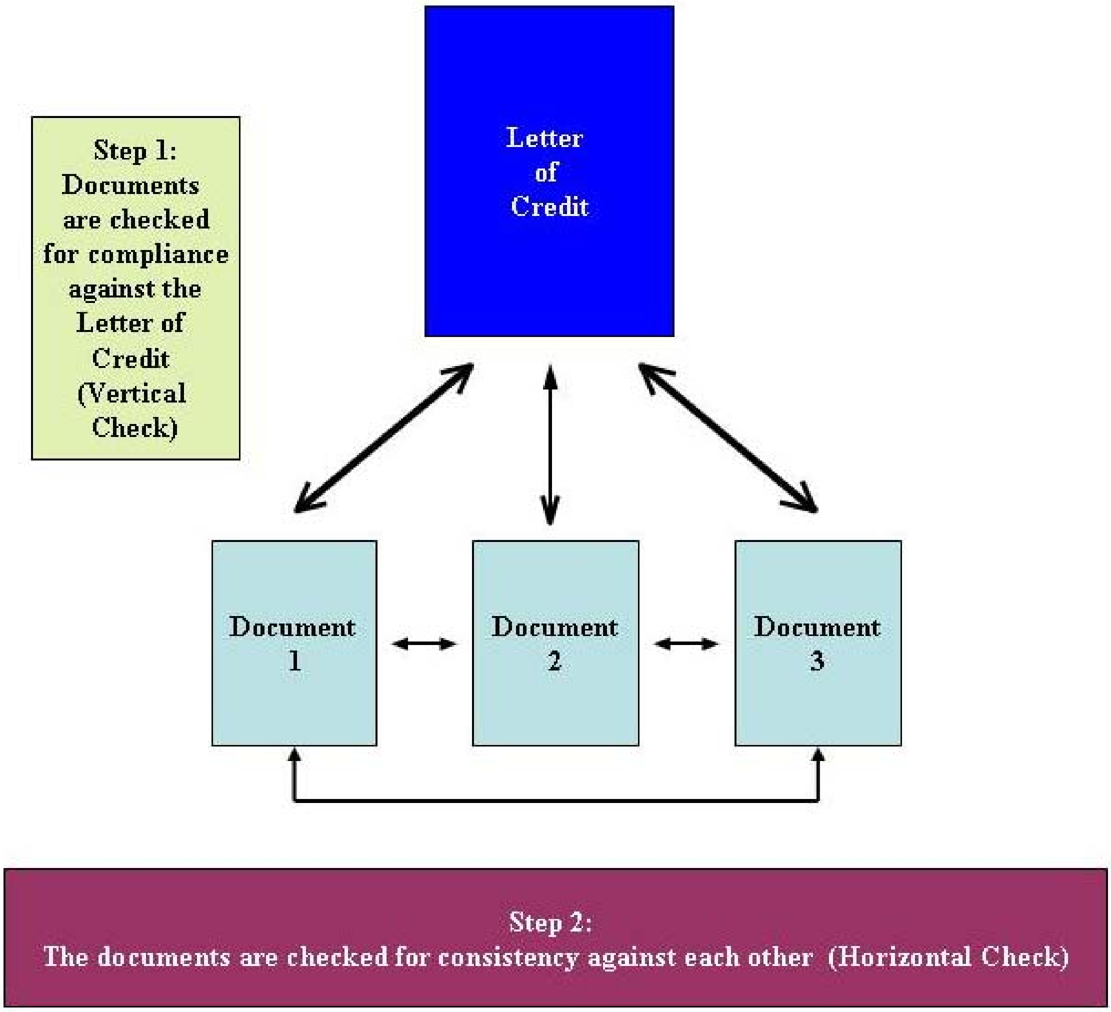
> Banks must examine all documents stipulated in the Credit with reasonable care, to ascertain whether or not they appear, on their face, to be in compliance with the terms and conditions of the Credit. Compliance … shall be determined by international standard banking practice as reflected in these Articles. Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in compliance with the terms and conditions of the Credit. Documents not stipulated in the Credit will not be examined by banks.

The documentary check may be referred to as vertical and horizontal cross-checking, that is, each document against the Letter of Credit and each document against others for consistency and, diagrammatically, this is shown at Figure 4.17. Documentary consistency is referred to in Article 21 of the UCP 500. This Article refers to documents other than transport, insurance and commercial invoice (because these are specifically dealt with by other articles) and states in part that banks will accept the documents as presented “provided that their data content is not inconsistent with any

[19] This period has been reduced to five days in the successive (current) version of the UCP 600 rules, however, detailed discussion of these rules are outside the scope of this thesis.
[20] For the purpose of discussion in this chapter, it is presumed that the transaction is not a Confirmed Letter of Credit. The documents are lodged with the Advising Bank, and this bank does not have the authority to pay on behalf of the Issuing Bank, meaning that the documents have to be sent to the Issuing Bank for final acceptance and payment.

other stipulated document presented" (International Chamber of Commerce 1993, p. 25). It should be noted that "the requirement of Article 21 of UCP 500 is not that the data content be identical, merely that the documents not be inconsistent" (ICC Banking Commission 2005, p. R559 / TA548rev). .

Figure 4.17: Letter of Credit checking: vertical and horizontal crosschecking (Bergami 2003, p. 108)



The Advising Bank has a duty to examine documents, but only with **reasonable care** to ascertain that documents **appear on their face** to comply with the Letter of Credit requirements. This, in itself, is a curious enough proposition, however, it becomes even more peculiar, when compliance needs to be considered in the context of international standard banking practices as reflected in the UCP 500. As stated in Chapter 3, these standards did not exist until ten years after the UCP 500 became operational and, in any case, when the International Standard Banking Practices were issued, in 1993, these were given a non-binding, non-authoritative status of ‘guidelines’, as

> The ISBP outlines international standard banking practice, in other words, how the Articles of the UCP should be applied by practitioners. Discrepancies are discrepancies and should be stated as such, i.e., this represents no change to existing practice. Documents are discrepant because they fail to comply with one or more terms and conditions of the credit or UCP (ICC Banking Commission 2005, p. R532 / TA576).

Indeed, Article 14(d)(ii) of the UCP 500 imposes an obligation on the Issuing Bank, or a bank acting on its behalf, to list all discrepancies in case of rejection of documents.

The process post-lodgement of documents may be summarised as follows. The Advising Bank checks the documents and, if all is in order, accepts these. If discrepancies are found, the Advising Bank advises the presenter of the discrepancies and holds the documents at their disposal. The presenter still owns these documents and, provided the presentation period has not lapsed, has the opportunity to retrieve the documents and re-present these, after correction – that is, if the discrepancies are capable of being corrected. The process of retrieval and re-lodgement may happen many times during the period of presentation, as the UCP 500 is silent on this (this situation has not changed under the UCP 600 either). The earlier the lodgement of documents, the greater the opportunity for rectification to occur within the stipulated times allowed under the particular letter of credit, therefore, delay is an important process risk consideration. Given all documents must be lodged in one presentation, delays in assembling the required documents diminish the time opportunity for rectification and this is another contributing factor to the export ‘pressure cooker’ environment that may also lead to behavioural risks, through a dysfunctional work place.

If the documents cannot be rectified, the Advising Bank will notify the Issuing Bank of the discrepancies it has discovered when it forwards the documents to the Issuing Bank for further action. Where the Advising Bank has discovered potential discrepancies but considers these to be insignificant and, therefore, unlikely to be a cause for rejection, it may forward the documents to the Issuing Bank under a ‘silent reserve’. This means that the Advising Bank will advise the Beneficiary of errors found, but will not disclose these to the Issuing Bank. If the documents are accepted by the Issuing Bank, payment is effected as planned. However, should discrepancies be raised, the Advising Bank's position is protected through the silent reserve, especially if they have advanced funds that need to be reclaimed.

During Step 6, the exporter is exposed to a number of risks identified in the Export Letter of Credit Business Model shown at Figure 3.31, including:

- process risks – elements surrounding documentary discrepancies that may manifest as data **errors** or **omissions** and **delays** in lodgement of documents. **Productivity loss**, through lost time in rectifying documents is another risk. **Hazards** may also be an additional risk where documents may be physically lost en route from one party to another, as their replacement may not become available within the available timeframes.
- behavioural risks – **dysfunctional work places** may be either the cause, or result, of the process risks identified above. Behavioural risks may also include the actions of the banks in respect of the document checking processes. This is also considered below in the context of the Issuing Bank's rights and obligations in a Letter of Credit transaction.

The likelihood and severity of risk will vary from one transaction to another. The risks identified above are, however, likely to apply to any Letter of Credit transaction.

Steps 7 to 11

These steps may vary in their sequence depending on the role of the Advising Bank, as authorised by the Issuing Bank. The role of the Advising Bank will also depend on the timing of the payment and the reimbursement arrangements applicable to a particular Letter of Credit transaction.

Immediate (at sight) payments are typically effected with the right of recourse, that is, the Advising Bank reserves the right to claim back the payment made to the Beneficiary, in cases where the Issuing Bank finds discrepancies on checking the documents, after receiving same. The usual process, in this instance, is for the Advising Bank to check the documents and, if deemed compliant, the Beneficiary is paid. The Advising Bank notifies the Issuing Bank accordingly, claiming re-imbursement. The documents are sent to the Issuing Bank and these are checked for compliance. If no discrepancies are found, the documents are given to the buyer and their account debited accordingly.

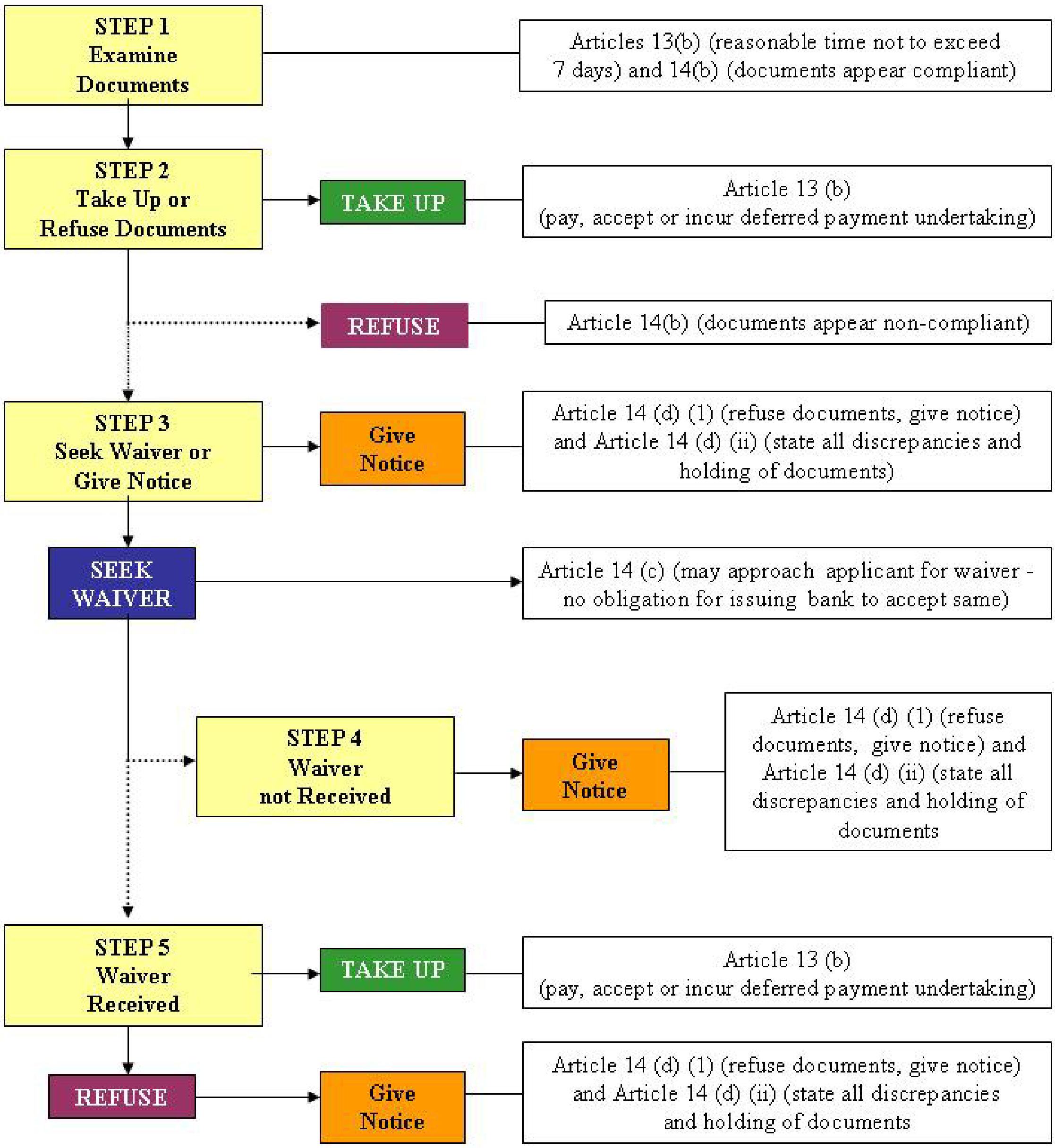
However, if the documents are deemed non-compliant, the Issuing Bank contacts the Applicant to establish whether the discrepant documents will be accepted. If the Applicant agrees, the Issuing Bank will seek a written waiver from them. The waiver is required by the Issuing Bank, otherwise the applicant may refuse payment, because the documents would not conform to the Letter of Credit and, therefore, be in breach of the initial arrangements (the Letter of Credit application).

For a deferred payment Letter of Credit, such as the one shown in Figure 4.1, the documents would remain subject to the Advising Bank checking procedures, after which they would be forwarded to the Issuing Bank. Obviously, in these circumstances, payment will follow at a future maturity date. The Issuing Bank checks the documents and, if these are deemed compliant, payment will be automatically triggered on the due date. If the documents are deemed non-compliant, the process as outlined above is followed. Any eventual notice of rejection must follow the process prescribed in Article14 of the UCP 500, shown at Figure 4.18, regardless of the payment maturity period.

One of the most critical problems faced by the Beneficiary is whether the documents will be accepted and taken up by the Issuing Bank, after they have been deemed compliant by the Advising Bank. The Advising Bank sends the documents to the Issuing Bank after checking, but acceptance, or not, may not be signalled for up to two weeks or more. This is because the documents are physically transferred to the Issuing Bank in another country and, it may take three to fours days or more for this transfer to be effected, even with a courier service. The Issuing Bank has seven clear bank working days to reach a decision and communicate this back to the bank from whence the documents came. Even though the Advising Bank may have indicated its acceptance of the documents, it must be remembered that the undertaking to pay is not given by this bank, but by the Issuing Bank. Consequently, "the issuing bank must decide on its own whether the documents presented under its credit are in compliance with the terms and conditions of the credit" (Collyer 1997, p. 35). This means that even a waiver is no guarantee of acceptance of non-compliant documents, because the 'unilateral right to accept documents … belongs only to the Issuing Bank, regardless of waivers from the applicant" (Bergami 2003, p. 118).

All of the examples cited earlier, at Step 5, are the result of banking differences in what constitutes documentary compliance. Undoubtedly, there are many more examples that could be cited but these would probably not provide any further insight into the problems of data accuracy and the Issuing Bank's acceptability of such data.

Figure 4.18: UCP 500 examination, acceptance and refusal of documents: the issuing bank (Bergami 2003, p. 109)



Where a discrepancy is cited, the substitution of the Applicant's (Buyer's) credit risk with that of their bank (Issuing Bank) is nullified. This is because, with a genuine discrepancy, the Issuing Bank will, in all probability, seek a written waiver from the Applicant in order to mitigate documentary acceptance risks. It is the Applicant's decision as to whether a waiver is given or not and, consequently, the Applicant is brought back into the credit risk equation. In the absence of discrepancies, the Applicant has no say in the payment, because the bank must honour its undertaking, but a discrepancy is a breach of the undertaking and the bank will seek the Applicant's approval before considering whether to accept and pay. Therefore, the Applicant assumes a controlling position in the transaction which is what the Letter of Credit was trying to avoid. Whilst the presence of a waiver may not guarantee payment, the absence of it would almost certainly prevent it. At times, 'inducements', usually by way of discounts, or similar, are sought by the Applicant before they may provide a waiver – this issue will be discussed in further detail in Chapter 6, in the context of the discussion of the findings of the empirical research.

Payment delay tactics are not unusual in Letter of Credit transactions through the "invention of discrepancies", that is, "using technicalities to dishonour documentary credits" (International Chamber of Commerce 2004)

> known to occur in situations where the issuing bank, having taken considerably less than 100% security from the L/C applicant, was provided with documents that seemingly complied. Upon enquiry, the issuing bank would find that the applicant had insufficient funds to cover the L/C payment. Unwilling to make the payment as due, the issuing bank would suddenly 'find' mistakes in the documents. This practice was simply designed to 'buy time' while the banks argued amongst themselves as to whether these discrepancies were real, or not, in accordance with the UCP 500 (Bergami 2009b, p. 200).

This appears to be common practice in some areas of the world, as disclosed at an International Chamber of Commerce meeting in 2005, with "a number of very frank admissions from some banks in Asia that re-examination of documents represented a very significant source of income" (Kreitman 2005). Apart from the questionable ethics of this behaviour, these practices lengthen settlement periods, as the funds are not transferred until the documents are re-examined and finally accepted. This has a negative impact on the beneficiary's cash flows and simultaneously increases the risk of payment default. The Beneficiary, therefore, is exposed to a number of risks identified in the Export Letter of Credit Business Model, shown at Figure 3.31, including environmental risks, with factors such as bank and customer risk; as well as behavioural risk on behalf of Issuing Banks. This demonstrates that, notwithstanding the presumed financial strength of the Letter of Credit, trust remains a critical factor.

Deferred payment Letters of Credit place liquidity pressure on the Beneficiary as, obviously, the funds are not paid by the Issuing Bank until some later stage. In these instances, the Beneficiary may seek a discounting of the proceeds. This is an advance payment against future receivables, consisting of the par value of the transaction minus a discount factor (the interest rate component over the advance payment period) and, typically, a bank processing fee. This request will only be considered in situations where the documents are deemed to be compliant by the bank receiving and checking same and the bank advancing the payment has confidence in the undertaking given by the Issuing Bank that payment will be effected as due. There is no obligation on a bank to discount proceeds. Evident in these arrangements are the country and bank risks that form part of environmental risks within the Export Letter of Credit Business Risk Model, shown at Figure 3.31.

In summary, this chapter has highlighted the most salient issues surrounding the very complex activities and relationships that occur from using a Letter of Credit as the payment mechanism. This chapter has demonstrated that certainty of payment may be more of a perception that a reality, due to the number of circumstances where, put simply, things may just go wrong.

Viewed from the Beneficiary's point of view, there is a number of environmental, behavioural and process risks, identified in the Export Letter of Credit Business Model, shown at Figure 3.31, that are not able to be controlled. However, there is also a number of internal processes that are capable of being controlled. Therefore, it is vital that robust processes and procedures be in place and that adequately skilled staff is available for these transactions.

The various risk management processes that Australian manufacturing exporters may use are explored in the context of the research findings in Chapter 6. Chapter 5 describes the methodology used for the empirical research, and provides a discussion on the objectives and the propositions.

5. Methodology

To recall, the basic proposition is that Letters of Credit reduce payment risk for Australian manufacturing exporters to ASEAN. This chapter discusses the approach adopted to test this proposition. The three main anticipated outcomes, to be discussed are:

1. identify the factors that have positive relationships to payment risks;
2. identify the factors that have negative relationships to payment risks; and
3. a set of policies procedures and strategies to minimise payment risk.

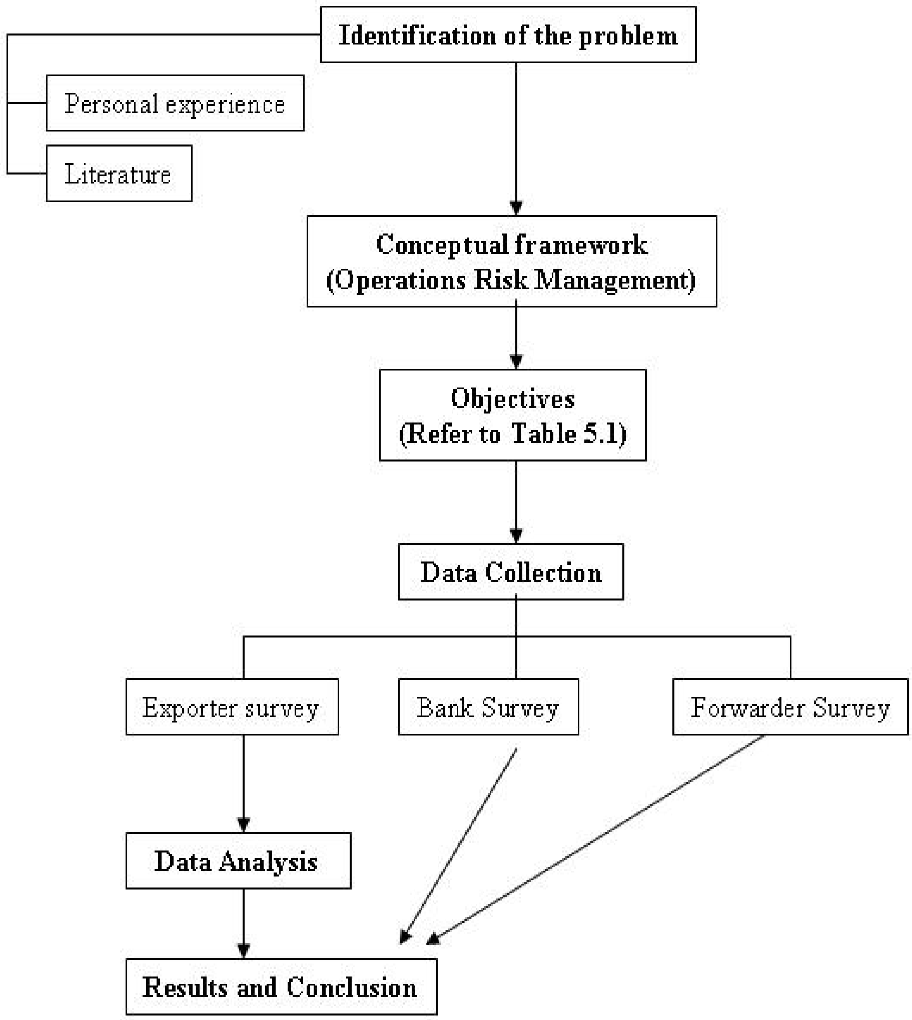
There is currently very little, if any, information in the public domain about documentary discrepancy rates in Letter of Credit transactions, from the exporter's point of view. The available information about discrepancy rates appears to be based on estimates from ICC annual surveys administered on line to trade finance professionals (DC-Pro 2004), sparse literature on documentary errors and a study in the USA (Mann 2000). The ICC has recently acknowledged that there are no reliable data on Letter of Credit operations and loss history and is considering investigation of this aspect of trade in conjunction with the Asian Development Bank (ICC Banking Commission 2010). Although there is widespread recognition that documentary errors exist, it seems that no investigation has taken place to date to discover why such discrepancies occur. The USA study was based on the examination of bankers' files and interviews with bankers, with no data collected from exporters. Consequently, it seems that no study has been conducted with exporters, in general, especially in the context of Australian manufacturing exports to ASEAN. This thesis, therefore, adopts an exploratory research design in the main.

There is little guidance from the literature on the identified variables in the area of this study, other than articles in trade magazines that identify and list the most common discrepancies (Baker 2000; Fact File 1999; UBS AG 2006) but do not investigate their causes or offer solutions. Instead generalised statements are made that are not helpful, for example,

> firms should aim for error-free documentation. They should make it company policy and develop strategies to eliminate all errors before presenting letters of credit for payment (Mehta 1999, p. 13).

Therefore, it has been necessary to rely on guidance from general risk management literature to develop the variables to be measured in this study. The data collection was guided by the conceptual framework developed in Chapter 3 – the Export Letter of Credit Business Risk Model, at Figure 3.31. The process of developing the methodology is shown in diagrammatic form at Figure 5.1.

Figurer 5.1: Development of methodology



The data were collected by means of written surveys and semi-structured interviews conducted personally or via telephone. The questionnaire was constructed using the Export Letter of Credit Business Risk Model as the basis for developing the questions in the survey. The ten objectives of the research are summarised at Table 5.1 and following is a discussion on the objectives.

Table 5.1: Objectives of the study

Objective	Variables and the associated questions in the survey instrument
1. Determine the attributes of the firm that are associated with the error rate	Firm size (Q3); Years of export experience (Q8); Type of industry (Q7) Number of transactions (Q16); Bank used (Q28); Delivery term chosen (Q29); The requirement for third party documents to be used in the transaction (Q31); Use of freight forwarders (Q32); Mode of transport (Q34, Q33); Means of communicating with external document providers (Q35); Document production (Q36, Q37, Q40, Q47); Lodgement and bank processing of documents (Q38, Q39, Q40, Q41, Q46); Country of export (Q2, Q9, Q15, Q24, Q52)
2. Measure the magnitude of trade between Australian manufacturing exporters and ASEAN that is conducted by L/C and also the percentage of this trade in proportion to total trade to the same geographical area	Total sales value (Q10); Export sales as a proportion of total sales (Q11) Percentage of sales using Letters of Credit (Q12)
3. Establish the reason for using L/C as the payment method of choice. This may link to the proposition that L/C are used as a risk management tool	Reason for using the Letter of Credit as the payment method (Q18); Methods used to assess country risk (Q17); Who (in the company or the party to the contract) decides on choosing the Letter of Credit as payment term (Q19); Usage of mercantile agent to assess country/customer risk (Q20); Use of credit insurance agency against non-payment (Q21)
4. Measure the usage of different types of Letters of Credit	Different types and maturity dates of letters of credit used (Q14, Q13, Q22, Q23)
5. Measure the magnitude and frequency of discrepancies, the amounts involved and the corrective measures to resolve any disputes ▪ why are these discrepancies allowed to occur? ▪ what arrangements are put in place when problems arise?	Frequency of documentary rejection (Q42, Q43); Types of errors (Q45) Acceptance of documents or payment variations (Q49); Corrective action to remedy discrepancies (Q44, Q48); Cost of correcting discrepancies (Q53)
6. Estimate the level of bad debts incurred as a result of L/C discrepancies	Total export sales bad debts (Q50); Total export sales bad debts resulting from discrepant documents under Letter of Credit terms (Q51)
7. Determine the priority of attributes for export documentation employees	Skills required for the transaction (Q27)
8. Determine the level of training received internally/externally by employees	Specific Letter of Credit training (Q5); Number of employees in export documentation (Q4); Staff experience with Letter of Credit documentation (in years) (Q6)
9. Determine whether the exporting firm is exposed to foreign exchange currencies and how this risk is managed	Currencies used (Q25); Forward exchange contracts or other risk management treatments (Q26)
10. Establish the frequency of discounting proceeds	Frequency of discounting proceeds (Q54); Reason for discounting proceeds (Q55)

5.1 Objectives

Objective 1 is to determine the attributes of the firm that are associated with the risk level of Letter of Credit transactions. The variables used for this objective include commonly used factors such as firm size, years of export experience, type of industry, country of export and the number of transactions. These variables are linked to the Environmental Risks in the Export Letter of Credit Business Risk Model. Elements comprising these risks include Customer Risk, Country Risk and Bank Risk. Other factors used to determine the attributes were physical factors related to the performance of the export consignment such as the delivery term chosen, the mode of transport used, the need for externally issued documents, whether the exporting firm uses the services of a freight forwarder and how they communicate with them. These variables are linked to the Process Risks and Behavioural Risks in the Export Letter of Credit Business Risk Model. Elements comprising these risks include Errors, Delays, Omissions, Productivity Loss and Dysfunctional work places. The reason for choosing these variables is because the delivery term chosen dictates the types of document required under the transactions. For example, under a Cost and Freight, or Carriage Paid To, transactionsthe exporter must contract for carriage on a pre-paid basis, and provide an appropriate transport document. Commonly exporters use the services of a freight forwarder to arrange for cargo booking and transfer the goods between their place of business and the carrier. The freight forwarder also produces transport documents on behalf of a carrier, a typical situation in airfreight consignments. As the transport documents are produced based on information provided by the exporter, the manner in which this information is provided, either manually or electronically, becomes important as this may contribute to documentary errors.

Other variables that were used for this objective include the production of internal documents and the process of lodging such documents with the bank. These factors are linked to Process Risks and the Errors, Omissions, Delays and Productivity Loss elements, as well as Opportunity Cost, an element of Environmental Risks and Behavioural Risks. These variables were chosen because documentation production is a critical issue in this research study and the timely lodgement of documents is an inherent step in complying with Letter of Credit transactions. The manner in which documents are produced, either manually or electronically, may impact on error rates. Company policies or procedures for the production of such documents may be another influencing factor on the accuracy of documentary data production. Therefore, information on the bank used for the transaction and the bank documentary processing outcomes was considered in this objective. These variables link to the Bank Risk, Customer Risk and Country Risk elements that form part of the Environmental Risks in the Export Letter of Credit Business Risk Model. The choice of bank may assist the exporter in meeting the documentary requirements of a Letter of Credit transaction through the provision of advice or by arguing the case on behalf of the exporter where the issuing bank intends to reject the documents.

Objective 2 is to measure the magnitude of trade conducted by Letter of Credit with a view to estimating its value and, subsequently, estimate potential losses from documentary discrepancies. The variables chosen for this objective include commonly used factors such as total sales value, the proportion of export sales to total sales and the percentage of Letter of Credit sales as a proportion of export sales.

Objective 3 is to establish the reason for using the Letter of Credit as a payment method. The variables chosen for this objective were the usage of mercantile agencies and credit agencies, as these would indicate a wish for exporting firms to assess Country Risk, Customer Risk and Bank Risk. Other variables were chosen to determine which other methods exporting firms use to assess country and customer risk, who the decision makers are in the choice of the method of payment within the exporting and firm and why the Letter of Credit is chosen. These variables link to the Customer Risk, Country Risk and Bank Risk elements of the Environmental Risks in the Export Letter of Credit Business Risk Model. The variable were chosen with the aim to determine whether exporting firms utilise an enterprise risk management approach in their choice of methods of payment and what drives them to choose the Letter of Credit as their method of choice.

Objective 4 is to measure the association between the different types of Letter of Credit used and the risk they pose to the exporting firm. The variables chosen for this objective were the type of Letter of Credit, the payment maturity date of the transaction and the use Letter of Credit of confirmation. The reason for choosing these variables is because the type of Letter of Credit may indicate the use of specialised trade finance deals, such as a Red Clause Letter of Credit. The usage of this type of Letter of Credit would signal that the exporter's financial position may not be strong as they would need access to some finance prior to shipment, requiring a high degree of trust between buyer and seller. With this type of arrangement, it is likely that the buyer will hold the balance of power in the transaction. The payment period is another important variable because this is an indication of the exporting firm's ability to service its debtors and is also an indication of cash flow requirements. These are important considerations because documentary discrepancies weaken the payment claim and may result in payment delays, with negative consequences on cash flows. The use of confirmation of a Letter of Credit signals an unacceptable country risk/bank risk profile from the exporter's perspective. Where confirmation is silent this may indicate either a fragile relationship with the buyer or an exporter with a low risk appetite. These variables link to the Customer Risk, Country Risk and Bank Risk elements of the Environmental Risks in the Export Letter of Credit Business Risk Model.

Objective 5 is to determine the cost of documentary errors to the exporting firm via measuring the magnitude and frequency of such errors. The variables chosen for this objective include commonly used factors such as the types of error, the frequency of documentary rejection by banks, the corrective action taken by the exporting firm to remedy errors, the percentage of transactions where documents are accepted by buyers even where errors exist and the cost of correcting errors. Documentary discrepancies are a core consideration of Letter of Credit transactions, as non-compliant documentation may lead to a delay in payment, the need to offer an inducement to the buyer to accept the documents or, in a worse case situation, non-payment may be the outcome. Documentary errors are linked to Process Risks and its elements in the Export Letter of Credit Business Risk Model. In particular, documentary discrepancies are linked to Errors (mistakes on documents); Omission (failing to provide all of the data contents on documents); Delays (incorrect documentation may result in processes being delayed, e.g., customs clearance or cargo booking, with consequential delays in product movement); Hazards (inaccurate documentation may result in the consignment being compromised in a variety of ways, such as incorrect storage, or goods despatched to the incorrect place of delivery); Fraud (perpetrated by the foreign buyer or their bank in the Letter of Credit process); and Productivity Loss (due to errors requiring corrective action). Behavioural Risks are also linked to the variables of this objective, as Dysfunctional work places may be either a contributing factor to errors being made or errors may be caused by inadequate processes. Opportunity Cost is another linked factor, because of the requirement to undertake corrective action and whilst this is taking place, other tasks cannot be simultaneously performed.

Objective 6 is to estimate the level of bad debts for Letter of Credit business to ASEAN countries. The variables for this objective are the bad debts from export sales and the percentage of Letter of Credit bad debts caused by discrepant documents. These variables aim to estimate the financial magnitude of bad debts due to documentary errors to determine "the frequency or severity of a loss" (Gruenstein 1998, p. 83). These variables are linked to the Environmental Risks of the Export Letter of Credit Business Risk Model, in particular, Bank Risk and Customer Risk. This is because where the documents are non-compliant, the decision to accept or reject the documents and, therefore, payment rests with the buyer and the issuing bank.

Objective 7 is to determine the priority of attributes for export documentation employees. The variable chosen for this objective was the attributes required to prepare Letter of Credit documentation. Respondents were asked to rank each of the ten attributes in order of importance from the exporter’s point of view. This objective is linked to the Process Risks of the Export Letter of Credit Business Risk Model. In particular, attributes such as Knowledge of the UCP 500 and Understanding of the Letter of Credit process link to the elements Errors, Omissions, Delays and Productivity Loss. The existence of these elements may cause chaos and, therefore, these are linked to Behavioural Risks and Dysfunctional work places in Export Letter of Credit Business Risk Model.

Objective 8 is to determine the knowledge and skills level of employees that are associated with export documentation functions and Letter of Credit transactions. The variables chosen for this objective include commonly used factors, such as the number of export documentation employees, the percentage of these employees who had received specific Letter of Credit training and the number of years of experience with such transactions. This objective is linked to the Hazards, Errors, Omissions, Delays and Productivity Loss elements of the Process Risks in the Export Letter of Credit Business Risk Model, with a consequent link to the Dysfunctional work places element of the

Behavioural Risks. The aim is to measure the association between knowledge, skills and experience and discrepancy rates and bad debts in Letter of Credit business to ASEAN.

Objective 9 is to determine the nature of foreign exchange exposure and how this risk is managed by the exporting firm. The type of currency used and the use of forward exchange contracts are the variables used for this objective. Both variables indicate the risk appetite of the exporting firm, as well as its risk management strategy to mitigate foreign exchange fluctuations. Where the firm does not trade in Australian dollars, it has an obvious exchange exposure and a commonly used mitigation strategy is enter into a forward exchange contract with a bank, to neutralise future exchange rate movements. This objective is linked to the Country Risk, Bank Risk and Customer Risk elements of the Environmental Risks of the Export Letter of Credit Business Risk Model. The exchange rate fluctuations reflect the eco-political situation of a country and risk associated with it. Customer risk and bank risk may manifest themselves through payment delays because of an unfavourable movement in the exchange rate from the buyer's perspective. In the case of the Letter of Credit, this may be through spurious claims of discrepancies as a veil to delay payment. Such spurious claims are usually at the behest of the buyer, with support from their bank, and indicate at least a temporary shortage of available funds on behalf of the buyer.

Objective 10 is to determine the frequency of discounting proceeds, that is, the selling of documents under a Letter of Credit to a bank, typically the exporter's bank, to receive funds ahead of the original payment date. The variables chosen for this objective are the frequency of discounting proceeds and the reason for seeking such discounts. An exporting firm seeking to discount proceeds usually does so for cash flow considerations. The importance of this objective is that the ability to discount proceeds may be nullified by documentary discrepancies, as it would be unusual for a bank to agree to discount the proceeds against flawed documents, because these increase the risk of payment rejection by the Issuing Bank. Therefore, there is a link between the ability to discount and the presentation of compliant documents.

Having discussed the objectives the next step was to collect the data.

5.2 Data

Data were collected from three different populations: exporters, forwarders and banks, using three different instruments, as described below. A copy of each survey is provided in Appendix 3.

5.2.1 Exporter survey description

The exporter survey comprised four main sections. The purpose of Section 1 (questions 1 to 16) was to gather information about the attributes of the exporting firm and the scope of its business. The purpose of Section 2 (questions 17 to 26) was to gather information about the trading risk of the exporting organisation and the risk appetite of exporting firms based on their approach to financial exposure. The purpose of Section 3 (questions 27 to 55) was to gather information on the exporting firm's operations, product delivery, documentary risks, cost of remedying errors and financial losses related to Letter of Credit transactions. The purpose of Section 4 (questions 56 to 62) was to gather demographic information about the respondents.

5.2.2 Forwarder survey description

The forwarder survey comprised four main sections. The purpose of Section 1 (questions 1 to 17) was to gather information about the attributes of the forwarding firms and the scope of their business. The purpose of Section 2 (questions 18 to 22) was to gather information about the trading risk of their exporting clients based on their provision of specific trade facilitation services. The purpose of Section 3 (questions 23 to 37) was to gather information on the exporting client's operations, product delivery, documentary risks, cost of remedying errors and financial losses related to Letter of Credit transactions, based on the specific trade facilitation services provided by the forwarding firm. The purpose of Section 4 (questions 38 to 44) was to gather demographic information about the respondents.

5.2.3 Banker survey description

The banker survey comprised four main sections. The purpose of Section 1 (questions 1 to 17) was to gather information about the attributes of the bank and the scope of its business. The purpose of Section 2 (questions 18 to 27) was to gather information about the trading risk of the exporting client organisations and their risk appetites, based on their approach to financial exposure. The purpose of Section 3 (questions 28 to 51) was to gather information on the exporting client firm's operations, product delivery, documentary risks, cost of remedying errors and financial losses related to Letter of Credit transactions. The purpose of Section 4 (questions 52 to 58) was to gather demographic information about the respondents.

All surveys required prior ethics approval before distribution.

5.3 Data collection

The surveys were administered after obtaining approval from Victoria University Human Research Ethics Committee.

After ethics approval the exporter questionnaire was distributed to a pilot sample. No amendments were made to the survey as a result of feedback from the pilot sample. The pilot sample was excluded from the survey population. Pilot sampling was not pursued for the forwarders and bankers surveys because these populations were too small. It was estimated that the total Australian population of forwarders was approximately one hundred, and that about twenty banks were involved with export Letter of Credit business. Sampling of forwarders and banks was carried out for validation purposes and for supplementing the exporter survey results, by way of clarifying and providing explanations for the findings.

Respondents to the exporter, forwarder and bankers surveys were given the option of participating in a semi-structured interview. A copy of the interview questions used for each population is provided in Appendix 3.

Sampling for the survey was purposive because the mailing list was compiled from information available in the public domain. Due to the non-random nature of the sample no statistical tests were carried out and, therefore, the analysis is tabular.

A total of 3059 surveys was distributed nationally during October and November 2005, to exporting firms. A subsequent mail out, in January 2006, to 300 firms that had not yet responded, failed to attract additional participants. A total of 329 (10.8%) responses was received. However, only 132 responses (4.32 %) were usable. Demographic exporter data are not available in the public domain in sufficient detail. As far as can be determined from available data the sample is broadly representative of the total population in accordance with estimates from Austrades (Harcourt 2003). This is reinforced by the high proportion of 'unusable' responses that roughly correlates with the estimated usage of about 30% to 40% according to industry sources. From the responses, fifteen individuals from different exporting firms volunteered to be interviewed. The interviews were conducted during April and May 2007. Wherever possible, interviews were conducted at the exporter's premises, otherwise by telephone.

A total of 103 surveys was distributed nationally during April and May 2006 to forwarders. A total of 16 responses was received, of which only 10 (9.71%) were useable. As the purpose of the survey was to validate and clarify exporter responses, no further mail out was distributed. From these responses, three individuals from different forwarding organisation volunteered to be interviewed. The interviews were conducted during April and May 2007 and, at that stage, one of the volunteers decided to withdraw from the interview process. Wherever possible, interviews were conducted at the forwarder's premises, otherwise by telephone.

A total of 17 surveys was distributed nationally during October and November 2006 to banks. A total of 5 responses (29.41%) was received. As the purpose of the survey was to validate and clarify exporter responses, no further mail out was distributed. From these responses, two individuals from different banks volunteered to be interviewed. The interviews were conducted during April and May 2007 and, at that stage, one of the volunteers decided to withdraw from the interview process. Wherever possible, interviews were conducted at the bank's premises, otherwise by telephone.

Additional information was gathered, apart from existing literature, from the OECD, Transparency International and the World Bank and this was used to construct a ranking of ASEAN countries based on their risk profile. This was done to determine the level of Environmental Risk (Country Risk, Customer Risk and Bank Risk elements of the Export Letter of Credit Business Risk Model) to which the Australian exporters may be exposed in transacting with ASEAN nations. The sources of this information are considered further in the data discussion in Chapter 6. Information from the Australian Bureau of Statistics was used in the context of estimating exporter population.

Having described the methodology, Chapter 6 provides an analysis and discussion of the data.

6. Survey Data Discussion and Analysis

In this chapter the findings of the written survey administered to exporters, banks and service providers, as outlined in Chapter 5 are discussed, supplemented, as relevant, by information derived from personal interviews with volunteer participants. The discussion in this chapter is based on a qualitative, rather than a quantitative, approach.

The risk profile of each ASEAN country is first provided, followed by the business profile of the surveyed population, before considering particular aspects of Letter of Credit transactions. The focus of the discussion will include: why the Letter of Credit is chosen as the payment method: who makes this decision in the exporting firm: what are the terms of delivery (Incoterms 2000) that are chosen; what is the payment period; how are documents produced; what are the major sources of documentation production; what is the cost of rectifying documentary errors; what is the level of bad debts; and to what degree staff in the exporting firm are skilled in dealing with Letter of Credit business.

The data discussed in this section will be used to test the propositions detailed in Chapter 5.

6.1 The country risk profile of ASEAN nations

There are several country-categorisation indices used to classify countries according to their level of risk. It is generally accepted that the indices available from the OECD, World Bank and Transparency International are the most commonly referred to by exporting organisations to establish a macro view of country risk, with further investigation pursued as appropriate. Table 6.1 shows the relative ranking of ASEAN nations based on Transparency International’s Corruption Perception Index for the period 2004 – 2009. Data for Brunei, Cambodia and Laos are not available. Transparency International collects data based on various surveys. The response data are augmented with country information from public sources to arrive at the index. The index is a measure of the degree of corruption perceived to exist in a particular nation. An improvement to a nation’s corruption index score is not easily achieved, unless significant changes take place. A score of 10 indicates a highly clean country and a score of 0 indicates a highly corrupt country. It can be observed from Table 6.1, that there is very little variation in the index score for ASEAN nations over the period 2004 -

2009, with little fluctuation in the vast majority of cases. This index is likely to be a fair representation of the business environment that an exporting firm may face when engaged in international business transactions. As corruption is not a measure of focus of this thesis, alternative sources of country risk evaluations also need to be considered.

Table 6.1: Transparency International Corruption Perception Index 2004 - 2009

Country	Year									
	2004[1]		2005[2]		2006[3]		2007[4]		2008[5]	
	Rank	Index	*Rank*	Index	*Rank*	Index	*Rank*	Index	*Rank*	Index
Brunei	-	-	-	-	-	-	-	-	-	-
Cambodia	-	-	-	-	-	-	-	-	-	-
Indonesia	*137*	2.0	*140*	2.2	*134*	2.4	*144*	2.3	*130*	2.6
Laos	-	-	-	-	-	-	-	-	-	-
Malaysia	*39*	5	*39*	5.1	*44*	5	*43*	5.1	*51*	5.1
Myanmar	*143*	1.7	*156*	1.8	*162*	1.9	*179*	1.4	*179*	1.3
Philippines	*104*	2.6	*124*	2.5	*126*	2.5	*136*	2.5	*143*	2.3
Singapore	*5*	9.3	*5*	9.4	*5*	9.4	*4*	9.3	*4*	9.2
Thailand	*66*	3.6	*60*	3.8	*65*	3.6	*93*	3.3	*84*	3.5
Vietnam	*106*	2.6	*114*	2.6	*118*	2.6	*129*	2.6	*125*	2.7

[1] (Lambsdorff 2005, pp. 235-238)
[2] (Lambsdorff 2006, pp. 299-302)
[3] (Lambsdorff 2007, pp. 325-330)
[4] (Lambsdorff 2008, pp. 297-302)
[5] (Lambsdorff 2009, pp. 397-402)

The World Bank has developed an index that categorises countries by a number of ‘doing business’ criteria. Of relevance to the discussion in this chapter are the measures shown in Table 6.2. The rank represents the relative standing of a nation in relation to the others. Overall, the number of nations in this index totalled 180 at the end of 2008. There are no data available for Myanmar, although the reasons for this do not appear to have been provided. The limiting factor of these data is that, although the index was first devised in 2004, the ASEAN nations were not categorised until 2008, therefore, there is only one period of observations available. Nevertheless, these data are relevant in providing some measure of ‘trading across borders’, that is, how easy it is to engage in an international transaction, be it an export or an import one. The data in Table 6.2 are at a macro level, but they assist, nevertheless, in the overall assessment of a country’s risk.

Table 6.2: 2008 Doing Business Ranking (The World Bank 2009)

Country	Rank	Trading Across Borders	Enforcing Contracts
Brunei	94	47	160
Cambodia	139	124	139
Indonesia	129	40	142
Laos	165	168	111
Malaysia	21	31	60
Myanmar	-	-	-
Philippines	141	66	116
Singapore	1	1	16
Thailand	12	10	24
Vietnam	91	73	29

'Enforcing contracts' is another important aspect of international trade transactions. It can be observed that corruption alone is not a good indicator of risk. In Table 6.2, Thailand and Vietnam in the 'enforcing contracts' category appear to score well, but the same countries do not fare well at all according to the data shown in Table 6.1. Therefore, it is appropriate to consider another country risk index.

The Organisation for Economic Co-operation and Development has devised a specific country risk categorisation based on a confidential model, details of which are not published. This model measures the credit risk of a country, that is, "the likelihood that a country will service its external debt" (Organisation for Economic Co-operation and Development 2009). Countries are classified

> through the application of a methodology comprised of two basic components: (1) the Country Risk Assessment Model (CRAM), which produces a quantitative assessment of country credit risk, based on three groups of risk indicators (the payment experience of the Participants, the financial situation and the economic situation) and (2) the qualitative assessment of the Model results, considered country-by-country to integrate political risk and/or other risk factors not taken (fully) into account by the Model. The final classification, based only on valid country risk elements, is a consensus decision of the sub-Group of Country Risk Experts that involves the country risk experts of the participating Export Credit Agencies (Organisation for Economic Co-operation and Development 2009).

The country risk classification is based on the 1997 'Arrangement on Officially Supported Export Credits', also referred to as the 'Knaepen Package'. "The rules of the Knaepen Package came into force on 1 April 1999" (Trade Directorate Organisation for Economic Co-operation and Development 2004, p. 3). One of the essential elements of the Knaepen Package is the system for assessing and classifying country risk and this has been achieved with the use of a scale ranging from 0 (lowest risk) to 7 (highest risk).

Government export credit agencies, such as the Export Finance and Insurance Corporation (EFIC) in Australia, use the OECD country classification as part of their commercial activities, when offering trade finance facilitation products. “EFIC does not issue market gradings for individual countries” (Export Finance and Insurance Corporation 2009), rather, it refers to the OECD's country risk grades. EFIC offers a documentary credit guarantee, effectively substituting the credit risk of the issuing bank with that of EFIC. Given that EFIC is an official export credit agency, its credit guarantee, therefore, is quite sound. EFIC offers this guarantee facility where a local bank is unwilling to confirm a foreign Letter of Credit. Therefore, this establishes the relevance of the OECD country gradings to export Letter of Credit transactions.

The OECD classification for ASEAN countries between the period 2004 – 2009 is summarised at Table 6.3. It should be noted that for Cambodia, the risk classification is only available for the period 2007 – 2008.

Table 6.3: OECD Country Risk Classification 2004 – 2009 for ASEAN countries (Organisation for Economic Co-operation and Development 2009)

Country	**Year**				
	2004	2005	2006	2007	2008
	Index	**Index**	**Index**	**Index**	**Index**
Brunei	**2**	**2**	**2**	**2**	**2**
Cambodia	**n/a**	**n/a**	**n/a**	**7**	**6**
Indonesia	**6**	**5**	**5**	**5**	**5**
Laos	**7**	**7**	**7**	**7**	**7**
Malaysia	**2**	**2**	**2**	**2**	**2**
Myanmar	**7**	**7**	**7**	**7**	**7**
Philippines	**5**	**5**	**5**	**5**	**4**
Singapore	**0**	**0**	**0**	**0**	**0**
Thailand	**3**	**3**	**3**	**3**	**3**
Vietnam	**5**	**5**	**5**	**4**	**4**

Table 6.3 shows little movement in the classification gradings of ASEAN countries during the five-year period examined. Singapore provides the least amount of risk, constantly assessed at level 0. This is followed by Brunei and Malaysia on level 2 and Thailand on level 3. The Philippines and Vietnam were both on level 5 at the start of the

period, but show, respectively, a marginal improvement to level 4 in 2008 and 2007. Indonesia's risk assessment improved from level 6 in 2004 to level 5 in 2005, where it has remained since. Cambodia ranked at level 7 in 2007 and marginally improved to level 6 in 2008. Laos and Myanmar are assessed as the most risky countries within this group, with a consistent classification at level 7 for the whole of the period examined.

The data shown at Tables 6.1, 6.2 and 6.3 appear to portray a similar picture, when viewed in aggregate terms. A relative country risk ranking has been devised, based on these data and this is shown at Table 6.4. Singapore is the lowest risk country and Myanmar is the highest risk country. The categorisation of the ASEAN countries is important from a risk perspective, in the context of an exporter's financial exposure. In particular, it will be useful to determine whether there is an association between the level of country risk and the use of the Letter of Credit for exports to those countries and whether this is influenced by the size of the exporting firm.

Table 6.4: Relative country risk ranking of ASEAN nations

Country	Corruption (Transparency International)	Doing Business (World Bank)	Country Risk (OECD)	**Rank (1= Lower risk; 10 = Higher risk)**
Singapore	5	1	0	**1**
Malaysia	39	21	2	**2**
Brunei	n/a	94	2	**3**
Thailand	66	12	3	**4**
Vietnam	106	91	4	**5**
Philippines	104	141	4	**6**
Indonesia	137	129	5	**7**
Cambodia	n/a	139	6	**8**
Laos	n/a	165	7	**9**
Myanmar	143	n/a	7	**10**

The categorisation of the exporting firm's size is provided in the next section, together with industry clusters and destination of exports.

6.2 The size of the exporting firm, industry clusters, destination and value of exports

6.2.1 The size of the exporting firm

It appears as though there is no common world-wide standard for the categorisation of firms according to their size. Consequently, several measures are utilised by different countries when attempting to define the category of a firm according to its size.

In Australia, the Corporations Act 2001, at Section 45A, categorises the size of a proprietary company into either small or large. A small proprietary company is one that meets at least two of the following criteria in a financial year:

1. consolidated revenue of less than \$ 25 million;
2. value of gross assets less than \$ 12.5 million; and
3. fewer than 50 employees at the end of the financial year.

A large proprietary company is one that meets at least two of the following criteria in a financial year:

1. consolidated revenue of \$ 25 million or more;
2. value of consolidated gross assets of \$ 12.5 million or more; and
3. 50 or more employees at the end of the financial year.

The Corporations Act presents some limitations when attempting to use its methodology to classify firms according to size. A significant limitation of the Corporations Act categorisation is that proprietary limited companies do not have any reporting obligations and, therefore, it is difficult, if not altogether impossible, to determine relevant data, such as employee numbers, revenue and asset values. Additionally, the categorisation is too restrictive, as it only provides for two categories of company and has the potential to limit the data analysis. Consequently, the Corporations Act does not provide a suitable categorisation method for this research.

In New Zealand there does not appear to be a common administrative definition, with turnover used by some as a measure, whilst others use taxes on employee salaries and wages (Lindner 2005, p. 9).

In the USA, organisations are categorised according to a single criterion, that is, they are a small businesses if they have fewer than 500 employees (Organisation for Economic Co-operation and Development 2003). This measure is even more restrictive than the Australian Corporations Act categorisation. Furthermore, the USA approach is inappropriate to the structure of the Australian market which is dominated by organisations with fewer than 500 employees. Therefore, the USA categorisation is not appropriate to this research.

In the European Union (EU), the categorisation of firms, for legal and administrative purposes, follows the European Commission Recommendation 2003/61/EC. This categorisation defines firms according to the criteria shown in Table 6.5.

Table 6.5: European Union categorisation of firms (Lindner 2005, p. 9)

<table>
<tr><th>Enterprises</th><th>Employees</th><th>Annual Turnover</th><th>Annual Balance Sheet</th><th>Autonomous (controlling interest)</th></tr>
<tr><td>Micro enterprise</td><td>1 to 9</td><td><2 million Euro</td><td><2 million Euro</td><td rowspan="3">25% or more of the capital or voting rights of another enterprise</td></tr>
<tr><td>Small enterprise</td><td>10 to 49</td><td>< 10 million Euro</td><td>< 10 million Euro</td></tr>
<tr><td>Medium enterprise</td><td>50 to 249</td><td>< 50 million Euro</td><td>< 43 million Euro</td></tr>
<tr><td>Large enterprise</td><td>More than 250</td><td>> 50 million Euro</td><td>> 43 million Euro</td><td></td></tr>
</table>

According to Lindner (2005) the main criterion for categorisation of a firm’s size, for statistical purposes, is the number of persons employed and/or turnover, although variations of these measures are applied in the EU.

The categorisation of a firm’s size based on turnover and balance sheet requirements presents the same problems as the Australian Corporations Act categorisation approach. Balance sheet and turnover measurements as determinants of a firm’s size may not be particularly relevant to this research, because these *per se* are not good indicators of export activity. For example, on the one hand, there is a number of firms that are not active at all in the export markets, even though they represent significant domestic economic activity and, on the other hand, there is a number of small firms that are primarily focused on export markets with little domestic activity. Therefore, categorisation by employee numbers would appear to provide greater opportunities for segmentation. Indeed, this approach appears to have been used in research of exporting firms, by Austrade (Australian Trade Commission), as reported by Harcourt [21](2005). This author, in reporting about the changes in relative participation rates in export business by Australian firms, refers to “micro and small exporters” (Harcourt 2005, p. 16). Although this is Australian research, it can be observed that the categorisation used is not based on the Australian Corporations Act, rather it appears to be more aligned to the EU categorisation. Consequently, the EU categorisation of firms, based on employee numbers, is the approach chosen for the purposes of this research.

The survey data, shown in Table 6.6, indicate that approximately 64% percent of respondents are from the smaller organisations, with small enterprises alone accounting for nearly half of all respondents (42.15%). This seems to be consistent with data from the Australian Bureau of Statistics, indicating that in 2001-02, 209 exporting firms accounted for 69% of total exported goods (Harcourt 2003). This appears to be

> consistent with Austrade research which showed large businesses being major contributors to revenue, but with SMEs being the main growth sector of the exporter community (Harcourt 2003, p. 1).

This tends to suggest that the larger enterprises are already active in the export markets, consequently, growth in exporting firm numbers is more likely to come from the smaller firms, with niche products designed to meet the specific needs of foreign customer bases.

Table 6.6: Firm categorisation by number of employees (n = 121)

Enterprise size	Number	Percentage
Micro enterprise	27	22.31
Small enterprise	51	42.15
Medium enterprise	26	21.49
Large enterprise	17	14.05
Totals	121	100.00

(For detailed data relating to this table refer to Appendix 4 Table A6.6)

[21] Tim Harcourt is the Chief Economist of Austrade. Austrade is the Australian Government's trade and investment development agency that assist Australian businesses initiate, sustain and grow trade and outward investment; administers the Export Market Development Grants scheme; and provides advice to the Australian Government on its trade and investment development activities (http://www.austrade.gov.au/About-Austrade/default.aspx - viewed 24 August 2009)

Indeed, as shown in Table 6.7, the data show that the history of export activity is generally shorter for the smaller firms than that of the larger firms. In Table 6.7, firms have been classified as 'new exporters' where they have been active in ASEAN markets for less than ten years. This classification has been based on the Export Market Development Grants (EMDG), a scheme that "encourages small and medium sized Australian businesses to develop export markets" (Australian Trade Commission 2009), by providing financial assistance to cover defined eligible expenses. The EMDG covers a period of nine years., entitling recipients to lodge eight yearly claims (the first claim can span over a two-year period). The final claim is lodged in the ninth year, but is reimbursed the following year, leading to the ten-year period as the classification of a new exporter.

It can be observed from Table 6.7 that, in aggregate terms, there is an almost equal split between the number of new exporters (54.4%) and established exporters (45.6%), however, there is a much higher proportion of new entrants in the micro-firm category (20) than that in the established exporters category (6). The data appear to support the notion that new entrants are, indeed, more likely to be from the smaller firms. Additionally, these data appear to support the claim that small to medium enterprises are "the main growth sector of the exporter community" (Harcourt 2002, p. 1). The Australian Trade Commission has been on "a mission to double the number of exporters" (Harcourt 2002, p. 1) and perhaps a degree of their success is reflected by the comparatively higher new exporter micro firms shown in Table 6.7.

Table 6.7: Period of export activity (n=105)

Period of export activity by size of firm						
Period of export activity		Size				Total
		Micro	Small	Medium	Large	
New exporters (10 years or less)	Count	20	21	9	7	57
	% of Total	*19.30*	*20.20*	*8.60*	*6.80*	*54.40*
Established exporters (more than 10 years)	Count	6	20	14	8	48
	% of Total	*5.50*	*18.80*	*13.30*	*7.50*	*45.60*
	Total count	26	41	23	15	105
	%	*24.80*	*39.00*	*21.90*	*14.30*	*100.00*

(For detailed data relating to this table refer to Appendix 4 Table A6.7)

6.2.2 Industry clusters

There is a number of different industries active in the ASEAN exports markets, however, these are not easily categorised using the Australian Standardised Industrial Trade Classification index, because this index would produce too many categories with low numbers of responses and, consequently, make any analysis difficult, if not altogether meaningless. Therefore, for the purposes of this thesis, the industry clusters, shown at Table 6.8, are used.

Table 6.8: Cluster of industries exporting to ASEAN
(For detailed data relating to this table refer to Appendix 4 Table a6.8)

Number	Industry Clusters
1	Food and Equipment
2	Health and Equipment/Allied Chemicals
3	Building and Related Products
4	Machinery/Automotive/Steel/Metals
5	Forestry/Mining/Drilling and Equipment
6	Other

The composition of each cluster, by size of the exporting firm, is shown at Table 6.9, where the dominance of the smaller size firms can be observed. Micro firms (21.1%) and small firms (39.8%) represent just over 60% of the total firms. The distribution of the firms across the different industry clusters appears to be evenly distributed by size, with the exception of one observation, 13 small firms in cluster 4 (Machinery/Automotive/Steel/Metals), which represents almost a quarter of the research sample and, apart from 'others', this is the largest cluster. This can probably be explained by the activity in some ASEAN nations, such as Thailand, where there are reasonably good export prospects, particularly in the automotive sector. The next highest exporting cluster is number 2 (Health and Equipment/Allied Chemicals) at the aggregate level, representing 17.1% of the research sample. Australia enjoys a good international reputation in the scientific world and it is probably not surprising to see some activity in this cluster. What is interesting to note is that two thirds of the organisations in this cluster are micro and small exporting firms, perhaps providing support to the claim made earlier that these organisations are more than likely niche suppliers to foreign markets.

Table 6.9: Size of exporting firms to ASEAN, by industry cluster

Cluster		Size				Total
		Micro	Small	Medium	Large	
1	Count	4	3	3	2	12
	% of Total	*3.30*	*2.40*	*2.40*	*1.60*	*9.80*
2	Count	7	7	4	3	21
	% of Total	*5.70*	*5.70*	*3.30*	*2.40*	*17.10*
3	Count	0	5	4	2	11
	% of Total	*0.00*	*4.10*	*3.30*	*1.60*	*8.90*
4	Count	7	13	6	5	31
	% of Total	*5.70*	*10.60*	*4.90*	*4.10*	*25.20*
5	Count	3	4	5	2	14
	% of Total	*2.40*	*3.30*	*4.10*	*1.60*	*11.40*
6	Count	5	17	4	8	34
	% of Total	*4.10*	*13.80*	*3.30*	*6.50*	*27.60*
Total	Count	26	49	26	22	123
	% of Total	*21.10*	*39.80*	*21.10*	*17.90*	*100.00*

6.2.3 Destination of exports

The ASEAN countries to which the above enterprises export are shown in Table 6.10.

Table 6.10: Export to ASEAN countries (n= 109)

(A total of 426 responses were received from 109 respondents.)

Country	Number of responses	Percentage
Brunei	11	2.58
Cambodia	4	0.94
Indonesia	69	16.20
Laos	4	0.94
Malaysia	76	17.84
Myanmar	9	2.11
Philippines	62	14.55
Singapore	78	18.32
Thailand	74	17.37
Vietnam	39	9.15
Total	426	100.00

(For detailed data relating to this table refer to Appendix 4 Table A6.10)

The data in Table 6.10 show export activity with all ASEAN countries, however, for some countries, such as Myanmar, Cambodia and Laos, export activities appear to be comparatively quite low.

From the data in Table 6.10, it is possible to construct a general risk exposure of exporting firms to ASEAN, based on the OECD country risk groupings, as shown in Table 6.11. It can be observed that by using the OECD country risk classification it may be possible to aggregate the relative country risks exposure into three major risk groups: low, medium and high. As Table 6.11 shows, just over a third of organisations (38.73%) trade with countries in the low risk category; more than half (57.27%) trade with medium risk countries; and only a few trade with high risk countries (3.99%).

Table 6.11: Australian exports to ASEAN credit risk categorisation

<table>
<tr><th>Country</th><th>Percentage</th><th>OECD Country Risk level</th><th>Total %</th><th>Low Risk %</th><th>Medium Risk %</th><th>High Risk %</th></tr>
<tr><td>Singapore</td><td>18.32</td><td>0</td><td>18.32</td><td rowspan="3">38.74</td><td rowspan="3"></td><td rowspan="3"></td></tr>
<tr><td>Brunei</td><td>2.58</td><td>2</td><td rowspan="2">20.42</td></tr>
<tr><td>Malaysia</td><td>17.84</td><td>2</td></tr>
<tr><td>Thailand</td><td>17.37</td><td>3</td><td>17.37</td><td rowspan="4"></td><td rowspan="4">57.27</td><td rowspan="4"></td></tr>
<tr><td>Philippines</td><td>14.55</td><td>4</td><td rowspan="2">23.70</td></tr>
<tr><td>Vietnam</td><td>9.15</td><td>4</td></tr>
<tr><td>Indonesia</td><td>16.20</td><td>5</td><td>16.20</td></tr>
<tr><td>Cambodia</td><td>0.94</td><td>6</td><td>0.94</td><td rowspan="3" colspan="2"></td><td rowspan="3">3.99</td></tr>
<tr><td>Laos</td><td>0.94</td><td>7</td><td rowspan="2">3.05</td></tr>
<tr><td>Myanmar</td><td>2.11</td><td>7</td></tr>
</table>

Therefore, Table 6.11 shows that nearly two thirds (61.26%) of exporting firms trade with ASEAN countries that are at the medium to high risk of the country risk spectrum. The low value for Brunei can be partly explained by the small size of its population. For other countries, factors contributing to a higher risk rating may include political factors, resulting in poor governance systems and/or the small size of the economy, with mainly subsistence levels of activities. To establish the significance of the country risk factor, in the context of risk magnitude, it is necessary to consider the value of export sales to each of the ASEAN countries and the methods used to ensure payment from ASEAN buyers.

6.2.4 Value of exports to ASEAN countries

As shown in Table 6.12, the value of exports to ASEAN countries is only available in categories and not absolute numbers. Nevertheless, these data provide an indication of the magnitude of trade that is conducted by the respondents across the ASEAN countries and the relative risk this may carry.

Table 6.12: Export sales values to ASEAN countries

Country	Export sales value (AUD equivalent)			Total	Risk category
	$ 1 - 5 M	$ 6 – 10 M	Above $ 10M		
Singapore	8	0	1	9	Low
Brunei	17	6	8	31	
Malaysia	4	0	1	5	
Thailand	5	0	1	6	Medium
Philippines	6	2	0	8	
Vietnam	8	2	2	12	
Indonesia	7	0	1	8	
Cambodia	22	5	7	34	High
Laos	21	5	8	34	
Myanmar	19	5	5	29	
Totals	117	25	34	176	

(For detailed data relating to this table refer to Appendix 4 Table A6.12a)

It can be observed from Table 6.12 that the majority of trade, by value, with ASEAN appears to be conducted by transactions that fall within the $ 1 to $ 5 Million (AUD equivalent) category and that, additionally, the majority of export transactions are with the higher risk ASEAN countries. There may be several explanations for these circumstances. One explanation may be that the methodology adopted for country risk assessment by agencies, such as the OECD, may not specifically reflect the trading conditions of the respondents, however, the data do not tend to support this. A different explanation could be that some of the trade is conducted through affiliated, or subsidiary, companies that Australian exporting firms may have established in the ASEAN countries with which they are dealing, effectively making these transfer transactions, rather than open market sales. The research data do not seem to support this notion, because the size profile of the Australian exporting community is largely composed of small to medium firms, with limited opportunities to set up offshore businesses. However, the situation is different for the large corporations that have indeed set up businesses in ASEAN countries, such as Singapore, Malaysia and Thailand. Another explanation is that long established relationships may exist between the exporting firms and the ASEAN customers. As one interviewee stated:

> *Typically our export customers repeat business month after month, so we know each other.*

Yet another, and perhaps more plausible, explanation may be that Australian exporting organisations are prepared to venture into export markets that may appear to be risky, but the exporting firms manage their risk through secure payment methods, such as prepayment or a Letter of Credit. As other interviewees stated:

> *… we are not desperate at all to do business with them [the foreign firms] … so we sort of stand firm on our terms and we just send them a model of letter of credit and that is how we will do it.*

and

> *… in securing payment we are ready to ask for advance payment or otherwise letter of credit – we do not offer other terms.*

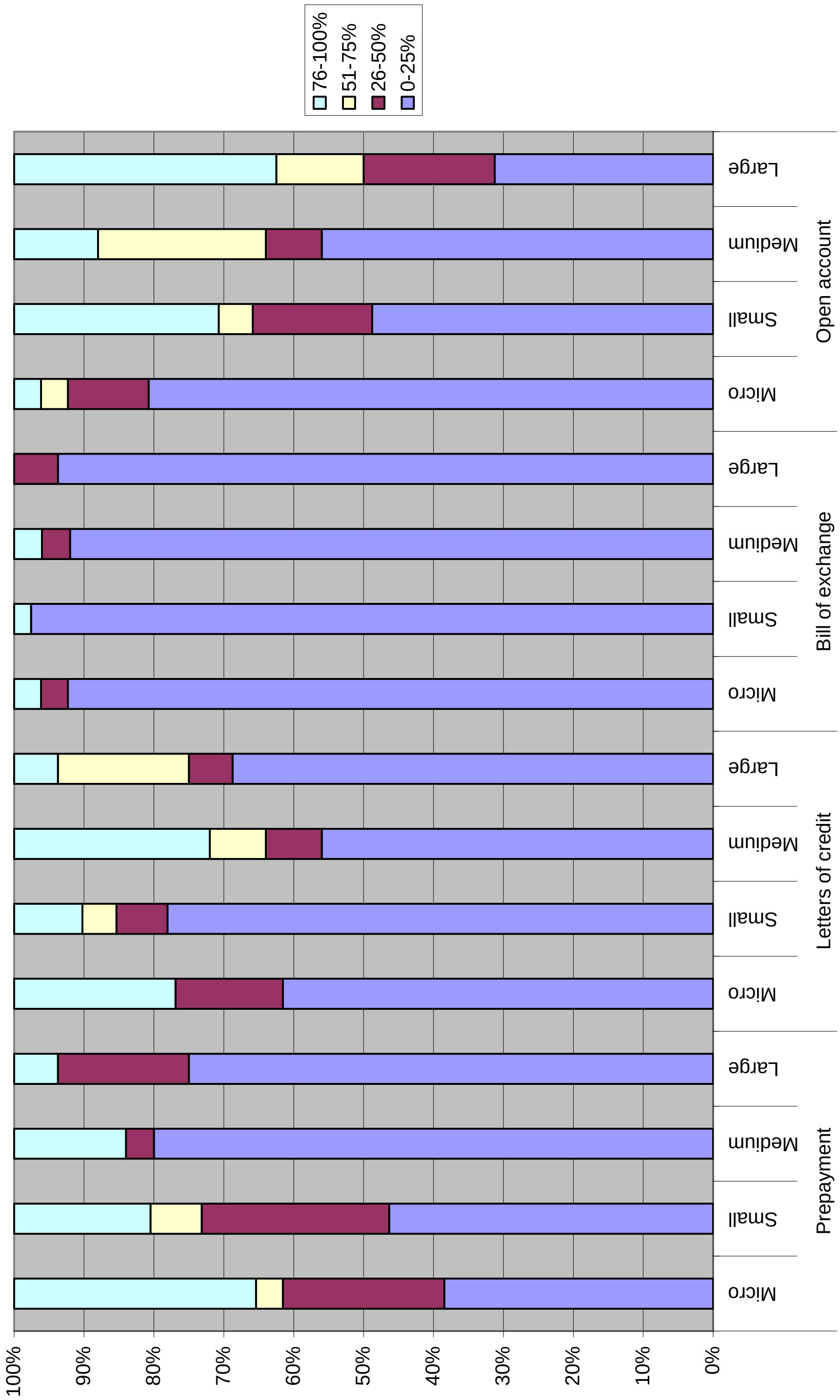
The mix of payment methods used by the respondents is discussed in the next section.

6.3 Methods of payment used for exports to ASEAN

The four traditional methods of payment: Prepayment, Letter of Credit, Bill of Exchange and Open Account, as expected, are all used to varying degrees by the respondents. Figure 6.1 shows the use of the different methods of payment by the size of the exporting firm. The methods of payment are shown from left to right in increasing order of security.

It can be observed that micro firms are the biggest users of prepayment, when judged by the percentage of use. Micro firms use prepayment in just under 40% of transactions. This high usage in not unexpected, as it is likely that these firms have comparatively less capital reserves and less ability to raise funds for working capital, therefore, advance payments assist with cash flow aspects of the business. Additionally, if the exporting firm is producing custom-made goods, advance payment leaves no doubt about the purchasing intentions of the buyer and, consequently, payment risk is greatly reduced, if not altogether eliminated. Respectively, small, medium and large firms appear to use prepayment less often than micro firms.

Figure 6.1: Exports to ASEAN by method of payment and firm size



(For detailed data relating to this table refer to Appendix 4 Figure A6.1)

Micro firms are also the second largest users of the Letter of Credit. In approximately 23% of cases these firms use the Letter of Credit as a debt settlement option in more than 75% of the times.

The medium size firm appears as the largest users of Letter of Credit, where approximately 28% of these firms use this method of payment at a rate greater than 75%. Approximately 10% and 6% of small and large firms, respectively, use the Letter of Credit at a rate greater than 75%.

Interestingly, the rate of usage for the Bill of Exchange, as shown in Figure 6.1, is quite low, regardless of firm size. This reflects the relatively poor payment security afforded by this method of payment, that, although requiring the involvement of the banks to obtain payment, the process nevertheless carries no guarantee (conditional or otherwise) from the banks.

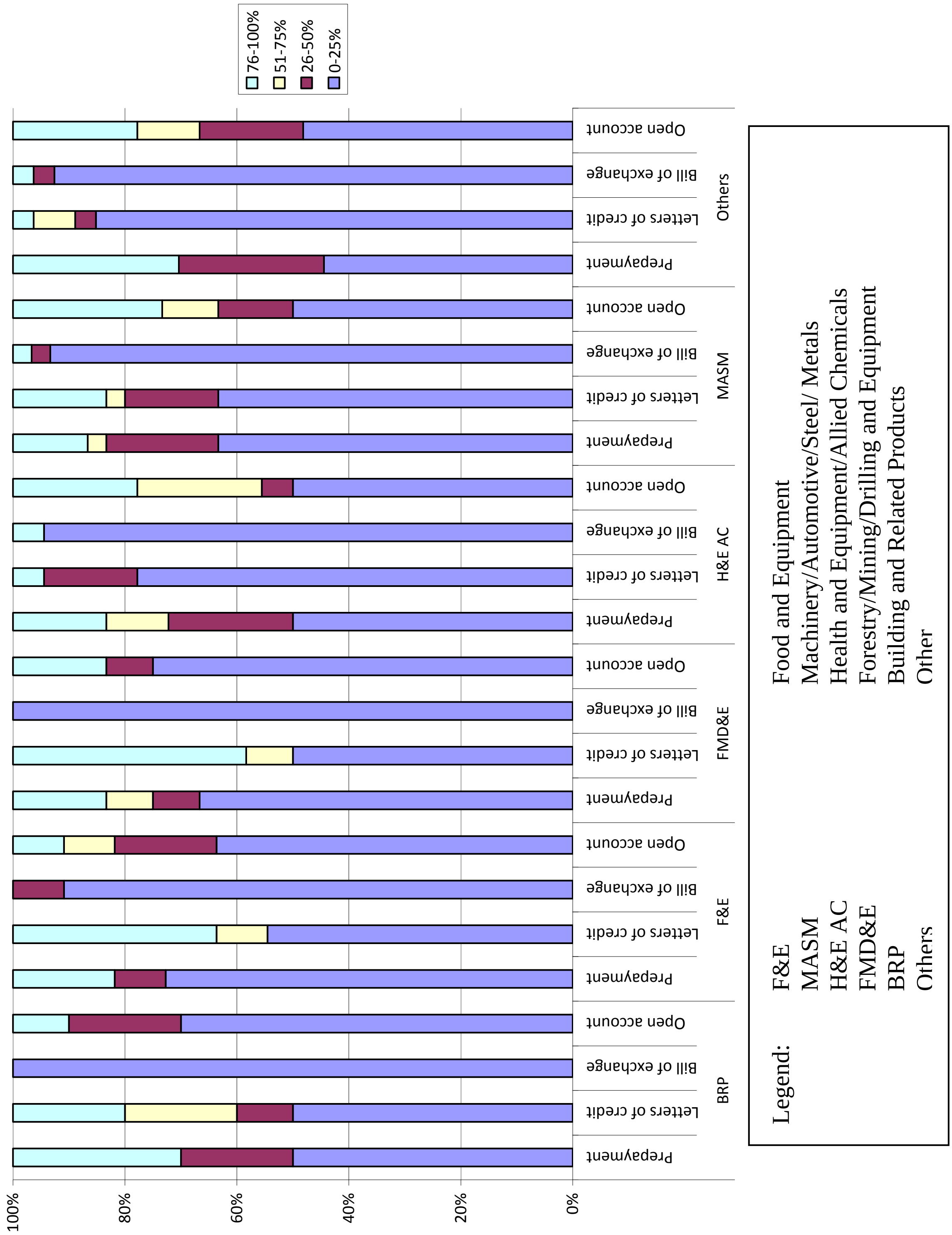
In relation to the Open Account option, not unexpectedly, micro firms are the smallest users. Approximately 80% of micro firms use this at a rate of 25%, or less. Conversely, large firms appear to use this method of payment much more readily, with approximately 38% at a rate greater then 75% and only approximately 30% utilising this at a rate of 25%, or less. There may be a number for explanations for the differences in the choice of methods of payment, including the relative country risk, as discussed earlier, the monetary value of the transaction, the years of activity as an exporter and associations between the traders, such as, for example, subsidiary, or affiliated company transactions.

When examining the links between the size of the exporting firm, the length of export activity (in years) and the method of payment used for exports to ASEAN, no discernible patterns were found (for detailed data refer to Appendix 4, Table A6.12a).

In relation to industry clusters the data, in Figure 6.2, show some variation on the use of the Letter of Credit as the method of payment. The Forestry/Mining/Drilling and Equipment cluster appears to make the highest use of the Letter of Credit, with approximately 41% using this at a rate greater than 75%. This is closely followed by the Food & Equipment cluster with approximately 37% using the Letter of Credit at a rate greater than 75%. Letter of Credit usage rates are at a rate greater than 75% for 20% of the Building and Related Products cluster, approximately 17% for the

Machinery/Automotive/Steel/ Metals cluster and approximately 10% for the Health and Equipment/Allied Chemicals cluster.

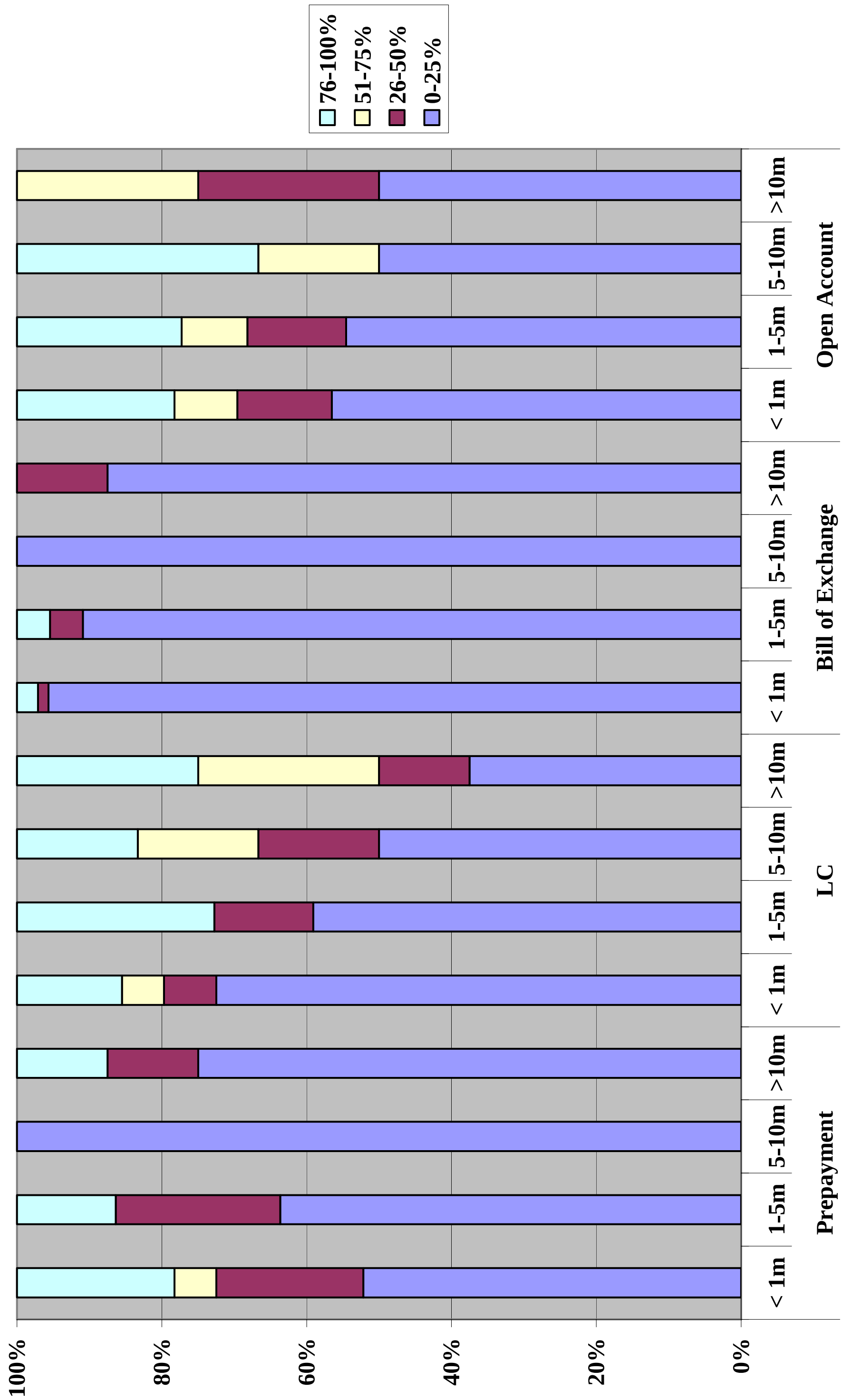
Figure 6.2: Exports to ASEAN by method of payment and industry cluster



(For detailed data relating to this table refer to Appendix 4 Figure A6.2)

In general terms, the data show that the Letter of Credit is more likely to be utilised as the level of export sales grows, as shown in Figure 6.3.

Figure 6.3: Methods of payment usage by total export sales



(For detailed data relating to this table refer to Appendix 4 Figure A6.3)

It can be observed from Figure 6.3 that as the total export sales increase, so too does the usage to the Letter of Credit. The precise reason for this phenomenon is not known, but it may be due to several factors, including an increase in transactional value resulting in a greater payment risk exposure or a desire to achieve greater certainty over payment times, therefore, better cash flow predictability.

6.4 Estimating the value of Letter of Credit business to ASEAN

A source of data for Letter of Credit values does not appear to be available from sources in the public domain. The Australian Bureau of Statistics does not collect this information. Enquiries to various organisations, including the Australian Bankers Association, the Reserve Bank of Australia and SWIFT did not yield any information. Although these data are bound to be available, at a firm level, the reluctance to divulge same means that the task of quantifying the value of Letter of Credit business is not easily achieved. This task was not envisaged in the original research, however, an estimation of Letter of Credit value is worthwhile to contextualise the potential magnitude of risk and, furthermore, this information may prove useful for future research.

Estimates of Letter of Credit business for ASEAN were obtained informally by two bankers, who, under caveat of utmost confidentiality, estimated that between 30% and 40% of export transactions used this method of payment. Additional data are available from responses to the survey administered to banks. The number of banks engaged in international trade finance in Australia is less than twenty and, therefore, quite small. Market share estimates for these banks, as at 2006, were obtained from a confidential banking industry source and this is shown at Table 6.13. Although only five responses were obtained from the survey, these represent approximately 40% of market share. This is total market share in trade finance and not just in ASEAN, but given that these responses account for about 40% of the total market they are considered representative of the total banking market for trade finance in Australia. The survey responses also estimate Letter of Credit business to be approximately 40%.

Based on the above figures, it may be possible to estimate the total value of Letter of Credit business to ASEAN for manufactured exports. “In 2008, Australia’s exports to ASEAN rose 24.8 per cent to $31.5 billion” (Market Information and Research Section

2009, p. 7), with manufacturing exports accounting for 25.2% of this figure, or approximately AUD 8.85 billion. Letter of Credit business has been estimated to be at an approximate rate of 40%, therefore, the total value of business subject to this method of payment is estimated to be about AUD 3.54 billion, and this is considered to be a significant figure in the context of this research.

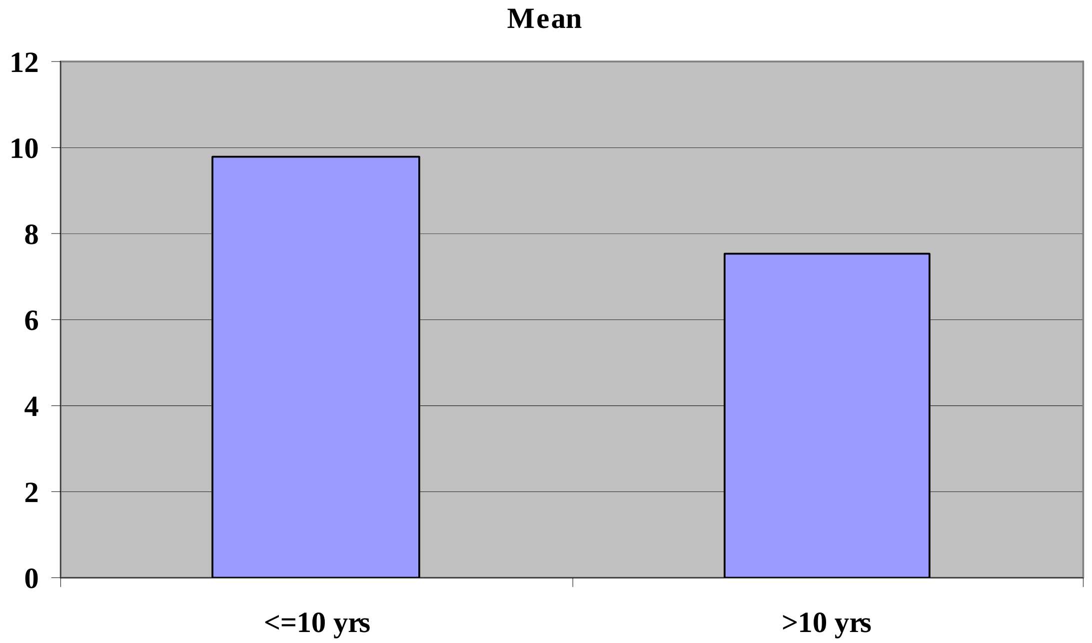
Table 6.13: Market share of banks dealing in international trade finance (2006)

Bank	Market share (%)
ANZ	21
NAB	17
Westpac	14
HSBC	10
Citigroup	7
CBA	6
ABN Amro	6
Bank West	4
BNP Paribas	3
Bank of Queensland	2
Bank of America	2
St George	2
Arab Bank	2
Suncorp Metway	1
Other	4

The value of Letter of Credit business is estimated to be approximately AUD 8 million per transaction. However, this estimation should be accepted with caution, because of the high standard error resulting from the method by which it was derived. For detailed data relating to this table refer to Appendix 4 Table A6.13a.

The years of export activity seem to have an influence on the Letter of Credit value, with new exporters (less than 10 years of activity) having a higher mean value, as shown in Figure 6.4. These data suggest that new exporters are more likely to use the Letter of Credit as a means of securing payment while establishing long-term relationships. Over time, as the exporters become more established in ASEAN markets, form longer-term relationships and acquire trading history with foreign buyers, the requirement for payment security may become more relaxed, commensurate with the increased level of trust developed through the longer-term relationship. It is generally accepted that this type of progression occurs naturally among traders and, therefore, the lower mean value for established exporters (> 10 years of activity), as shown in Figure 6.4 is consistent with this notion.

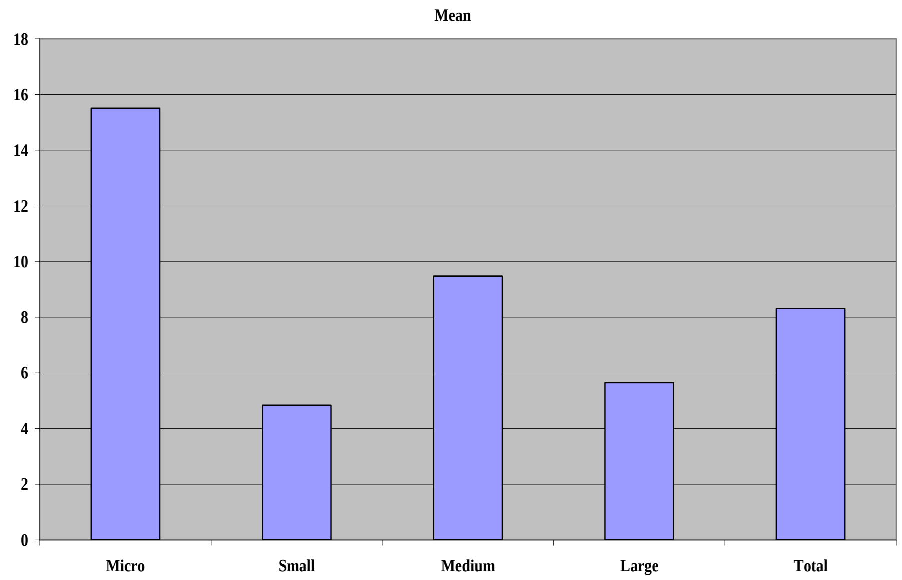
Figure 6.4: Mean Letter of Credit value



(For detailed data relating to this table refer to Appendix 4 Figure A6.4)

In terms of the mean Letter of Credit value by firm size, as shown in Figure 6.5, it can be noticed that micro enterprises appear to have a higher mean value.

Figure 6.5: Mean Letter of credit value by firm size

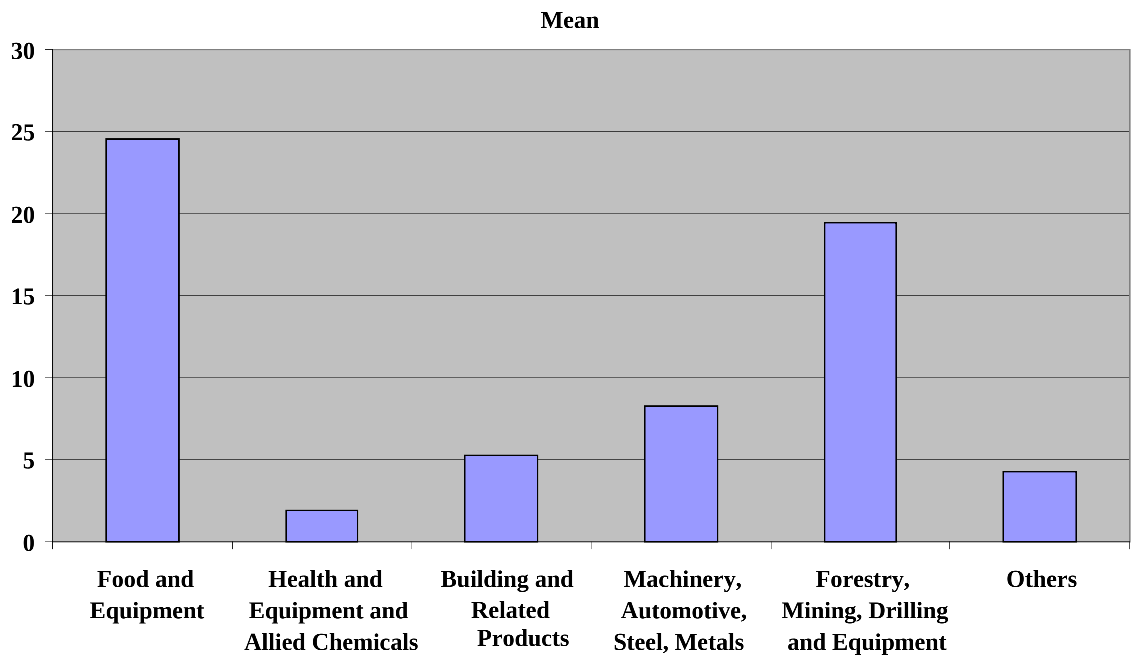


(For detailed data relating to this table refer to Appendix 4 Figure A6.5)

This tends to suggest that the micro firm is supplying niche foreign markets with highly specialised products of a relatively high value and, quite possibly, these products would be custom-made to individual requirements. Therefore, the micro firm's profile would be one of few but highly skilled and specialised employees. This assertion is supported by the data shown in Table 6.7 that clearly indicate that the highest proportion of new exporters falls in the micro-firm category.

In relation to industry clusters, it can be observed from Figure 6.6 that 'Food and Equipment' and 'Forestry, Mining, Drilling and Equipment' have a high Letter of Credit average value mean. The data suggest that these two clusters are the most active in terms of value of business transacted using Letters of Credit. This appears to be supported by the data in Figure 6.2 that show Letter of Credit usage at a rate greater than 50% in approximately half of the cases.

Figure 6.6: Letter of Credit mean by sector



(For detailed data relating to this table refer to Appendix 4 Figure A6.6)

Having considered, in the context of survey responses, elements of country risk and Letter of Credit transaction magnitude and usage, the next section focuses on the method by which Australian manufacturing exporters assess country and customer risk;

the factors that contribute to the choice of Letter of Credit as the payment method; the types of Letter of Credit used; and the currency used in these export transactions and the mechanism employed to manage the firm's foreign exchange exposure.

6.5 Internal assessment of country and customer risk, reason to trade by Letter of Credit and foreign exchange risk management

In deciding to enter an export market, a firm needs to undertake its own internal country risk and customer risk assessment, in the context of its risk appetite. This is because whilst public country ranking, as discussed earlier, may be useful at the macro level, such rankings are not useful at the micro level in capturing differences between industry sectors or clusters or assessing individual importers. The internal assessment of country and customer risk will enable the exporting organisation to decide whether to trade or not and whether the payment method should be by Letter of Credit or some other means.

6.5.1 Internal country risk and customer risk assessment

The various methods used by exporting firms to assess country and customer risk are summarised at Table 6.14.

Table 6.14: Internal methods used by the exporting firm to assess country and customer risk

Method	**Responses**	
	Number	Percent
Checklist	12	9.6%
Delphi Technique	0	0.0%
Quantitative	7	5.6%
Inspection visits	21	16.8%
Combination	40	32.0%
Austrade services	45	36.0%
Total	125	100.0%

(For detailed data relating to this table refer to Appendix 4 Table A6.14)

It can be noted from Table 6.14 that the checklist technique is only used in 9.6% percent of cases and the quantitative technique in only 5.6% of cases. It is interesting to note that the Delphi technique is not used at all. The reason for this is not known, but a possible explanation for this could be that the Austrade services are regarded as a substitute for the Delphi technique. This is because of the role and presence of Austrade and its Trade Commissioners in providing advice on local market conditions and possible importer contacts. Whilst the exporting firm may not be in a position to use the Delphi technique for commercial-in-confidence reasons, Austrade, in a neutral role is able to communicate freely with external parties and its collective knowledge can be disseminated and used by individual exporting firms privately to gain information about particular markets and market segments. Indeed, Austrade Services is the method most relied on by 36% of respondents. This is closely followed by the use of a combination of methods (32%). Inspection visits are used only by 16.8% of respondents. The comparatively high cost factor of choosing this method of assessment may explain its overall low usage rate. Interestingly, though, the data show a comparatively high inspection visit usage by the small firm, as shown in Table 6.15. However, there is no noticeable usage difference across the various industry clusters.

Table 6.15: Inspection visits by firm size and industry cluster

Industry Clusters		**Size**				**Total**
		Micro	Small	Medium	Large	
Food and Equipment	Count	0	1	1	0	2
	% of Total	.0%	5.0%	5.0%	.0%	10.0%
Health and equipment and allied chemicals	Count	1	2	0	1	4
	% of Total	5.0%	10.0%	.0%	5.0%	20.0%
Building and related products	Count	0	1	0	0	1
	% of Total	.0%	5.0%	.0%	.0%	5.0%
Machinery, Automotive, steel, metals	Count	3	2	1	0	6
	% of Total	15.0%	10.0%	5.0%	.0%	30.0%
Forestry, mining, drilling and equipment	Count	1	1	1	1	4
	% of Total	5.0%	5.0%	5.0%	5.0%	20.0%
Others	Count	0	3	0	0	3
	% of Total	.0%	15.0%	.0%	.0%	15.0%
Total	Count	5	10	3	2	20
	% of Total	25.0%	50.0%	15.0%	10.0%	100.0%

(For detailed data relating to this table refer to Appendix 4 Table A6.15)

The precise reason for the comparatively higher usage of industry visits to assess country risk/customer risk is not known. One explanation for this may be the export of custom-made products, where an inspection visit may be more desirable for the exporter, so they know the conditions under which the product needs to operate. However, because of the small number of responses, conclusions on this issue may not be reliable. The reason for choosing the Letter of Credit as the method of payment is summarised under Table 6.16. It can be noted that this is a multiple response question and, therefore, the total exceeds 100%.

Table 6.16: Reason for choosing Letter of Credit payment terms

Reason for choosing Letter of Credit payment	**Responses**		**Percent of Cases**
	N	Percent	
Importing country regulations	6	6.1%	8.8%
Unacceptable country risk	19	19.4%	27.9%
Unacceptable customer risk	54	55.1%	79.4%
Value of export sale	19	19.4%	27.9%
Total	98	100.0%	144.1%

(For detailed data relating to this table refer to Appendix 4 Table A6.16)

It is can be clearly observed form the above Table that the Letter of Credit is the instrument of choice used by exporters to mitigate foreign customer payment risk. As one interviewee in a medium size exporting firm explains

> *We have always preferred letter of credit because we are more likely to get our money than in any other way other than having paid up front before orders.*

Another medium size exporting firm interviewee advises that

> *In Asia we deal exclusively with letters of credit. We would not choose to sell any other way other than a letter of credit. We have some that are at sight and some which will be terms.*

An interviewee with a large size exporting firm explains the trading terms as

> *The arrangements we have going is the letter of credit. We have a couple of categories we work with there. We obviously have open [account] terms with some customers, but they have to be quite large and large corporations that would typically support that, or a long untarnished payment history and also be in a stable political country.*

An interviewee with a small size exporting firm explains that

In the last three years we have adopted the policy of any new client only really getting two choice of payment – either T/T [Telegraphic Transfer] prior to shipment or letter of credit payable at sight.

The decision to use the Letter of Credit does not appear to be affected by either the size of the firm or industry cluster. This is significant because it indicates that customer risk is a universally important consideration for exporters, regardless of the environment in which they operate. Some firms have developed thresholds to manage foreign customer payment risk. For example, an interviewee in a small exporting firm explains that

For transactions under US dollars 30,000, it has to be cash up front. Transactions above US dollars 30,000 will do letters of credit as long as obviously the customer can – has the ability to do that, and the letters of credit terms are at sight

The use the Letter of Credit in non-mandatory situations, that is, where it is not stipulated by the importing country, may be decided by a number of individuals within an organisation. The responses are summarised at Table 6.17.

Table 6.17: Who decides to use Letter of Credit payment terms

Decision makers	Frequency	Percent
Sales	16	19.3%
Marketing	1	1.2%
Finance	18	21.7%
Combination	32	38.6%
Other	16	19.3%
Total	83	100.0%

(For detailed data relating to this table refer to Appendix 4 Table A6.17)

The most commonly used method of choosing to trade on Letter of Credit terms, according to 38.6% of respondents, is through a combined decision making process. This approach is consistent with the principles of Enterprise Risk Management (ERM), that support decision making across the organisation, rather than operating in ‘silos’. However, not surprisingly, there is also a significant proportion of decision making that occurs in both the sales (19.3%) and the finance (21.7%) areas and this does not suggest that an ERM approach is followed in these firms.

Mercantile/credit agencies are not widely used by the participants, as can be observed from the summary data in Table 6.18.

Table 6.18: Usage of mercantile/credit agencies

Use of agency	Frequency	Percent
Yes	17	17.2%
No	82	82.8%
Total	99	100.0%

(For detailed data relating to this table refer to Appendix 4 Table A6.18)

Micro firms do not make use of mercantile/credit agencies for country risk/customer risk assessment. Small firms make only marginal use of these organisations in all categories (except in the machinery, automotive, steel, metals category, where there is no usage at all). The medium-sized firm uses mercantile/credit agencies at a slightly higher rate than small firms in the forestry, mining, drilling and equipment category and marginally higher again in the building and related products category. None of the large firms in the food and equipment and building and related product categories use mercantile/credit agencies but there is marginal use of these organisations in the other categories, with the machinery, automotive, steel, metals category recording the highest usage. The data suggest that very few of the respondent exporters utilise the services of mercantile/credit agencies as part of their risk assessment processes. This may be explained by the fact that, if the exporting firm is using prepayment, there is no credit risk once funds have been received by the exporter prior to shipment. In the case of the Letter of Credit, the conditional guarantee of payment is given by the issuing bank, consequently, the services of a mercantile/credit agency are probably not warranted, because the exporter could easily establish the bona fides of the foreign bank by making enquiries through their own bank.

Export credit agencies, as another risk mitigation tool, are used by exporters but not at high rates. Whilst mercantile/credit agencies are typically used to gain information about a prospective client's credit worthiness, the role of export credit agencies is to provide payment insurance against sovereign and customer default. A summary of responses to the usage of export credit insurance is provided at Table 6.19. There is evidence from the data that export credit insurance is used across all industry clusters, with the small and medium enterprises being the largest users. However, the usage rate is only 20.2% in aggregate terms. Because of the small number of responses, conclusions on this issue may not be reliable. One possible explanation for this low usage rate may be how export credit insurance is underwritten.

Table 6.19: Usage of export credit insurance agency

Responses	Frequency	Percent
Yes	20	20.2
No	79	79.8
Total	99	100.0

(For detailed data relating to this table refer to Appendix 4 Table A6.19)

The export credit insurer must approve all countries and individual customers with whom the exporter wants to trade. A fee is charged for this service, usually as a percentage of the contract value. Export credit insurance does not cover one hundred percent of a bad debt, as usually claims are settled on the basis of eighty to ninety percent of the loss, in accordance with the policy. Export credit insurance is at comparatively higher premiums than cargo insurance. According to industry sources in Australia, cargo insurance premiums are generally between 0.25% and 0.3% of the value of the goods insured, and export credit insurance premiums are about 1% for very large clients but are usually at 2% of the export sales value for most organisations, and certainly this rate would apply to the small to medium enterprises. Thus the exporter may not perceive export credit insurance as good value for money. Another explanation for the low export credit insurance usage may be due to the use of the Letter of Credit as the payment method. As shown in Table 6.16, the predominant reason for choosing Letter of Credit terms is unacceptable customer risk. Given that the Letter of Credit already provides a conditional guarantee of payment, notwithstanding foreign country and bank risk, the exporter may perceive the payment undertaking by the foreign bank as an acceptable risk and, therefore, not seek to use export credit insurance.

Exporters also have the opportunity of gaining increased payment security by having the Letter of Credit confirmed by either a third bank or, preferably, their bank. This procedure shifts the bank risk from the Issuing Bank (importer’s bank) to the Confirming Bank and mitigates country and Issuing Bank risk. There are fees associated with confirmation of a Letter of Credit but these are not significant. Failure of the buyer to obtain confirmation sends a strong signal to the exporter about the credit-worthiness of the buyer. A summary of the responses is provided at Table 6.20. It can be observed that 24.5% of respondents use Confirmed Letters of Credit for ASEAN trade.

Table 6.20: Usage of Confirmed Letters of Credit for ASEAN trade

Usage	Frequency	Percent
Yes	24	24.5 %
No	74	75.5 %
Total	98	100.0 %

(For detailed data relating to this table refer to Appendix 4 Table A6.20)

In dollar terms, Confirmed Letters of Credit account for just over 40.5 Million Australian Dollars, but three transactions alone account for 38 Million Australian Dollars (for detailed data refer to Appendix 4 Table A6.20a). However, if these transactions are removed from the calculations, the use of Confirmed Letters of Credit does not appear to be associated necessarily with value alone. These limited data suggest that some exporters are keen to mitigate foreign country and bank risk by trading on Confirmed Letter of Credit. As the details of the transactions are not known, it is not possible to make further comments on this issue.

Confirmation of a Letter of Credit may be exercised on a ‘silent basis’. In an ordinary Confirmed Letter of Credit, as described above, the trading parties and the banks know of the confirmation. In a silent confirmation the exporter privately arranges for confirmation of the Letter of Credit without the knowledge of either the Issuing Bank or the importer. This is a legitimate process that is condoned by the Letter of Credit rules – UCP 500 (and UCP 600). Silent confirmation is typically used in sensitive trading relationships, where a request for confirmation may be viewed by the buyer as an expression of mistrust on behalf of the seller and this may cause a collapse of the business deal. Bank charges associated with silent confirmation are, obviously, for the account of the exporter. Silent confirmation was used by only five respondents in the survey and only three of these replied, reporting a total value of approximately 5 Million Australian Dollars (for detailed data refer to Appendix 4 Table A6.20b). Because of the small number of responses, conclusions on this issue may not be reliable. Silent confirmation was used for export sales to Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam. These countries were classified as low to medium risk in accordance with Table 6.11. One explanation for the absence of silent confirmation in high risk countries, such as Cambodia, Laos and Myanmar could be due to the type of relationships that exist between the Australian exporters and the importers with which they deal. If these relationships are not particularly sensitive, silent confirmation may not be required. Additionally, if the exporters have good long standing relationships, they may not perceive a need for silent confirmation.

The other risk that Australian exporters may face in doing business with ASEAN countries is an exchange risk. The responses to the choice of trading currency and the methods used to manage currency exposure are shown at Table 6.21.

It can be observed that only two payment currencies are used for exports to ASEAN – the Australian Dollar and the United States Dollar. As Table 6.21 shows, these two currencies are equally used.

Table 6.21: Usage of foreign currency and exchange risk management approaches

Mechanisms reduce exchange risk		**Currency use**			**Total**
		AUD	USD	USD/ AUD	
Export Department enters into Forward Exchange contract to all foreign exchange transactions	Count	2	4	1	7
	% of Total	3.23%	6.45%	1.61%	11.29%
Export Department enters into Forward Exchange contract over specified value	Count	3	1	0	4
	% of Total	4.84%	1.61%	0.00%	6.45%
Finance/Treasury Department responsible for the firm's exchange risk	Count	6	7	0	13
	% of Total	9.68%	11.29%	0.00%	20.97%
Foreign exchange risk is managed by the firm's bank, stipulated guideline	Count	0	3	0	3
	% of Total	0.00%	4.84%	0.00%	4.84%
There is no specific foreign exchange management strategy	Count	13	9	2	24
	% of Total	20.97%	14.52%	3.23%	38.71%
Other	Count	6	5	0	11
	% of Total	9.68%	8.06%	0.00%	17.74%
Total	Count	30	29	3	62
	% of Total	48.39%	46.77%	4.84%	100.00%

This means that approximately half of the exporters do not have a foreign exchange exposure but the balance do. Of those who have a foreign currency exposure, in 9 cases (about 31%) there is no foreign exchange management strategy in place. In 7 cases (about 24%) the finance department of the firm is responsible for the management of foreign exchange risk. In 4 cases (about 14%) all foreign exchange transactions are managed by forward exchange contracts and in 3 cases (about 10%) the bank manages the firm's foreign exchange exposure. Only one respondent reported that foreign exchange exposure was subject to company policy. This issue, although important for the firm, is beyond the scope of this thesis for a detailed analysis.

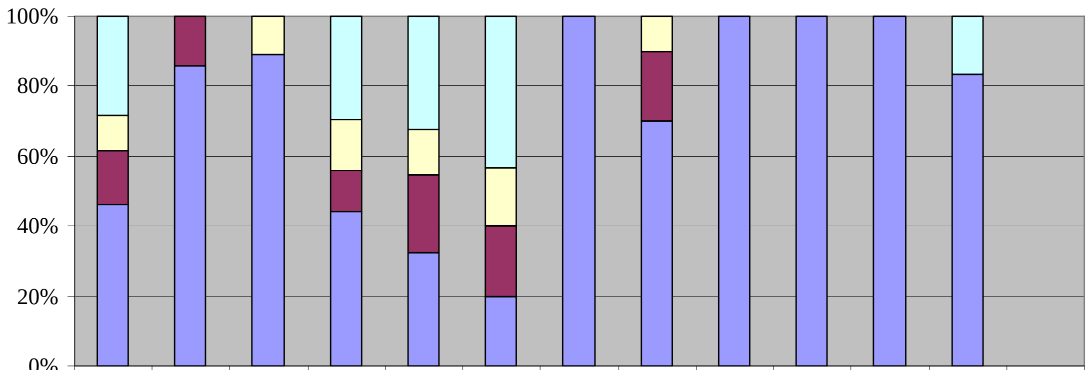
Having considered and discussed the trading risks exporters face in operating in ASEAN markets, it is appropriate to consider the operations of the Letter of Credit and these are considered and discussed in the next section.

6.6 Letter of Credit operations

It is important to consider aspects of export sales contracts in the context of their specific performance clauses, because these will be reflected in the documentary demands of a Letter of Credit as discussed in this section.

The documentary requirements of the Letter of Credit are affected by the use of delivery terms. Typically international trade contracts for the sale of goods make reference to a specific set of delivery terms, the Incoterms 2000. Incoterms is an acronym for international commercial terms. There are thirteen terms and each specifies whether it is the seller, or the buyer, that has responsibility for the provision of the transport document and, as appropriate, insurance coverage. A summary of the seller's transport document and insurance cover responsibilities under Incoterms 2000 are shown at Table 4.2. It should be noted that the choice of Incoterms 2000 is reached through contract negotiations, therefore, whilst it may be appropriate for the exporter to seek less onerous terms, from a risk management perspective, the ultimate decision will be significantly influenced by supply, demand and competitor activity in the relevant foreign markets, coupled with the exporting firm's overall risk appetite. At one end of the Incoterms 2000 the risk spectrum, the least risk for the seller is Ex Works (EXW), and the other end of the risk spectrum, the term with the highest risk is Delivered Duty Paid (DDP). The Incoterms 2000 apportion incremental risks to the seller from EXW to DDP, in accordance with the increasing obligations of each term. In an EXW transaction the seller's obligations are merely to make the goods available at the agreed collection point, packed and marked in accordance with the contact of sale. There is no obligation on the seller to clear the goods for export, enter into a contract of carriage or insurance, undertake import clearance, pay duties and taxes or deliver domestically in the importing country. The risk in transit transfers from seller to buyer at the agreed collection point, typically the seller's premises. In DDP the opposite applies, whereby the seller is responsible to arrange for the goods to arrive at the agreed delivery point in the foreign country at their own cost and risk. Therefore, the seller must secure export clearance, contract for carriage and insurance, import clearance, payment of duties and taxes, and foreign domestic delivery whilst retaining the risk in transit until the goods reach the agreed delivery point. A summary of the Incoterms 2000 chosen is shown at Figure 6.7. It should be noted that this is a multiple response answer.

Figure 6.7: Usage of Incoterms 2000



	EXW	FAS	FCA	FOB	CFR	CIF	CPT	CIP	DAF	DES	DEQ	DDU	DDP
76-100	11	0	0	10	10	26	0	0	0	0	0	2	0
51-75	4	0	1	5	4	10	0	1	0	0	0	0	0
26-50	6	1	0	4	7	12	0	2	0	0	0	0	0
0-25	18	6	8	15	10	12	6	7	5	5	5	10	0

(For detailed data relating to this table refer to Appendix 4 Figure A6.7)

It can be noted from Figure 6.7 that the most commonly used term is CIF, followed by CFR and FOB. The term EXW appears to be the fourth most commonly used term. The CIP, FCA, FAS and DDU terms are not widely used. The terms DAF, DES and DEQ appear to receive only marginal use and the term DDP is not used at all. The discussion will, therefore, only focus on the four most commonly used terms.

The choice of terms suggests that exporters are able to negotiate terms that may be considered as reasonable for them and their buyers, yet avoid, as much as possible, terms that are risky and onerous. Indeed, as a case in point, interestingly, the term DDP (the riskiest) does not appear to be used at all.

In the context of Letter of Credit transactions, there is a direct link between the choice of Incoterms 2000 and the documentation demands of this method of payment. The seller is responsible to contract for carriage and provide a transport document under CFR (sea transport only) and CPT (multimodal transport) terms, and additionally provide insurance under CIF (sea transport only) and CIP (multimodal transport) terms. It is also customary for the seller to provide a transport document under FOB terms, although strictly speaking, the buyer is responsible for entering into a contract of carriage. The reason for this variation to the FOB Incoterms 2000 is generally well accepted and arises primarily from the Letter of Credit demands for a transport document and the practicalities of export sales arrangements. It is much easier for the exporter to contract for carriage locally than for the importer to do so from a foreign country, thus the exporter generally accepts to engage in a contract of carriage to facilitate the transaction. The cost of carriage remains unchanged under this variation and accrues to the importer.

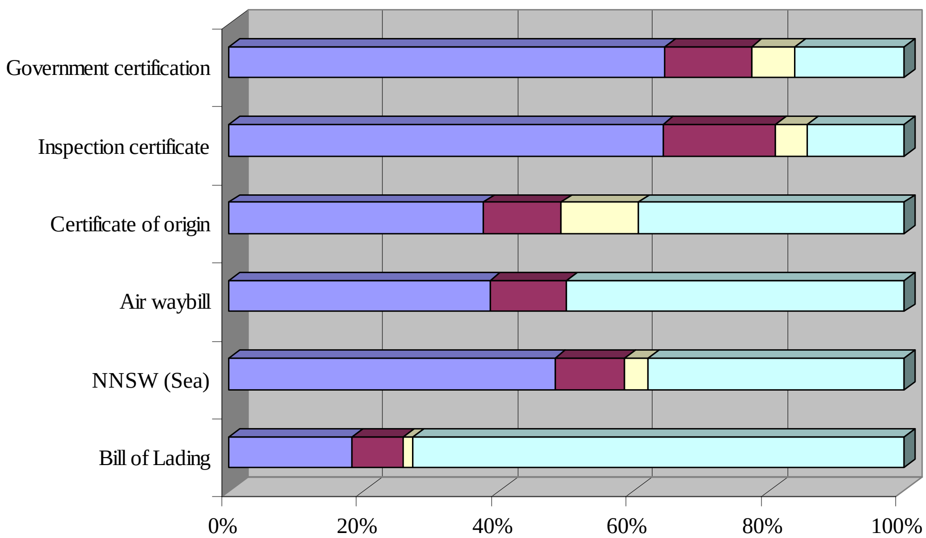
The terms DAF, DES, DEQ, DDU, DDP (D terms) do not usually require the presentation of a transport document in a Letter of Credit transaction. This is because the seller does not fulfil their obligation until the goods are placed at the agreed destination point and, in any case, the risk in transit remains with the seller until delivery is achieved. In these circumstances, therefore, the Letter of Credit will demand a form of delivery receipt authenticated by the buyer. These types of transaction are inherently more risky for the exporter, because unless a timely receipt can be secured, to comply with the Letter of Credit demand, payment may be jeopardised. It would appear that, as shown in Figure 6.7, Australian exporters make minimal use of D terms in the ASEAN trade, suggesting contract negotiation follow a risk minimisation approach.

The exporter contracts with third parties in a number of Incoterms 2000 contracts, viz; FOB, CFR, CIF, CPT and CIP terms and may additionally need to engage third parties in other circumstances, such as when government certification or inspection certification are required. Engagement with third parties inevitably results in the production of third party documentation. The types of document, their frequency of use, the instructions given for their production and the associated risks are discussed in the next section.

6.6.1 Externally issued documentation: type, frequency, instruction, production and risk

Third party documents, that is, externally issued documents, are a common feature of Letter of Credit transactions. The responses shown in Figure 6.8 show that transport documents (Bill of Lading, NNSW (Non-negotiable sea waybill) and Air waybill), as a group, are the most common externally issued documents required in Letter of Credit transactions and these will be discussed later in this section.

Figure 6.8: Most commonly required third party documents



	Bill of Lading	NNSW (Sea)	Air waybill	Certificate of origin	Inspection certificate	Government certification
76-100	48	11	22	24	6	5
51-75	1	1	0	7	2	2
26-50	5	3	5	7	7	4
0-25	12	14	17	23	27	20

(For detailed data relating to this table refer to Appendix 4 Figure A6.8)

Certificates of Origin requirements may be due either to mandatory importing requirements of a foreign country or to claim preferential duty treatment on imports, based on either the general preferential duty treatment or a Free Trade Agreement. In the case of Australian origin products, preferential duty treatment is only available through Free Trade Agreements, as Australia does not qualify for special treatment under the generalised system of preference for duties.

Government certification requirements are typically required to satisfy the importing requirements of foreign countries. The specification for such certification is stipulated by the government of the importing country. As Table 6.22 shows, government certification requirements apply to a number of industries. The highest use of government certification is in the Machinery/Automotive/Steel/Metal industry cluster. This may be due to standards certification or controlled products, such as dual-use products, that is, products that are capable of being used for civil or military purposes. The two next highest users are, respectively, Food and Equipment, and Forestry/Mining/Drilling and Equipment industry clusters. It is not difficult to imagine government controls over food and equipment to maintain product quality and integrity. Forestry, Mining, Drilling and Equipment would also be subject to government certification because these are items of quarantine concern, due to their potential to carry or spread disease.

The risk in documentation is not considered high, as the requirements of importing countries are known to the bureaucracy of the exporting country and permit issuing agencies typically use similar specific documentation, designed to comply with applicable international standards. The documentary requirements of permits are known prior to the Letter of Credit being established and, consequently, the demands of this method of payment should be capable of being met. The problems inherent in the production of external documents are universally applicable, in principle, to any and all such documents. There is the added risk of human behaviour when different individuals are involved in a process. Typically, the exporter would notify the external document issuer by written instruction as to the documents required. As the permit issuer acts on instructions given by the exporter, they are not able to perform any compliance checks against the Letter of Credit requirements. Indeed, it would be unusual to provide a copy of the Letter of Credit to the permit issuing agency. In the case of some quarantine permits, the form is partially completed by the exporter, including details such as the exporter and importer and vessel/flight details. The hybrid completion of this form – partially by the exporter and partially by the permit issuing agency – further reduces the risk of documentary discrepancies. It should be noted that in some instances, government certification may be performed electronically but, at the time of writing, this process was not available to any of the ASEAN countries.

Table 6.22: Government certification requirements by industry clusters

Sector		Government certification				Total
		0-25	26-50	51-75	76-100	
Food and Equipment	Count	3	0	2	1	6
	% of Total	9.7%	.0%	6.5%	3.2%	19.4%
Health and equipment and allied chemicals	Count	3	0	0	0	3
	% of Total	9.7%	.0%	.0%	.0%	9.7%
Building and related products	Count	1	0	0	0	1
	% of Total	3.2%	.0%	.0%	.0%	3.2%
Machinery, Automotive, steel, metals	Count	7	2	0	2	11
	% of Total	22.6%	6.5%	.0%	6.5%	35.5%
Forestry, mining, drilling and equipment	Count	2	1	0	2	5
	% of Total	6.5%	3.2%	.0%	6.5%	16.1%
Others	Count	4	1	0	0	5
	% of Total	12.9%	3.2%	.0%	.0%	16.1%
Total	Count	20	4	2	5	31
	% of Total	64.5%	12.9%	6.5%	16.1%	100.0%

Inspection certificates are the result of inspection of consignments “carried out prior to the shipment of the goods [pre-shipment inspections] and most pre-shipment inspections are voluntarily requested by the private sector” (Jeker and Balchin 2005, p. 575). Pre-shipment inspections “assure the importer that the goods conform to the technical specifications and the quality standards laid down in the contract and that the quantities exported are accurate” (International Trade Centre UNCTAD/WTO and Commonwealth Secretariat 1999, p. 72). These inspections are conducted “through an independent agent such as an inspection company” (Johnson 1997, p. 527), engaged by the importer, who is mitigating the supply of non-conforming goods. The inspection agency is provided with a copy of the contract and Letter of Credit by the buyer and these documents form the basis for the inspection. The goods are examined by the inspection agency “at the place of manufacture or assembly prior to despatch” (Branch 2000, p. 328), who issues either a ‘clean report of findings’, if all is on order with the inspection or a ‘discrepancy report’, where the contract specifications and/or the requirements of the Letter of Credit have not been adhered to. On occasion, inspection certificates may be the result of government import regulations, although this is becoming less so, especially in the ASEAN countries. It can be observed from Figure 6.8 that although inspection certificates are not very highly used, they are nevertheless in existence. As can be observed from Table 6.23, there is no clear difference in the requirement for inspection certificates based on the length of export activity by Australian firms.

These data suggest that inspection certificates are driven by commercial requirements of individual transactions. Although the reason for the requirement of inspection certificates is not known, it is likely that buyers are using this documentary requirement in Letter of Credit transactions to overcome the limitations of the banker's role in documentary checking procedures. As discussed earlier, the role of the banker is to check the documents for compliance but the bankers neither concern themselves with the goods, as per Article 4 of the UCP500, nor do they make any representations about the goods as to either their condition or existence or value, as per Article 15 of the UCP 500. Consequently, the inspection certificate provides tangible evidence as to the existence and conformity of the goods to the contract of sale. It is expected that the requirements for inspection certificates would diminish over time, as "with trust the buyer is less likely to require inspection certificates" (Hinkelman and Mansergh 2008, p. 10).

Table 6.23: Inspection certificate requirement

Export period	Percentage of transactions with Inspection certificate					
		0-25	26-50	51-75	76-100	Total
Less than 10 Yrs	Count	11	4	1	3	19
	% of Total	27.5%	10.0%	2.5%	7.5%	47.5%
More than 10 yrs	Count	15	3	0	3	21
	% of Total	37.5%	7.5%	.0%	7.5%	52.5%
Total	Count	26	7	1	6	40
	% of Total	65.0%	17.5%	2.5%	15.0%	100.0%

(For detailed data relating to this table refer to Appendix 4 Table A6.23)

The distribution of responses in Table 6.23 appears to support this notion as, in 65% of transactions there is low demand for inspection certificates – less than 25% – whilst there is strong demand in only 15% of transactions. From a risk perspective in terms of documentary compliance, the exporter, it is argued here, has a low risk exposure. This is because of the actual process that is followed to conduct the inspection and issue the report. Both the inspection agency and the exporter have copies of the contract of sale and the Letter of Credit prior to the inspection taking place. The exporter is typically required to provide only a copy of the commercial invoice to supplement the physical inspection. As the commercial invoice is internally produced, the exporter should be able to comply fully with the terms and conditions of both the contract of sale and the Letter of Credit. The risk the exporter may have is one of timing in this process as, to meet the deadlines of the Letter of Credit, the inspection must occur within the allowable window period. However, this is not considered to be a significant hurdle and there is no evidence that scheduling of inspection visits is problematic. Where the inspection report demands a transport document be supplied by the exporter, the risks are higher due to the external production of any document, as discussed above.

In relation to cargo insurance, in the majority of cases, exporters have open policies, enabling them to issue certificates of insurance internally. A summary of responses is provided at Table 6.24. It can be observed that exporters have open insurance policies operating in 63.3% of cases for CIF contracts and 70% for CIP contracts.

Table 6.24: Use of open insurance policies

Open Insurance Policy	Yes	No
CIF Contracts	38 (63.3%)	22 (36.7%)
CIP contracts	7 (70%)	3 (30%)

(For detailed data relating to this table refer to Appendix 4 Table A6.24)

Where exporters are using open insurance policies, they are able to generate internally produced insurance certificates and these are acceptable under Article 34 of the UCP 500. It is generally accepted that internally generated documents have less compliance risk than externally produced documents because there are comparatively less variables in the production of internally produced documents. There are also the added risks of human behaviour when different individuals are involved in a process. Typically, the exporter would send the instructions to the insurer for the insurance document to be produced. As the insurer acts on instructions given by the exporter, they are not able to perform any compliance checks against the Letter of Credit requirements.

The external production of insurance documents is subject to the same risks as other externally produced documents, as discussed earlier.

Transport documents are always issued externally, however, these may be issued by different parties, as the exporter may choose to deal direct with carriers or engage the services of a freight forwarder. The forwarder typically acts as a “middle man” simultaneously representing the carrier and the exporter. The common services provided by a forwarder include negotiations on carrier freight rates, collection of goods from the exporter’s premises and delivery of same to carrier, assistance with border control activities (customs and other permit issuing agencies) and temporary warehousing of goods. Depending on the arrangements in place with the carrier, the forwarder may also issue the transport document as the authorised agent of the carrier and this is typical of airfreight movements. Regardless of the arrangements in place between the forwarder and the carrier, the transport document is issued as a result of instructions given by the exporter to the relevant party. In the case of maritime cargo movements, this is usually by way of forwarding instructions/interim receipt and for airfreight cargo consignments this is typically via the shipper’s letter of instruction. It is important, in the context of documentary risk, to determine the level of engagement of third parties and how instructions for carriage and documentation are conveyed by the exporter.

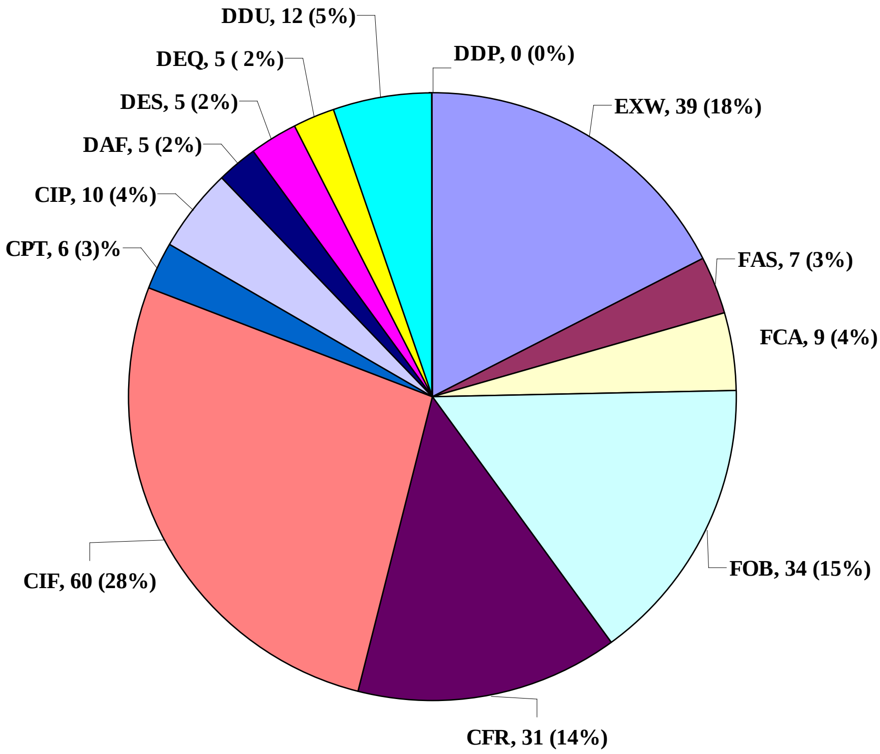
As can be noted from Table 6.25, the majority of exporters (81.2%) utilises the services of forwarders and this does not appear to be influenced by either the size of the firm or the industry cluster.

Table 6.25: Use of freight forwarders

Use of freight forwarder	Frequency	Percent
Yes	82	81.2 %
No	19	18.8 %
Total	101	100.0 %

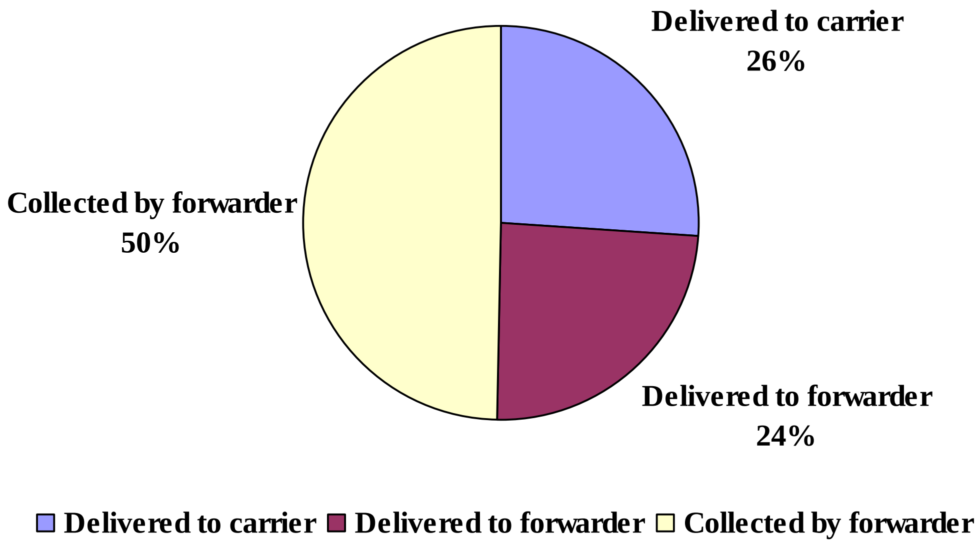
The routine use of freight forwarding services is also supported by the choice of Incoterms 2000, as shown in Figure 6.9. The only Incoterms 2000 that does not place any obligations on the seller in relation to the movement of goods is EXW and this term is used in 18% of situations and this almost exactly accounts for the ‘no’ answer in Table 6.25.

Figure 6.9: Incoterms 2000 percentage of use for each term



Exporters typically use a freight forwarder due to operational requirements, consequently, specialised services that organisations are unwilling or unable to provide for themselves are outsourced. Examples of such services include delivery of shipping containers to the export wharf. On a cost-benefit analysis it would not be worth it for the exporting firm to purchase (or lease/rent) a container-carrying vehicle and appropriate human resources, because it would be unlikely that the vehicle and staff would be utilised to full capacity and, where surges in activities occur, available resources may not be adequate to the task, so outsourcing provides a better alternative. This is supported by the responses, summarised in Figure 6.10. In 50% of export transactions to ASEAN, freight forwarders collect the goods from the exporter's premises and, in 24% of cases, the goods are delivered to the forwarder. Delivery of cargo to the carrier directly is effected in only 26% of consignments.

Figure 6.10: Domestic delivery options

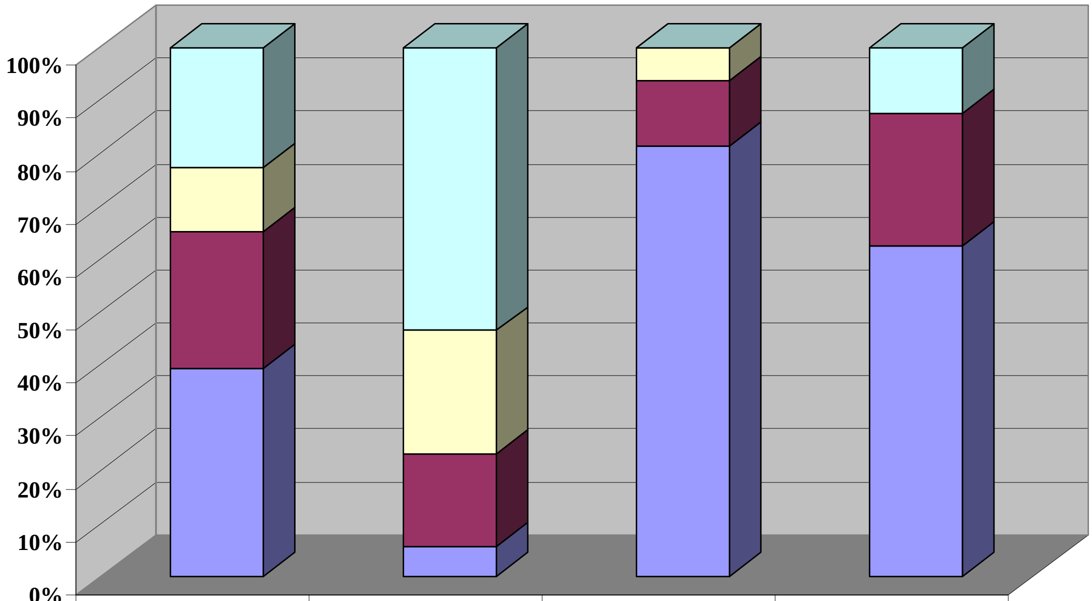


(For detailed data relating to this table refer to Appendix 4 Figure A6.10)

As can be observed from Figure 6.11, the mode of transport used for exporting goods is primarily by sea, with air freight usage also high. As Australia is an island continent, the use of land-based transport, such as road and rail, has limited application and can only be used as combined (multi-modal) transport. Combined transport is where more than one mode of transport is used to carry the consignment from origin to destination. As combined transport is only minimally used, discussion will not focus on this option. The use of postal services for exports, although higher than combined transport, is still at comparatively low rates and, given the limitations of postal consignments, such as the inability to send dangerous goods, stipulated allowances for maximum size and weight of packages and the high postal charges, this mode of transport is also not the focus of the discussion. Consequently, the focus of discussion will be limited to three types of transport documents: the Bill of Lading and the Non Negotiable Sea Waybill (both applying to maritime transport) and the Air Waybill (applying to air transport).

To recall, transport documents may be issued by carriers (airlines and shipping lines) or freight forwarders acting as agents of carriers. Therefore, it can be seen that freight forwarders play a central role not only in facilitating the movement of goods but also in relation to the generation of documents, the data contents of which are largely provided by the exporter through their instructions.

Figure 6.11: Mode of transport usage frequency



	Air	Sea	Post	Combined (multimodal)
76-100	15	46	0	1
51-75	8	20	1	0
26-50	17	15	2	2
0-25	26	5	13	5

In order for the forwarder (or carrier) to produce transport documents that are acceptable to the exporter, the forwarder (or carrier) firstly needs to be informed about the relevant data required. The method employed to instruct external document producers is shown, in summary form, at Table 6.26. It is clear from these data that in the vast majority of cases (82.44%) forwarders, or carriers, receive paper–based instructions.

Table 6.26: Method of instructing external document producers

Issue of instructions	Forwarding Instructions / Shipper's Letter of Instruction	Electronic instructions (FWB/PRA)	Totals
Bill of Lading (B/L)	46	16	62
Non-Negotiable Sea Waybill (NNSW)	25	2	27
Air Waybill (AWB)	37	5	42
Totals	108	23	131
Percentage	82.44%	17.56%	100%

The data suggest that the method chosen for instructing forwarders or carriers (manual or electronic) is independent of the size of the exporting firm, the number of Letter of

Credit transactions processed on an annual basis or the number of specialist export documentation staff.

It is also necessary to consider the documentation production process relating to internally issued documents to establish the overall documentation production risks. The exporting firm is predominantly responsible for its own documentation production, with only 14.5% of documents out-sourced to third parties, as shown in Table 6.27. Therefore, the exporting firm has the possibility of devising robust processes that reduce the likelihood of errors and, therefore, risk, simply because these processes are within the purview of the exporting firm.

Table 6.27: Documentation production responsibilities

Responsibility	Frequency	Percent
Internally prepared by employees	65	85.5%
Outsourced	11	14.5%
Totals	76	100%

Consequently, any documentary discrepancies that may arise, in the context of internally produced documents (for example, commercial invoices, packing lists/slips, certificates of origin and value), are the result of breakdown of internal processes or a lack of adequate processes. The issue of human resources within the exporting firm, in the context of skills and education, is discussed later in the chapter.

The majority of documentation is prepared by specialised staff, with general administration staff responsible for documentation production in just under 30% of cases, as shown in Table 6.28.

Table 6.28: Documentation production: internal responsibility

Internal responsibility	Frequency	Percent
Specific department/dedicated personnel	41	70.69%
General administration staff	17	29.31%
Totals	58	100%

From a risk management point of view, it is more desirable to have specialists produce the documentation as they are more skilled in understanding the pedantic requirements of Letter of Credit transactions and the rules within which such transactions operate.

Additionally, these specialists understand the ramifications of any aberrations in processes and likely timely remedies available to the exporting firm.

There is a number of methods employed to produce documentation, as summarised in Table 6.29. It is worthy of note that, in the majority of transactions (54.9%) documents are still produced manually. This raises a number of concerns, both from the viewpoints of efficiency and risk.

Table 6.29: Internal methods used for documentation production

Method	Frequency	Percent
Manually prepared documentation	50	54.9%
Computer generated doc using internal designed programs	22	24.2%
Computer generated doc using commercial software	16	17.6%
Other	3	3.3%
Totals	91	100%

It is generally accepted that automated processes are comparatively more efficient than manual operations. Automation of documentation production functions reduces repetition of input, particularly in export documentation, as much of the data requirements are repeated across different documents. For example, the exporter and importer details will remain constant regardless of whether they appear on the invoice or the packing list. With manual processes, these data have to be produced twice, whereas with automated systems, data only need to be input once and the system can automatically transfer these data to populate the same fields across a number of different documents. Additionally, automated processes offer risk reductions in a number of areas. In so far as documentation production is concerned, automation can greatly reduce the possibility of human error in the process. For example, arithmetical calculations are an essential part of any commercial invoice. The quantity sold is multiplied by the unit of sale value to derive the total payable against each line item. Where multiple line items are sold on the same invoice each line item total is added to derive the total payable for the goods. Depending on the Incoterms 2000 chosen and how this is applied to the unit price, other items such as freight, insurance or consular documentation fees, may need to be added to the price of the goods. As the quantity of manual calculations increases, the risk of error will increase also. These errors may include arithmetical errors and transposition errors due to human intervention.

The choice of in-house documentation production method is independent of industry clusters. As can be observed from Table 6.30, micro and small firms predominantly use in-house manual documentation production, whereas medium and large firms tend to rely on automated processes using either in-house developed computer programs or commercially available software solutions.

Table 6.30: In-house methods of documentation production

Firm Size		**Method of documentation production**				Total
		Manually prepared documentation	Computer generated documentation using internal designed programs	Computer generated documentation using commercial software	Other	
Micro	Count	17	3	3	0	23
	% of Total	18.7%	3.3%	3.3%	0%	25.3%
Small	Count	20	8	4	1	33
	% of Total	22.0%	8.8%	4.4%	1.1%	36.3%
Medium	Count	8	6	6	1	21
	% of Total	8.8%	6.6%	6.6%	1.1%	23.1%
Large	Count	5	5	3	1	14
	% of Total	5.5%	5.5%	3.3%	1.1%	15.4%
Total	Count	50	22	16	3	91
	% of Total	54.9%	24.2%	17.6%	3.3%	100.0%

Perhaps one reason for the higher adoption rate of automated systems by the larger firms is financial affordability, especially when considering commercially available applications. According to industry sources, fully integrated specialist software solutions can cost upwards of AUD 30,000 per annum to maintain and run. It would be difficult to imagine a micro firm prepared to make this sort of investment, especially if the level of export business was low in terms of either its volume or value. It should be noted that even where automated documentation production systems are used, these are hardly ever integrated with internal or external systems. As a consequence of the high rate of manual documentation production micro and small firms, therefore, carry the highest documentation error risk, due to the human factor. This point will be discussed later in the chapter in the context of documentary discrepancy rates.

The next section focuses on practices used by exporters prior to the lodgement of documents with the bank, who decides where the documents are lodged and the acceptance or notification period taken by the bank.

6.6.2 Documentary presentation practices

As can be observed from Table 6.31, the majority of exporters (74%) present documents to their own bank. In the context of risk management, it is desirable for the exporter to deal with its own bank. This is because, as an existing customer, the exporter may be given a comparatively faster documentary checking service and notification of documentary discrepancies. To recall, documents found discrepant on first presentation may be retrieved, changed and resubmitted, as long as this occurs within the allowable presentation period of the Letter of Credit. Therefore, the earlier the exporter receives notification of discrepancies, the more time the exporter has to correct such discrepancies. This assumes increasing importance where the documents involve external parties as, the greater the number of parties involved, the longer the time required to remedy errors. Notwithstanding the preference for exporters to use their own banks, there is no evidence from the data that this translates into a faster notification of discrepancies in practice.

Table 6.31: Place of documentary presentation

Place	Frequency	Percent
Own bank only	54	74.0%
Advising bank	15	20.5%
Any bank	4	5.5%
Total	73	100.0%

It should be noted that the decision to deal with the exporter’s own bank may be influenced by a number of internal factors, as shown in Table 6.32. The data show that the decision as to which bank receives documents in a Letter of Credit transaction, in 408% of cases, is due to the requirements of the finance area in a firm, with company policy accounting for 25% of cases and sales/marketing only 13.2%. In only 10.5% of cases documentation staff have the authority to decide where documents are lodged.

Table 6.32: Place of documentary presentation

Responsibility for choosing where to lodge documents	Frequency	Percent
Company Policy	19	25.0
Sales/Marketing	10	13.2
Finance	31	40.8
Documentation Staff	8	10.5
Other	8	10.5
Total	76	100.0

The high decision-making role of the finance area may be explained by the credit terms an exporting firm extends to its customers, and the pressure this places on cash flows. To recall, where extended payment terms are used, it is possible for the exporting firm to discount the proceeds, in order to receive payment in advance of the maturity date of the debt. Discounting results in a payment of less than the par value amount of the receivable but the benefit for the exporting firm is that it provides cash flow. As can be observed from Table 6.33, Letters of Credit with extended credit terms are used in 40.2% of cases, therefore, making it possible for the proceeds to be discounted and this explains the high involvement of finance, as it is generally accepted that the decision to discount is within the purview of the finance area within a firm.

Table 6.33: Letter of Credit maturity date

Payment period	Number	Percentage
Sight	67	59.8%
Deferred payment	45	40.2 %
Total	112	100%

Discounting of Letter of Credit proceeds is independent of the size of the firm and, according to the data, nine respondents reported a total of 128 transactions discounted for the year. One respondent, a medium size specialist machinery manufacturer, reported 100 discounted transactions. The sample indicates that the value of discounted transactions ranges form $ 50,000 to $ 30 million (n=6). Exporters use the standard Letter of Credit, whether discounted, or not, with virtually no use of specialist type Letter of Credit such as Red Clause, Transferable, Back-to-Back and Revolving credits.

It should be noted that discounting of proceeds does not remove the risk of payment default from the exporter, as invariably in all discounted transactions the bank does not assume the collection risk. Furthermore, discounting of proceeds is only contemplated in situations where the bank offering this service has reasonable grounds to believe that the payment will be forthcoming as scheduled. In a Letter of Credit context this means that the documents presented by the exporter must be compliant. A good risk management approach to minimise the chances of documentary discrepancies is to consult with the bank during the process of executing a Letter of Credit transaction prior to the lodgement of the documents. Although exporting companies consult with banks prior to lodging export documentation under a Letter of Credit transaction, this appears to be independent of the size of the exporting firm. As can be observed from Table 6.34, the proportion of firms consulting with banks is highest with large firms (75%), whereas it is only approximately 32% for medium firms, 75% for small firms and approximately 56% for micro firms. No pattern is detectable in these data. The practice of exporters choosing to consult with their own bank also appears to be independent of the length of time the firm has been exporting.

Table 6.34: Consultation with bank

Consult		**Size**				**Total**
		Micro	Small	Medium	Large	
Yes	Count	9	16	6	9	40
	% of Total	12.7%	22.5%	8.5%	12.7%	56.3%
No	Count	7	8	13	3	31
	% of Total	9.9%	11.3%	18.3%	4.2%	43.7%
Total	Count	16	24	19	12	71
	% of Total	22.5%	33.8%	26.8%	16.9%	100.0%

The next section focuses on documentary discrepancies, including frequency of errors and types of discrepant documents, practices adopted to rectify errors (where possible), estimated cost of error rectification and potential financial losses.

6.6.3 Documentary discrepancies, resolution and possible losses

As can be observed from Table 6.35, documentary discrepancies in Letter of Credit transactions were experienced by 26% of firms that responded to the survey. According to the data, documentary discrepancy is independent of firm size or industry cluster.

Table 6.35: Documentary discrepancy frequency (n=72)

Documentary rejection	Frequency	Percent
Yes	20	26
No	57	74
Total	77	100.0

Notwithstanding these documentary discrepancy rates, there is evidence that loss avoidance practices are used by Australian exporters when dealing with Letter of Credit business. As some of the interviewed exporters explained

> *With the Letter of Credit we have a set of guidelines we issue to customers so we specify what we expect to see on our Letter of Credit (large firm)*

and

> *When we request a Letter of Credit we allow the client to set it up. They fax me a copy of it. I check it and if for some reason there is something on it that does not suit us, and we find this regularly, I will write back to them and request and amendment (small firm)*

and

> *We send a standard format to customers saying this is what we wish for them to set up an irrevocable documentary credit based on those terms and in ninety percent of the situations they follow that exactly. They might make some small changes. If they do make small changes, if it is something of concern to us we get them to do an amendment. But yes, we send them standard formats to follow (small firm)*

Similar responses were received from another six exporters. The standard format that is referred to is either a template style form with all of the requirements outlined on it, or a detailed pro-forma invoice from which the Letter of Credit may be established.

The estimated dollar value of potential financial losses through documentary discrepancies may be inferred by applying the percentage of firms that report experiencing discrepancies over the estimated total value of Letter of Credit business to ASEAN. Therefore, if this assumption is accepted, based on the total value of Letter of Credit business to ASEAN estimated in section 6.4 of this chapter, the potential financial loss could be upwards of AUD 920 million.

To recall, the magnitude or amount of discrepancies is immaterial to the banker's decision to accept or reject the documents. That is, the documents either comply, in which case they are accepted, or they do not comply in which case they are rejected. Discrepancy rates appear to be independent of the usage of standard operating procedures or company policies in the preparation and lodgement of documents. It is likely that errors may be due to the implementation of specific procedures, implying human error in the process.

Responses to the survey, as shown in Table 6.36, indicate that discrepancies occur across a variety of documents, in general, and also that discrepancies may occur due to missed time-lines. It can be observed from Table 6.36 that discrepancies have been identified across eight documents (items a to h) and that six factors (items i to n) have also been identified as contributing to discrepancies.

Table 6.36: Discrepancies

Discrepancies	**Number**	**Percent**
Documentary discrepancies		
a. Errors in bill of exchange	21	15.9%
b. Errors in the commercial invoice	22	16.7%
c. Errors in the packing list	21	15.9%
d. Errors in the transport document	23	17.4%
e. Errors in the insurance document	19	14.4%
f. Errors in the inspection certificate	14	10.6%
g. Errors in the certificate of origin	18	13.6%
h. Errors in government certification	11	8.3%
Discrepancy factors		
i. Late shipment	16	12.1%
j. Missed consignment in a predetermined delivery schedule	9	6.8%
k. Documents lodged outside allowed presentation	17	12.9%
l. Documents presented after Letter of Credit expiry	13	9.8%
m. Missing documents	15	11.4%
n. Incorrect shipment/partial shipment	11	8.3%
Total	230	100%

The data show that documentary errors (items a to h in Table 6.36) are evenly spread, with the lowest levels of discrepancies evident with inspection certificates and government certification. The comparatively slightly lower discrepancy rates may be explained by the generally lower usage of these documents in transactions. It would be unusual for inspection certification to be demanded for every consignment, whereas a commercial invoice would be an inescapable requirement of any transaction. Likewise government certification, such as quarantine certificates, would only feature against product specific transactions and, therefore, not be routine. In relation to discrepancy factors (items i to n in Table 6.36.), it can be observed that missed consignments and incorrect shipments attract the lowest discrepancy rates, however, these differences do not appear to be significant.

According to the data, the majority of respondents (67.5%) experienced between 1 and 5 discrepancies, as shown in Table 6.37. However, given that the Letter of Credit compliance regime demands zero tolerance for errors, any discrepancy is unacceptable, because of the possibility of documentary rejection and non-payment by the bank.

Table 6.37: Documentary discrepancies averages by respondents

Number of errors	Number of respondents	Percentage
1-5	27	67.5
6-10	4	10.0
11-15	9	22.5
Totals	40	100%

The occurrence of either documentary discrepancies or discrepancy factors appears to be independent of how long the firm has been exporting and this suggests that what really matters is the experience of the individual executing the transaction and not the experience of the firm. The data show that whilst discrepancies occur, in the vast majority of cases (71.3%), these happen at a rate of less than 25%, as shown in Table 6.38. There is no difference between documentary discrepancies and factors or the size of the firm and the occurrence of discrepancies cannot be explained by the size of the firm.

Table 6.38: Frequency of discrepancies

Frequency of discrepancies	Responses	
	Number	Percentage
0-25	164	71.3%
26-50	39	17.0%
51-75	17	7.4%
76-100	10	4.3%
Total	230	100.0%

However, when the responses are considered by industry sector, as shown in Table 6.39, it appears that, apart from the Others industry cluster, the Machinery, Automotive, Steel and Metals industry cluster experiences the highest documentary discrepancy rate, although these are, in the main, at occurrence rates below 26%.

Table 6.39: Documentary discrepancies by industry cluster

Industry cluster		**Documentary discrepancy rate**				**Total**
		0-25	26-50	51-75	76-100	
Food and Equipment	Count	7	3	1	0	4
	% of Total	20.6%	8.8%	2.9%	.0%	11.8%
Health and Equipment and Allied Chemicals	Count	11	2	0	1	7
	% of Total	32.4%	5.9%	.0%	2.9%	20.6%
Building and Related Products	Count	11	0	0	0	3
	% of Total	32.4%	.0%	.0%	.0%	8.8%
Machinery, Automotive, Steel, Metals	Count	21	10	3	2	7
	% of Total	61.8%	29.4%	8.8%	5.9%	20.6%
Forestry, Mining, Drilling and Equipment	Count	12	6	1	0	4
	% of Total	35.3%	17.6%	2.9%	.0%	11.8%
Others	Count	36	6	2	0	9
	% of Total	105.9%	17.6%	5.9%	.0%	26.5%
Total	Count	98	27	7	3	34
	% of Total	288.2%	79.4%	20.6%	8.8%	100.0%

(Percentages and totals are based on respondents)

Similar comments also apply to the discrepancy factors, as shown in Table 6.40, where, apart from the Others industry cluster, the Machinery, Automotive, Steel and Metals industry cluster experiences the highest factor rate, although these are at occurrence rates below 26%. Discrepancies are not limited to any one particular type of document or factor. The higher error rates experienced by this sector may be explained by the type of product. For example, when selling machinery, especially if custom-made, the description of the goods as shown on the Letter of Credit may be more detailed than for other cargo and the additional data requirement may contribute to documentary discrepancy rates. An interviewed exporter from a medium size machinery manufacturing company advised

> *We have experienced discrepancies. Not frequently and usually typographical. They are actually unavoidable … you inevitably get*

typographical errors. We just fix them. Easy, easily done. It's been that way in this job.

Table 6.40: Factors by industry cluster

Industry cluster		Factors rate				Total
		0-25	26-50	51-75	76-100	
Food and Equipment	Count	1	0	0	0	1
	% of Total	3.7%	.0%	.0%	.0%	3.7%
Health and Equipment and Allied Chemicals	Count	3	1	0	0	3
	% of Total	11.1%	3.7%	.0%	.0%	11.1%
Building and Related Products	Count	2	0	0	0	2
	% of Total	7.4%	.0%	.0%	.0%	7.4%
Machinery, Automotive, Steel, Metals	Count	15	5	1	2	8
	% of Total	55.6%	18.5%	3.7%	7.4%	29.6%
Forestry, Mining, Drilling and Equipment	Count	7	1	0	1	4
	% of Total	25.9%	3.7%	.0%	3.7%	14.8%
Others	Count	22	2	6	3	9
	% of Total	81.5%	7.4%	22.2%	11.1%	33.3%
Total	Count	50	9	7	6	27
	% of Total	185.2%	33.3%	25.9%	22.2%	100.0%

(Percentages and totals are based on respondents)

Additionally, it may be difficult to complete production and conclude the logistical arrangements within the time frames stipulated by the Letter of Credit. As one interviewed exporter from a medium size machinery manufacturing company explained

We have late shipments possibly. It is very rare that the Letter of Credit has expired on us, but late shipment crops up sometimes.

It does not appear that there are detailed international comparisons of discrepancy rates on Letter of Credit transactions available in the public domain and no evidence has been found that similar studies have been conducted in Australia. Indeed, the ICC itself acknowledges the limitations and the lack of data surrounding Letter of Credit transactions and losses in its Rethinking Trade Finance: Global Survey 2010 and in its second recommendation it states

> Industry is well aware that a lack of a comprehensive set of statistics on trade finance limits efforts to confirm the trends revealed by market intelligence surveys. With no precise statistics available, there is nonetheless anecdotal evidence indicating that L/C will continue to account for a significant, if not a growing share of trade finance. One

> development reinforcing this belief is the dynamic nature of South-South trade, were letters of credit play a prominent role for a variety of reasons – higher levels of security, enforceability and standardisation. ICC has recently proposed to fill the information gap in trade finance, in particular by providing business performance data evidencing the loss history of different trade finance risk categories. As noted above, ICC is now designing a Register to collect such information, in partnership with the ADB [Asian Development Bank] (ICC Banking Commission 2010, pp. 57-58).

Notwithstanding the ICC report, to recall, a previous study was conducted in the USA based only on documentary examination of bank files on Letter of Credit transactions and interviews with bankers (Mann 2000). It should be noted that the USA study did not include direct input from exporters and did not seek to discover the frequency of discrepancies experienced by exporting firms. Nevertheless, a comparison of results between the USA study and the research in this thesis may be useful to discover whether similar general patterns occur with the type of discrepancies in Letter of Credit transactions. A summary of the findings of both studies is shown at Table 6.41. It can be observed that nearly 53% and 65% of USA and Australian exporting firms, respectively, had experienced defective documents/documentary discrepancies. There is not enough information available to comment on the number of discrepancies. The data shown in Table 6.41 may appear to suggest that Australian exporters experience comparatively higher discrepancy rates but this may not be the case because the frequency of discrepancies for the USA study is not available and, consequently, it is not possible to comment further on this aspect. According to an Australian banker, interviewed for this thesis, documentary discrepancy rates are believed to be lower than the 70% world-wide estimates from the ICC (ICC Thailand 2002)

> *I would say that probably 70 per cent of our documents at the moment are okay on first presentation and 30 percent would probably have to go back to them and try and get the documentation corrected.*

Australian exporting firms appear to experience missing documents and late shipments at a comparatively less frequent rate but the specific reasons for this variation are not known. Importantly, in the context of possible financial losses caused by non-compliance in Letter of Credit transactions, the data from both the USA and Australian studies indicate that documentary defects are the primary cause and, as stated earlier, human error may be a contributing factor.

Table 6.41: Comparison of Letter of Credit discrepancy rates between the USA and Australia

Country	USA*		Australia		Variation
Type of discrepancy	**Number**	**Percentage**	**Number**	**Percentage**	**Percentage**
Defective documents / Documentary discrepancies**	293	52.89%	149	64.78%	+ 11.89%
Missing documents	75	13.54%	15	6.52%	- 7.02%
Late shipment	62	11.19%	16	6.96%	- 4.23%
Late presentation	48	8.66%	17	7.39%	-1.27%
Expired	36	6.50%	13	5.65%	- 0.85%
Overdraft	16	2.89%	n/a	n/a	n/a
Incorrect shipment	14	2.53%	11	4.78%	+ 0.99%
Partial shipment	7	1.26%			
Other	2	0.36%	9	3.91%	+ 3.55%
Total Discrepancies	**554**		**230**		

* Percentages shown on the basis of number of discrepancy cases. The original publication shows percentages on the basis of bank files examined.
** Documentary discrepancies represents items a to h from Table 6.36.

When discrepancies occur these may be corrected, if possible, but only where the exporter is able to do so and still meet the requirements of the Letter of Credit. As Table 6.42 shows, in 78% of instances, discrepant documents were adequately corrected, however, in a small number of instances the ability to effect the corrections was much lower and, in these cases, the potential for financial losses is likely to have been higher.

Table 6.42: Successful resubmission of complaint documents

Successful resubmission percentage	Frequency	Percent	Valid Percent	Cumulative Percent
0-25	4	3.0	8.0	8.0
26-50	4	3.0	8.0	16.0
51-75	3	2.3	6.0	22.0
76-100	39	29.5	78.0	100.0
Total responses	50	37.9	100.0	

As no other data are available it is not possible to make any further comments on this aspect, however, the cost of rectifying documentary discrepancies may be estimated.

The estimated cost of rectifying documentary discrepancies has been calculated by multiplying the average cost per error by the number of annual Letter of Credit transactions. According to survey respondents, summarised in Table 6.43, 14 errors were reported, requiring a total of 44 hours rectification time at a total cost of $ 4,970, with an average cost per error between $ 72 and $ 113. Based on the only response from a bank, representing approximately 20% market share, the number of ASEAN Letters of Credit processed annually is approximately 26,000. Therefore, the total annual number of Letters of Credit processed is estimated to be 130,000. By multiplying the total number of ASEAN Letter of Credit transactions by the cost of rectifying errors, the total annual cost of rectifying documentary discrepancies is, therefore, estimated to be in the range between 9.36 million and 14.69 million Australian dollars per annum. This is a net cost to the exporting organisation and a productivity loss. It is not possible to comment any further with the available data. It should be noted that this type of data is difficult to obtain, in detailed form, as participants are unwilling to disclose this information.

Table 6.43: Estimated average cost of rectifying documentary discrepancies in ASEAN Letter of Credit export business

Number or errors		14
Total time spent rectifying errors		44 hrs
Total cost		$4,970
Av Time per error	approx	3 hrs
Av cost per error	approx	$ 72 -$113

(For detailed data relating to this table refer to Appendix 4 Table A6.44)

When discrepancies occur that cannot be corrected, there are three options that may be followed, depending on the circumstances. The first circumstance may be where the discrepancy is minor and in the opinion of the exporter’s bank is not significant, such as a spelling error in a street name on the transport document and it is likely that this will be ignored and the documents forwarded to the Issuing Bank for acceptance. If the Issuing Bank does not detect the discrepancy or considers it immaterial in the context of the Letter of Credit transaction and rules, the buyer will be presented with the documents for acceptance and payment, as due. If the Issuing Bank contests the documents citing a discrepancy, the exporter's bank may argue the case on behalf of the exporter in order to secure acceptance of the documents by the Issuing Bank and, by implication, ensure payment as due. The second circumstance may be where the discrepancy is not minor, but not so obvious, or where they may be more than one minor discrepancy, the exporter's bank may process the documents under "silent reserve", that is, advise the exporter of the errors but not communicate these to the Issuing Bank. In this circumstance the exporter retains the risk of documentary rejection. It will be left up to the Issuing Bank to detect the errors and reject the documents as appropriate. The third circumstance may be where the discrepancy is obvious, such as an incorrect shipment date and this must be signalled as an error. As the determination of a discrepancy is subject to interpretation, there may occasions where the exporter's bank and the Issuing Bank have a difference of opinions. In such circumstances, the matter may be resolved between the banks or it may ultimately be referred back to the exporter, to negotiate an outcome with the buyer. To recall, as per Articles 3 and 14 of the UCP 500, documents that are not accepted are held at the disposal of the presenter.

The differences of interpretation between the exporter's bank and the Issuing Bank may result in payment delays or, in a worse-case situation, non-payment. As can be observed from the data in Table 6.44, in 11.8% of cases, differences in interpretations occur between banks that cause the document to be rejected by the Issuing Bank after the exporter's bank has signalled its acceptance of the documents lodged by the exporter.

Table 6.44: Letter of Credit cases where documents are accepted by the exporter's bank as compliant, but rejected by the Issuing Bank as non-compliant

	Frequency	Percent
Documents accepted by exporter's bank but rejected by the Issuing Bank	7	11.8
Documents accepted by the exporter's bank and the Issuing Bank	52	89.2
Total	59	100

The percentage of transactions that are subject to differing interpretations between banks is shown in Table 6.45. It should be noted that the 50% response is based on only two Letter of Credit transactions, that is one transaction encountered a problem, and the other did not.

Table 6.45: Percentage of Letter of Credit transactions subject to different banks' interpretations

Percentage of transaction subject to different bank interpretation	Frequency	Percent
1.0	2	28.6
2.0	1	14.3
5.0	1	14.3
10.0	2	28.6
50.0	1	14.3
Total	7	100

In order better to understand the implication of the response in Table 6.45, it is necessary to quantify the number of Letter of Credit transactions that have been subject to different interpretations by banks, so the magnitude of this problem may be estimated. The data in Table 6.46 shows that the number of Letter of Credit transactions affected by the different interpretations of banks is estimated to be twenty-one. Although it is not possible to estimate the monetary value of these transactions, the data suggest that for the survey sample, the interpretations of the Letter of Credit rules are not subject to wide or systemic variations across banks in different countries.

In the few instances where different interpretations occur, the solutions adopted to try to reach a resolution are for either the exporter's bank to argue the case on behalf of their client with the Issuing Bank or for the exporter's bank to refer the matter to the exporting firm, without further involvement, or to leave it to the exporter and the buyer to negotiate a settlement with a view to having the documents accepted. The data do not reveal any preference in the choice of any one of the three solutions outlined above and this is independent of firm size, industry cluster or importing country.

It should be noted that the Issuing Bank may claim fatuous discrepancies as a means of delaying payment on behalf of the buyer. This process is commonly referred to as "manufacturing discrepancies", referred to earlier in the thesis, although based on the available data this practice does not appear to be common-place in the context of this research. As one interviewed banker explained

They [buyer] don't have the cash to pay for it though sometimes as you know most of the transactions are in US dollars and so they can't get their hands on US dollars and sometimes it is a bit of an issue.

Table 6.46: Number of Letter of Credit transactions affected by different banks' interpretations

Number of Letter of Credit transactions		Percentage of differing bank opinions					Total number of Letter of Credit transacted
		1.0	2.0	10.0	50.0	Total	
2	Count	0	0	0	1	1	1
	% of Total	.0%	.0%	.0%	16.7%	16.7%	
3	Count	0	0	1	0	1	1
	% of Total	.0%	.0%	16.7%	.0%	16.7%	
8	Count	1	0	0	0	1	1
	% of Total	16.7%	.0%	.0%	.0%	16.7%	
15	Count	0	1	0	0	1	2
	% of Total	.0%	16.7%	.0%	.0%	16.7%	
60	Count	1	0	0	0	1	1
	% of Total	16.7%	.0%	.0%	.0%	16.7%	
150	Count	0	0	1	0	1	15
	% of Total	.0%	.0%	16.7%	.0%	16.7%	
Total	Count	2	1	2	1	6	21
	% of Total	33.3%	16.7%	33.3%	16.7%	100.0%	

Another interviewed banker was quite adamant that differences between banks would not cause documentary rejection, stating

I have never ever seen two banks get into a full blow on and dispute where the documents are totally rejected because the banks would not totally agree with themselves.

On a world-wide basis, the problems of discrepancies and spurious claims still exist, as the Rethinking Trade Finance: Global Survey 2010 (ICC Banking Commission 2010) states that

> results show that 34% of respondents had seen an increase in the number of refusals … the number of respondents seeing spurious or doubtful discrepancies declined to 44%, although this still represents a very high percentage of discrepancies that have little or no foundation (Collyer, G., p. 12).

Where documentary discrepancies occur that are not capable of being rectified, it seems that in the vast majority of cases, the buyer elects to accept the documents and pay nevertheless, as can be observed from Table 6.47.

Table 6.47: Letter of Credit documentary discrepancy resolution

Discrepancy resolution	0-25%	51-75%	76-100%	Total
Importer accepts documents and pays as planned	5	2	25	32
Importer seeks variation to the Letter of Credit - extended payment	5			5
Importer seeks a reduction in price	4		1	5

However, as the response rate is very low, care should be taken in the interpretation of these data, particularly as there may be other contributing factors that could explain buyer acceptance of discrepant documents in Letter of Credit transactions. These factors may include market forces and long-term established relationships. The findings on the acceptance of discrepant documents by buyers is consistent with the findings of a previous USA study (Mann 2000) where it was found that "applicants almost always waive the discrepancies and permit full payment" (p. 2513). In one circumstance in the USA study "the applicant did not refuse payment ; it permitted payment of 94% of the agreed amount" (Mann 2000, p. 2513). Whilst a reduction in price does not occur frequently, there is evidence in both the USA and the Australian studies that this does occur. It is important to note that the methodologies of the two studies are different, however, the results are consistent, highlighting this as a universal issue.

Bad debts resulting from Letter of Credit transactions were reported by ten respondents, as shown in Table 6.48. The bad debts experience reported by the surveyed population is independent of firm size or industry cluster. As can be observed from Table 6.48, fifty percent of the respondents experienced bad debts at a rate of 1% or lower. The maximum loss experienced by one organisation was 20%. However, it is not possible to quantify the magnitude of the bad debts. The results from this sample seem to correlate with the USA study reporting that "applicants would refuse payments in less than one per cent" of cases (Mann 2000, pp. 2513-2514).

Table 6.48: Average percentage of bad debts from Letter of Credit transactions

Average percentage of bad debts	Frequency	Percent	Cumulative Percent
0.5	1	10	10
1	4	40	50
3	1	10	60
5	1	10	70
10	2	20	90
20	1	10	100
Total	10		100

The distribution of bad debts is shown in Table 6.49. It can be observed that there is no discernible pattern between bad debts and country risk in the study sample, suggesting that bad debts may be based on a transaction-by-transaction basis, especially as their occurrence in the survey sample appears to be independent of firm size or industry cluster.

Table 6.49: Average percentage of bad debts from Letter of Credit transactions

Country	Bad debts frequency
Burma (Myanmar)	1
Indonesia	1
Malaysia	1
Philippines	2
Singapore	2
Thailand	2
Vietnam	1

Having considered discrepancies and bad debts, it is also relevant to consider whether dysfunctional work-places may be a contributing factor to documentary discrepancies and this is discussed in the next section.

6.6.4 Attributes for Letter of Credit processes

Dysfunctional work-places are a behavioural risk. Dysfunctionality may be the result of a chaotic environment, that is, one where there is a lack of controls or where controls are inadequate. However, dysfunctionality may also be caused by human error in processes. To be able better to understand the dynamics of a Letter of Credit transaction, respondents were asked to rank ten attributes, as shown in Table 6.50. Although there is some variation in the number of responses, meaning that some participants did not do a complete ranking, the difference is not sufficiently significant to invalidate the data.

Table 6.50: Attributes in Letter of Credit transactions from exporters' point of view

Attributes		Ranking										Total
		1st	2nd	3rd	4th	5th	6th	7th	8th	9th	10th	
1	Detailed knowledge of UCP 500	3	2	5	3	2	4	2	3	6	10	40
2	Understanding the Letter of Credit process	32	12	2	5	3	1	2	0	0	1	58
3	Prior experience in Letter of Credit transactions	15	21	10	4	6	0	2	2	0	0	60
4	Formal education in a relevant area	2	3	5	7	0	5	4	4	7	6	43
5	Relationship between buyer/seller	4	9	12	8	6	8	2	2	1	1	53
6	Country of export	3	6	9	5	7	9	4	2	2	4	51
7	Prior trading history	4	7	8	6	8	5	8	3	3	1	53
8	Supply-demand market forces	0	0	0	1	4	2	7	8	10	9	41
9	Relationships with the bank	2	3	6	6	4	7	4	9	4	2	47
10	Common industry practices	3	2	1	6	5	3	6	5	7	10	48

As can be observed from Table 6.50, the three top-ranked attributes are, equally, number two (understanding the Letter of Credit process) and number three (prior experience in Letter of Credit transactions) and number five (relationship between the seller and the buyer). The responses are independent of company size, industry cluster and number of employees directly employed in export documentation functions. The high rankings of understanding and experience in Letter of Credit transactions were expected, however, this was not the case for all responses. The relationship between seller and buyer ranked quite high and one explanation for this may be that where a good relationship exists between the traders, the chances of rejecting discrepant documents are likely to be lower, because of the strength of the relationship. This may also explain the relatively low ranking of country risk, as in the eyes of the exporter this would be mitigated by a strong relationship with the importer. A strong trading relationship could also explain the market supply and demand forces being ranked as least important.

Detailed knowledge of the UCP 500 ranked quite low and one explanation for this ranking may be that in understanding the process and having prior knowledge of Letter of Credit transaction, a degree of knowledge may be acquired that is sufficient for these transactions. This may also explain the relatively low importance placed by the respondents on the desirability of formal education in an area related to Letters of Credit.

Common industry practices and the relationship with the bank are ranked relatively low and this may also be influenced by the top three responses, that is, understanding the Letter of Credit process, prior experience with this payment instrument and a strong trading relationship. Responses were also obtained from freight forwarders and these are shown in Table 6.51. Although care needs to be taken in interpreting these responses, because of the low number (n=9), it can be observed that there is a high degree of correlation between the exporters' responses and those of freight forwarders.

Table 6.51: Attributes in Letter of Credit transactions from freight forwarders' point of view

Attributes	1st	2nd	3rd	Others	Total
Knowledge of UCP 500			1	4	5
Understanding the Letter of Credit process	1	1	1	2	5
Experience in Letter of Credit transactions	2	1		2	5
Education in relevant area				5	5
Relationship between buyer and seller		1		4	5
Country of export			1	4	5
Prior trading history			1	4	5
Supply-demand market forces			1	4	5
Relationships with the bank	1			4	5
Common industry practices		1		4	5

Understanding the Letter of Credit process and experience in Letter of Credit transactions are the highest ranked attributes by freight forwarders and this matches the responses from exporters. If these data are considered in conjunction with responses from banks, as shown in Table 6.52, it appears that there is a convergence of opinions about the most desired attributes relating to Letter of Credit business.

Table 6.52: Attributes in Letter of Credit transactions from bankers' point of view

Attributes	1st	2nd	3rd	Others	Total
Knowledge of UCP 500	1			4	5
Understanding the Letter of Credit process	2	2		1	5
Experience in Letter of Credit transactions	1	2	1	1	5
Education in relevant area				5	5
Relationship between buyer and seller		1		4	5
Country of export	1			4	5
Prior trading history			1	4	5
Supply-demand market forces				5	5
Relationships with the bank			3	2	5
Common industry practices				5	5

Although care needs to be exercised in interpreting the responses from the bankers, because these are a small number (n=5), the data nevertheless concur with the responses from exporters and freight forwarders that ranks the understanding of the Letter of Credit process and experience in dealing with Letters of Credit as the two most important attitudes. Whilst experience can only be gained over time and, therefore, cannot be 'given' to an individual, understanding, that is, knowledge can be imparted. Individuals can be educated on the Letter of Credit processes as a strategy to mitigate documentary non-compliance and thereby payment delays or, in more severe cases, bad debts.

Based on the responses, in approximately 75% of cases, less than 50% of staff have received specific Letter of Credit training, as shown in Table 6.53.

Table 6.53: Percentage of staff with specific Letter of Credit training

Percentage of staff with specific Letter of Credit training	Frequency	Percent	Valid Percent	Cumulative Percent
0-25	70	53.0	64.2	64.2
26-50	12	9.1	11.0	75.2
51-75	5	3.8	4.6	79.8
76-100	22	16.7	20.2	100.0
Total	109	82.6	100.0	

The data shown in Table 6.54 indicate that experience in Letter of Credit transactions is five years or less in approximately 55% of cases.

Table 6.54: Experience in Letter of Credit transactions (n = 104)

Years of experience	Frequency	Percent	Valid Percent	Cumulative Percent
0-1 year	16	12.1	15.4	15.4
2-3years	27	20.5	26.0	41.3
4-5years	14	10.6	13.5	54.8
more than 5 years	47	35.6	45.2	100.0
Total	104	78.8	100.0	

The data from Table 6.55 suggest that the number of Letter of Credit transactions operate at opposite ends of the scale. In approximately 37% of cases, the number of Letter of Credit transactions is less than five per annum and in approximately 48% of cases, the transaction levels are above 51 per annum.

Table 6.55: Number of Letter of Credit transactions per annum (n = 122)

Transactions	Frequency	Percent	Valid Percent	Cumulative Percent
Up to 5	45	34.1	36.9	36.9
6 to 10	10	7.6	8.2	45.1
11 to 20	4	3.0	3.3	48.4
21 to 50	4	3.0	3.3	51.6
More than 51	59	44.7	48.4	100.0
Total	122	92.4	100.0	

As can be observed from Table 6.56, the documentary rejection rate is independent of the number of staff employed in export documentation functions.

Table 6.56: Rejection rates by number of staff employed in documentation functions

Number of staff		Letter of Credit ever been rejected		Total
		Yes	No	
None	Count	0	2	2
	% of Total	.0%	2.8%	2.8%
One	Count	4	23	27
	% of Total	5.6%	32.4%	38.0%
Two	Count	8	15	23
	% of Total	11.3%	21.1%	32.4%
3 or more	Count	3	16	19
	% of Total	4.2%	22.5%	26.8%
Total	Count	15	56	71
	% of Total	21.1%	78.9%	100.0%

There is no evidence linking firm size or length of export activity to documentary discrepancies or bad debts. However, when discrepancy rates are analysed on the basis of internally produced documents only, that is, items a, b, c and e from Table 6.36, it can be observed from Table 6.57 that the discrepancy rates are generally higher when staff training is low.

Table 6.57: Rejection rates by internally produced documents

Percentage of staff with specific Letter of Credit training		Errors in the bill of exchange	Errors in the commercial invoice	Errors in the packing list	Errors in the insurance certificate
0-25	Count	14	12	9	11
	% of Total	66.7%	54.5%	42.9%	57.9%
26-50	Count	4	6	5	4
	% of Total	19.0%	27.3%	23.8%	21.1%
51-75	Count	1	1	1	1
	% of Total	4.8%	4.5%	4.8%	5.3%
76-100	Count	2	3	6	3
	% of Total	9.5%	13.6%	28.6%	15.8%
Total	Count	21	22	21	19
	% of Total	100.0%	100.0%	100.0%	100.0%

For example, there is a 66.7% discrepancy rate on the bill of exchange associated with a low percentage of trained staff and a similar trend can be observed for the commercial invoice (54.5%), the packing list (42.9%) and the insurance certificate (57.9%). It can be observed that the downward trend in discrepancies continues as staff training increases. However, there is a slight increase in the numbers for the 76-100 staff training and, although the reason for this is not certain, the most likely explanation is the increased numbers of transactions. These data underscore the importance of training in Letter of Credit transactions.

In relation to specific Letter of Credit training, it appears that short courses are being offered to the public but their up-take is not very high. The Australian Institute of Export, the peak industry body representing the interests of Australian exporters, offers a one-day course in every major capital city at regular intervals, entitled ‘Understanding Documentary Credits’. Their enrolments for 2009 calendar year were 60 students (Matsuki 2010). The Australian Institute of Export also offers a three-day ‘Export Procedures Course’ that, in part, addresses aspects of Letter of Credit transactions and this attracted 196 students for the same period (Matsuki 2010). Although there are some other industry organisations that offer short courses, it is known that enrolments numbers are low. As these courses are attended by existing, as well as by new exporters, it is difficult to imagine that enough skills are being developed in the exporting community, especially when considered in the light of the Federal government’s wish to continue to increase the number of exporters (Brewer 2010). It is argued here that a more educated individual will have more knowledge and skills better to deal with the intricacies of Letter of Credit business and this is likely to enhance the experience gained over time.

It was anticipated that the questionnaire would be completed by individuals involved in the Letter of Credit process from an operational level, however, it is evident that this is not the case. The questionnaires have been filled by individuals with knowledge of the firm’s activities but not those who make decisions about Letter of Credit processes. Therefore, the information is not relevant to the research questions, consequently, the data from section 4 of the exporter’s survey were not analysed.

6.7 Data Discussion Summary

There is evidence from the data that Australian manufacturing exporters doing business with ASEAN nations are using the Letter of Credit as a risk management tool in order to secure payment. The main reason why the Letter of Credit is utilised is because foreign buyers and their countries are regarded by Australian exporters as an unacceptable credit risk.

In deciding on the use of the Letter of Credit as the payment method of choice the results indicate that an ERM approach is being pursued as, in a significant proportion of firms, combined decision making across different organisational units is reported.

The use of Letters of Credit is not without risks and these ultimately relate to documents, as where documents are non-complaint the payment assurance is severely weakened. The results show a concerning level of documentary discrepancy frequency, although this is less than half of that estimated by the ICC on a global basis. Significantly though, these documentary discrepancies appear to convert to bad debts at a rate that is generally below one percent and this is consistent with the findings of a previous USA study (Mann 2000). Despite the low bad debt rate, documentary discrepancies may contribute to payment delays and, additionally, cause productivity losses through their rectification.

The most desirable attributes for Letter of Credit processes have been identified as experience and knowledge. Although experience cannot be imparted, knowledge can, but it does not appear that there are enough opportunities available for education in this specific aspect of international trade transactions.

Having discussed the data the conclusions and recommendations are provided in the next chapter.

7. Summary, Conclusion and Recommendations

This chapter summarises the main points of the thesis and provides a conclusion, based on the research objectives, together with a framework for the theoretical implications of this study, followed by a set of recommendations. The limitations of the data are acknowledged and possible opportunities for future research in this area are suggested.

7.1 Summary

This thesis focused on a specific area of risk management, that is, the risks associated with Letter of Credit transactions to which Australian manufacturing exporters may be exposed, when trading with ASEAN countries. It is generally accepted that the Letter of Credit is perceived by exporters to be considered as a guarantee of payment. This thesis investigates the use and purpose of the Letter of Credit as a form of international payment risk management tool. A short history of trade finance instruments was provided as background to the developments that took place over the centuries. Of particular importance and relevance to this research are the developments since the Middle Ages and the Renaissance period in Europe that have provided some of the doctrines and principles that are now embedded in modern day international transactions. Examples of these include the development of the use of the bill of exchange where different currencies are involved and parties reside in different countries and the Doctrine of Baldus that gave rise to the protesting of a bill of exchange.

The literature review was divided into three parts. Part I identified and discussed the development of various risk management approaches over the years and how these appear to be converging towards an Enterprise-wide Risk Management (ERM) approach, regardless of the country or the standard used. Part II identified literature that was relevant to the Letter of Credit process with a focus on discrepancies. Part III considered an internal audit risk management approach for Letter of Credit transactions and proposed a theoretical framework to manage the risks associated with these transactions.

An explanation and discussion of the complexities of Letter of Credit operations was provided to highlight the potential risks that are an integral part of this payment mechanism, particularly in relation to documentary discrepancies that strike at the core of this method of payment.

The methodology was developed from the identification of the problem within an operations risk management context, from which the objectives were developed. There were two types of data used for this research. Primary data were obtained through written surveys and semi-structured personal interviews administered to firms who were exporting Australian manufactured products to ASEAN. Secondary data were obtained from the public domain. These data were analysed concurrently to achieve the objectives of the study. These objectives are discussed in the next section.

7.2 Conclusion

This research had ten objectives and each one of these is discussed below.

Objective 1: Determine the attributes of the firm that are associated with the error rate

Most exporting firms are small enterprises of which approximately half are new exporters (less than ten years of export activity) trading in a medium to high credit risk environment with the Letter of Credit more commonly used as transaction values increase. Most commonly, CIF is used as the delivery term, with open insurance policies. Exporters predominantly use freight forwarders to get their exports to ports. The majority of documents is manually completed and exporters prefer to deal only with their bank.

Objective 2: Measure the magnitude of trade between Australian manufacturing exporters and ASEAN that is conducted by L/C and also the percentage of this trade in proportion to total trade to the same geographical area

In 2008 manufacturing exports to ASEAN were estimated to be AUD 8.85 billion and Letter of Credit business is estimated to account for about 40% of total transaction values at approximately AUD 3.54 billion.

Objective 3: Establish the reason for using Letters of Credit as the payment method of choice. This may link to the proposition that Letters of Credit are used as a risk management tool

The primary reason for choosing the Letter of Credit in the majority of cases is unacceptable customer risk. Country risk and transaction value are two other significant reasons.

Objective 4: Measure the usage of different types of Letters of Credit

The standard Letter of Credit payable at sight is used in the majority of cases. Confirmed Letters of Credit are used in less than a quarter of cases.

Objective 5: Measure the magnitude and frequency of discrepancies, the amounts involved and the corrective measures to resolve any disputes. Why are discrepancies allowed to occur? What arrangements are put in place when problems arise?

About one quarter of transactions experience documentary discrepancies. The majority of documentary discrepancies occur on in-house produced documentation. The reason for discrepancies occurring is not known with certainty but discrepancies may occur for a number of reasons including the failure to follow procedures or because of human activity. The cost of rectifying a single discrepancy, where possible, is estimated at AUD 113. Where the discrepancy cannot be rectified three outcomes are possible:

a. Minor discrepancies that do not materially effect the consignment may be ignored by the banks and payment effected regardless; or

b. Exporter’s bank may process under ‘silent reserve’ and payment will be forthcoming if the Issuing Bank accepts the documents; or

c. Documents are subject to prior acceptance by the buyer before payment is effected.

Objective 6: Estimate the level of bad debts incurred as a result of Letter of Credit discrepancies

It was not possible to quantify the magnitude of bad debts with certainty. In approximately half of responses bad debts are at levels of 1% or less and this is consistent with a separate USA study. A single case reported a twenty per cent loss but no further details were provided, preventing further comment.

Objective 7: Determine the priority of attributes for export documentation employees

The three top-ranked attributes, in priority order, are: understanding the Letter of Credit process; prior experience in Letter of Credit transactions; and relationship between the seller and the buyer.

Objective 8: Determine the level of training received internally/externally by employees

In the majority of cases, staff handling Letter of Credit transactions have no specific training other than perhaps on-the-job training, although no information is available about in-house training, preventing further comment.

Objective 9: Determine whether the exporting firm is exposed to foreign exchange currencies and how this risk is managed

Approximately half of the respondents do not have a currency exposure because they trade in AUD only. Company policies to manage foreign exchange exposure, where applicable, are not commonly used. The finance department is involved in foreign exchange risk management in just over eleven percent of cases.

Objective 10: Establish the frequency of discounting proceeds

Proceeds are discounted but this applies in the minority of circumstances and it is independent of the size of the firm.

The recommendations that arise from the objective outlined above are provided in the section following the theoretical implications that are discussed below.

7.3 Theoretical implications

Having analysed and discussed the data from the survey in the previous chapter, this section considers the Export Letter of Credit Business Model and its application and relevance to the research findings of this thesis.

To recall, the basic proposition of this thesis is to test whether Letters of Credit are used to manage risk exposure in export payments. This was specifically tested in respect of Australian manufactured products to ASEAN. In order to assess the value of the Letter of Credit as a risk mitigation tool in international payments, the Export Letter of Credit Business Model, as outlined in Chapter 3, is used as a conceptual framework against which positive and negative aspects of the research findings, as discussed earlier in this chapter, may be considered. This model is applicable as a risk management framework in any international trade transaction at the micro level. The model is reproduced at Figure 7.1.

Figure 7.1: Export Letters of Credit Business Risk Model (adapted from McNamee) (Bergami 2010, p. 168)

7.3.1 Environmental Risks

Environmental Risk comprises three main elements: Country, Bank and Customer Risk. As stated before, all of these risks are known to exist, as evidenced by the fact that these risks are measured by different approaches, including the OECD's *Country Risk Assessment Model*, World Bank's *Doing Business* project and a variety of reports and surveys by Transparency International. In the context of Letter of Credit business, country risk is an important consideration because more than half of the surveyed exporting firms transact with medium to high risk countries, as per Table 6.11.

Micro and medium firms are the greatest users of the Letter of Credit, as per Figure 6.1. The Letter of Credit tends to be the payment method of choice as export sales increase. As country risk and bank risk are inextricably linked and the Letter of Credit effectively provides for the substitution of the importer's credit risk with that of their bank, these issues need to be considered together. The data, at Table 6.14, show internal assessment of country and customer risk being conducted through a variety of approaches, some of which indicate an Enterprise Risk Management approach. Export Credit insurance, as shown in Table 6.19, is also used as an additional risk management tool.

By far the biggest reason for choosing the Letter of Credit as a payment term is the unacceptable customer risk, as per Table 6.16. The use of confirmation of Letters of Credit, itself an indicator of risk consideration by the exporting firm, in the context of bank/country risk, is evidenced by a significant proportion of responses choosing to use confirmation, as per Table 6.20. Bad debt risks in Letter of Credit transactions are reported in Table 6.49, albeit at below 1% of traded values, a figure generally consistent with that found in existing literature. Bad debts were reported in seven of the ten ASEAN nations, as shown in Table 6.50. Bank Risk in this study is evidenced by the data shown at Table 6.45 where there are differential interpretations of documents by the Issuing Bank, resulting in non-acceptance and non-payment. These differences, however, appear to have been resolved on behalf of the exporter by their bank. However, recent government policy changes may increase bank risk as, in countries such as the Philippines, recent government reforms to enable thrift banks to issue Letters of Credit have resulted in banks only needing one experienced staff member on site.

In summary, the use of the Letter of Credit is a useful tool in reducing the risk of trading with foreign countries, importers and their banks. Therefore, within the Environmental Risk section, the results support the inclusion of the Country Risk, Customer Risk and Bank Risk elements in the Export Letter of Credit Business Risk Model.

7.3.2 Process Risks

Process Risk comprises four main elements: Errors, Omissions, Delays and Frauds, with two additional elements: Hazards and Productivity losses, respectively, shared with Process Risk and Behavioural Risk.

Hazards of a physical nature are mainly managed through the choice of Incoterms 2000, as shown in Figure 6.7, and the delivery method chosen to have the export consignment transported to the point of export, with 50% of consignments collected by forwarders, as shown in Figure 6.10. Additionally, physical hazards are managed through the application of cargo insurance coverage, as shown in Table 6.24. Hazards of a documentary nature are likely to be part of the Errors, Omissions and Delays elements. There is a link between the choice of Incoterms 2000 and the consequential physical risk apportioned to the seller. The Letter of Credit would demand evidence of insurance in case of CIF and CIP transactions and this would effectively mitigate physical hazard.

Errors may occur in a number of different processes but the focus of this thesis is on Letter of Credit risks that may be manifested through documentary errors resulting in non-compliance. A number of these errors may also be caused by Omissions. These Omissions may be data missing from documents, either as the result of internal processes (in-house generated documents) or externally generated documents. Indeed, Table 6.37 evidences the existence of discrepancies that arise in both internal and external documents.

Omissions in documents are evidenced by the data reported in Table 6.42. This Table also indicates circumstances where non-documentary omissions occur, such as in the case of partial shipments.

Delays may relate to the physical movement of product but very importantly delays may also relate to payment resulting from non-compliant documents. The trading relationship that exists between the exporter and the importer (applicant) may be an influential factor in circumstances where discrepancies exist. Existing literature reports that discrepancies are common-place but that payment is refused in less that one percent of cases on average, as the buyer is not concerned on the technicalities of documentary accuracy, unless this indicates the ultimate delivery of non-confirming goods.

However, the issue of payment delays paints a very different picture, especially in the garment industry where, according to existing literature, there is a propensity for importers to delay payment for up to a month using discrepant documents as the reason for the delay. Under these circumstances, exporters face increased financials costs, as payment delays have consequential effects on cash flows and profitability. Furthermore, as evidenced by the data in Table 6.48, at times importers may also seek a reduction in price to accept non-compliant documents.

Frauds, unless perpetrated by the exporter, are only likely to occur where a Letter of Credit may be received directly by a foreign bank, however, in this study there is no evidence of such practice from the data.

Productivity losses may be simply regarded as the culmination of the events identified in this section. There are costs associated with rectifying discrepant documents, as shown in Table 6.44. There are also further unquantified losses to the exporting firm when time needs to be spent negotiating documentary acceptance from an importer that has received non-compliant documents.

Although the Letter of Credit does not prevent discrepancies occurring, there is evidence that the vast majority of these discrepancies do not materially affect the ultimate payment, albeit some delays may occur. An exporter with discrepant documents still carries a stronger position in relation to a claim for payment from an importer, as Issuing Banks are known actively to discourage and 'pressure' importers to accept immaterial documentary discrepancies. If exporters were dealing with open account or bill of exchange transactions, banks would not be in a position to exert the same pressure on importers.

The reasons and the supporting evidence outlined in this section warrant the Hazards, Errors, Omissions, Delays, Frauds, and Productivity Losses elements being included in the Export Letter of Credit Business Risk Model.

7.3.3 Behavioural Risks

Behavioural Risks comprises Dysfunctional work places. There is a strong correlation between Process Risks and Dysfunctional work places, where each may affect the other. On one hand, where processes are not followed by staff, this will contribute to dysfunction in the firm. On the other hand, unclear (or non-existent) processes will result in chaos in the exporting firm. Staff need to be competent and committed to the processes of an organisation because risk increases as competence decreases. As discrepancies are not caused by machines but humans, documentary discrepancies are created by humans. Consequently, given the high proportion of manually generated internal documents, there is a higher propensity for errors. To recall, the data show that discrepancy rates appear to be independent of standard operating procedures or policies, implying human error. Although the Letter of Credit does not prevent dysfunction in a work-place, it can certainly assist in highlighting flawed processes, enabling the firm to consider appropriate remedies. Consequently, the inclusion of Dysfunctional work places in the Export Letter of Credit Business Risk Model is warranted.

On balance it is argued here that the Letter of Credit, although not a perfect instrument in the hands of exporters, nevertheless provides much better payment assurance and risk management options than those afforded by open account or bill of exchange transactions.

7.4 Recommendations

There is evidence form this research that the Letter of Credit is used by Australian manufacturing exporters to ASEAN as a risk management tool to mitigate payment default by foreign buyers. However, there is a umber of areas where processes could be improved and recommendations to this effect are outlined below.

Recommendation 1

The internal assessment of country and customer risk does not appear to follow an ERM framework. Although more than three-quarters of respondents identified unacceptable customer risk as the reason for choosing a Letter of Credit, only 38.6% of respondents are utilising an inter-departmental approach in choosing the Letter of Credit as the payment method of choice.

It is recommended that the exporting firm adopt an integrated approach to risk management by incorporating the choice of payment method into its ERM framework. This will improve the overall understanding of the company's risk position from an inter-departmental perspective.

Recommendation 2

Exporting firms may be subject to foreign exchange exposure and the data from this research show that this aspect of trade is not managed well.

It is recommended that exporting firms develop foreign exchange risk management strategies using an ERM approach, to minimise any potential losses from unfavourable foreign currency movements, particularly given the large fluctuations *in the value of the Australian dollar in international markets over the past two years. The setting of appropriate foreign exchange risk management strategy must be inter-departmental and, at the very least, include sales, marketing and finance. It is recommended that an appropriate threshold be established in line with the firm's risk appetite in the context of its trading environment.*

Recommendation 3

The Letter of Credit is established by the foreign bank with specific documentary requirements. Some exporting firms are proactive in managing these requirements by providing foreign buyers with a set of acceptable terms.

It is recommended that all exporting firms develop a template of acceptable Letter of Credit conditions to maximise the opportunity of a successful transaction. The template should be developed using a multi-disciplinary approach that encompasses sales, marketing, finance, distribution and external service providers, such as freight forwarders, to ensure conditions can be complied with.

Recommendation 4

Documentary discrepancies occur in the processing of Letter of Credit transactions and, consequently, the exporting firm jeopardises the payment protection afforded by this method of payment and prevents the discounting of proceeds in deferred payment circumstances. There are poorly developed procedures for processing Letter of Credit transactions and where such procedures exist, there is evidence of poor adherence.

It is recommended that

a. standard operating procedures be developed where these do not exist and that these incorporate, as much as possible, checklists for staff to follow to ensure compliance to the Letter of Credit requirements to maximise payment opportunities; and

b. where procedures currently exist, it is recommended that staff be directed to use and follow these procedures and if the procedures are found to be inadequate, it is recommended that staff be included in the revision of such procedures.

The involvement of staff in the development of new or revised procedures is likely to produce a sense of 'ownership' and commitment to the process, thereby increasing the likelihood of compliance. Compliant documents enable the *exporting firm to seek discounting of the proceeds in deferred payment arrangements.*

Recommendation 5

The majority of documentation is still produced manually, potentially exacerbating documentary discrepancy rates.

It is recommended that

a. *to decrease the documentary discrepancy rates, in-house documentation production be automated, wherever possible, either using commercially available software solutions or devising proprietary in-house solutions.*
b. *exporting firms should leverage automated documentation production by utilising and integrating systems available from service providers, such as freight forwarders.*

Recommendation 6

There is evidence that a small number of exporting firms trade with the use of "Delivered terms Incoterms 2000". The choice of such terms increases the exporter's risk in transit for the goods and places a more onerous and difficult to comply with burden of proof of delivery through documentary evidence in Letter of Credit transactions.

It is recommended that Delivered terms Incoterms 2000 not be used in export Letter of Credit transaction to reduce the carriage risk exposure and remove the burden of proof of delivery from the Letter of Credit documentary requirements.

Recommendation 7

There is evidence from the data that staff are not specifically trained in Letter of Credit processes and this contributes to documentary discrepancy rates.

It is recommended that

a. *all documentation staff receive adequate training on the processes and procedures relating to Letter of Credit transactions, prior to their involvement in such transactions.*
b. *sales, marketing, finance and distribution staff be trained at a basic level on the processes and procedures associated with Letter of Credit business, in an ERM approach to managing this method of payment.*

c. *Austrade review its policies related to the eligibility of Export Market Development Grant recipients – these are new exporters – to mandate appropriate minimum levels of training on Letter of Credit business, to minimise payment defaults through documentary discrepancies. The minimum level of training may be satisfied by attendance at existing courses, such as those offered by the Australian Institute of Export or the development of new courses. Funding for this initiative may be required but this should be regarded as an investment in the development of future export business.*

7.5 Limitations

This research is not without limitations and the following comments should be taken into consideration when applying the results.

- The topic is narrow by its nature as it is limited to examining a small segment of the total risks that a firm faces in the daily conduct of its business.
- The theoretical framework uses a conceptual approach that is limited to operational risk. The framework was an adaptation of a previous internal audit model for managing business risk. The new framework, although used to analyse Letter of Credit transactions in the present thesis, has great potential because its principles have wider conceptual applications in other risk management contexts at the macro level.
- The sample population was limited to Australia and further limited to local manufacturing exporters to ASEAN nations. A different population sample may yield different results.
- A number of variables was measured on a categorical scale which limited their use for advanced analysis.

7.6 Suggestions for future studies

There is scope to extend this research in the future by widening the sample population to include all Australian exporters in order to learn more about the use and purpose of the Letter of Credit in international trade transactions.

There is also scope to widen the research by including all countries with which Australia trades and not just the ASEAN nations.

There is further scope for studying the interaction between the Letter of Credit and other risk management practices, because other methods may be used instead of the Letter of Credit to secure payment from foreign buyers.

Additionally, studies could be conducted with importers in Australia and foreign countries to learn whether their risk management approaches are similar to, or different from, those used by exporters.

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Appendix 1

A.1 Text of the UCP 500

UCP 500

Article 1
Application of UCP
The Uniform Customs and Practice for Documentary Credits, 1993 Revision, ICC Publication no. 500, shall apply to all Documentary Credits (including to the extent to which they may be applicable, Standby Letter(s) of Credit) where they are incorporated into the text of the Credit. They are binding on all parties thereto, unless otherwise expressly stipulated in the Credit.

Article 2
Meaning of Credit
For the purposes of these Articles, the expressions "Documentary Credit(s)") mean any arrangement, however named or described, whereby a bank (the "Issuing Bank") acting at the request and on the instructions of a customer (the "Applicant") or on its own behalf,

- **i.** is to make a payment to or to the order of a third party (the "Beneficiary"), or is to accept and pay bills of exchange (Draft(s)) drawn by the Beneficiary,
  or
- **ii.** authorises another bank to effect such payment, or to accept and pay such bills of exchange (Draft(s)),
- **iii.** authorises another bank to negotiate,

against stipulated document(s), provided that the terms and conditions of the Credit are complied with.
For the purposes of these Articles, branches of a bank in different countries are considered another bank.

Article 3
Credits v. Contracts

- **a.** Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever is included in the Credit. Consequently, the undertaking of a bank to pay, accept and pay Draft(s) or negotiate and/or to fulfil any other obligation under the Credit, is not subject to claims or defences by the Applicant resulting from his relationships with the Issuing Bank or the Beneficiary.
- **b.** A beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the Applicant and the Issuing Bank.

Article 4
Documents v. goods/Services/Performances
In Credit operations all parties concerned deal with documents, and not with goods, services and/or other performances to which the documents may relate.

Article 5
Instructions to Issue/Amend Credits

a. Instructions for the issuance of a Credit, the Credit itself, instructions for an amendment thereto, and the amendment itself, must be complete and precise.
In order to guard against confusion and misunderstanding, banks should discourage any attempt:
  - **i.** to include excessive detail in the Credit or in any amendment thereto;
  - **ii.** to give instructions to issue, advise or confirm a Credit by reference to a Credit previously issued (similar Credit) where such previous Credit has been subject to accepted amendment(s), and/or unaccepted amendment(s).

b. All instructions for the issuance of a Credit and the Credit itself and, where applicable, all instructions for an amendment thereto and the amendment itself, must state precisely the document(s) against which payment, acceptance or negotiation is to be made.

Article 6
Revocable v. Irrevocable Credits

a. A Credit may be either
  - **i.** revocable
    or
  - **ii.** irrevocable.

b. The Credit, therefore, should clearly indicate whether it is revocable or irrevocable.

c. In the absence of such indication the Credit shall be deemed to be irrevocable.

Article 7
Advising Bank's liability

a. A Credit may be advised to a beneficiary through another bank (the "Advising Bank") without engagement on the part of the Advising Bank, but that bank, if it elects to advise the Credit, shall take reasonable care to check the apparent authenticity of the Credit which it advises. If the bank elects not to advise the Credit, it must so inform the Issuing Bank without delay.

b. If the Advising Bank cannot establish such apparent authenticity it must inform, without delay, the bank from which the instructions appear to have been received that it has been unable to establish the authenticity of the Credit and if it elects nonetheless to advise the Credit it must inform the Beneficiary that it has not been able to establish the authenticity of the Credit.

Article 8
Revocation of a Credit

a. A revocable Credit may be amended or cancelled by the Issuing Bank at any moment and without prior notice to the Beneficiary.

b. However, the Issuing Bank must:
  - **i.** reimburse another bank with which a revocable Credit has been made available for sight payment, acceptance or negotiation – for any payment, acceptance or negotiation made by such bank – prior to receipt by it of notice of amendment or cancellation, against documents which appear on

their face to be in compliance with the terms and conditions of the Credit;

ii. reimburse another bank with which a revocable Credit has been made available for deferred payment, if such a bank has, prior to receipt by it of notice of amendment or cancellation, taken up documents which appear on their face to be in compliance with the terms and conditions of the Credit.

Article 9
Liability of issuing and Confirming Banks

a. An irrevocable Credit constitutes a definite undertaking of the Issuing Bank, provided that the stipulated documents are presented to the Nominated Bank or to the Issuing Bank and that the terms and conditions of the Credit are complied with:

i. if the Credit provides for sight payment – to pay at sight;

ii. if the Credit provides for deferred payment – to pay on the maturity date(s) determinable in accordance with the stipulations of the Credit;

iii. if the Credit provides for acceptance:

a. by the Issuing Bank – to accept draft(s) drawn by the Beneficiary on the Issuing Bank and pay them at maturity,
or

b. by another drawee bank – to accept and pay at maturity Draft(s) drawn by the Beneficiary on the Issuing Bank in the event the drawee bank stipulated in the Credit does not accept Draft(s) drawn on it, or to pay Draft(s) accepted but not paid by such drawee bank at maturity;

iv. if the Credit provides for negotiation – to pay without recourse to drawers and/or bona fide holders, Draft(s) drawn by the Beneficiary and/or document(s) presented under the Credit. A Credit should not be issued available by Draft(s) on the Applicant. If the Credit nevertheless calls for Draft(s) on the Applicant, banks will consider such Draft(s) as an additional document(s).

b. A confirmation of an irrevocable Credit by another bank (the "Confirming Bank") upon the authorisation or request of the Issuing Bank, constitutes a definite undertaking of the Confirming Bank in addition to that of the Issuing Bank, provided that the stipulated documents are presented to the Confirming bank or to any other Nominated Bank and that the terms and conditions of the Credit are complied with:

i. i. if the Credit provides for sight payment – to pay at sight;

ii. ii. if the Credit provides for deferred payment – to pay on the maturity date(s) determinable in accordance with the stipulations of the Credit;

iii. iii. if the Credit provides for acceptance:

a. by the Confirming Bank – to accept Draft(s) drawn by the Beneficiary on the Confirming Bank – to accept Draft(s) drawn by the Beneficiary on the Confirming Bank and pay them at maturity,
or

b. by another drawee bank – to accept and pay at maturity Draft(s) drawn by the Beneficiary on the Confirming Bank, in the event the drawee bank stipulated in the Credit does not accept Draft(s) drawn on it, or to pay Draft(s) accepted but not paid by such drawee bank at maturity;

iv. if the Credit provides for negotiation – to negotiate without recourse to drawers and/or bona fide holders, Draft(s) drawn by the Beneficiary and/or document(s) presented under the Credit. A Credit should not be issued available by Draft(s) on the Applicant. If the Credit nevertheless calls for Draft(s) on the Applicant, banks will consider such Draft(s) as an additional document(s).

c. **i.** If another bank is authorised or requested by the Issuing Bank to add its confirmation to a Credit but is not prepared to do so, it must so inform the Issuing Bank without delay.

ii. Unless the Issuing Bank specifies otherwise in its authorisation or request to add confirmation, the Advising Bank may advise the Credit to the Beneficiary with out adding it's confirmation.

d. **i.** Except as otherwise provided by Article 48, an irrevocable credit can neither be amended nor cancelled without the agreement of the Issuing Bank, the Confirming Bank, if any, and the Beneficiary.

ii. The issuing Banks shall be irrevocably bound by an amendment(s) issued by it form the time of the issuance of such amendment(s). A Confirming Bank may extend its confirmation to an amendment and shall be irrevocably bound as of the time of its advice of the amendment. A Confirming Bank may, however, choose to advise an amendment to the Beneficiary without extending its confirmation and if so, must inform the Issuing Bank and the Beneficiary without delay.

iii. The terms of the original credit (or a Credit incorporating previously accepted amendment(s)) will remain in force for the Beneficiary until the Beneficiary communicates his acceptance of the amendment to the bank that advised such amendment. The Beneficiary should give notification of acceptance or rejection of amendment(s). If the Beneficiary fails to give such notification, the tender of documents to the Nominated Bank or Issuing Bank, that conform to the Credit and to not yet accepted amendment(s), will be deemed to be notification of acceptance by the Beneficiary of such amendment(s) and as of that moment the Credit will be amended.

iv. Partial acceptance of amendments contained in one and the same advice of an amendment is not allowed and consequently will not be given any effect.

Article 10
Types of credit

a. All Credits must clearly indicate whether they are available by sight payment, by deferred payment, by acceptance or by negotiation.

b. **i.** Unless the Credit stipulates that it is available only with the Issuing Bank, all Credits must nominate the bank (the "Nominated Bank") which is authorised to pay, to incur a deferred payment undertaking to accept Draft(s) or to negotiate. In a freely negotiable Credit, any bank is a Nominated Bank.

Presentation of documents must be made to the Issuing Bank or the Confirming Bank, if any, or any other Nominated Bank.

ii. Negotiation means the giving of value for Draft(s) and/or document(s) by the bank authorised to negotiate. Mere examination of the documents without giving of value does not constitute a negotiation.

c. Unless the Nominated Bank is the Confirming Bank, nomination by the Issuing Bank does not constitute any undertaking by the Nominated Bank to pay, to incur a deferred payment undertaking, to accept Draft(s), or to negotiate. Except where expressly agreed to by the Nominated Bank and so communicated to the Beneficiary, the Nominated Bank's receipt of and/or examination and/or forwarding of the documents does not make that bank liable to pay, to incur a deferred payment undertaking to accept Draft(s), or to negotiate.

d. By nominating another bank, or by allowing for negotiation by another bank, or by authorising or requesting another bank to add its confirmation, the Issuing Bank authorises such bank to pay, accept Draft(s) or negotiate as the case may be, against documents which appear on their face to be in compliance with the terms and conditions of the Credit and undertakes to reimburse such bank in accordance with the provisions of these Articles.

Article 11
Teletransmitted and Pre-Advised Credits

a. **i.** When and Issuing Bank instructs an Advising Bank by an authenticated teletransmission to advise a Credit or an amendment to a Credit, the teletransmission will be deemed to be the operative Credit instrument or the operative amendment, and no mail confirmation should be sent. Should a mail confirmation nevertheless be sent, it will have no effect and the Advising Bank will have no obligation to check such mail confirmation against the operative Credit instrument or the operative amendment received by teletransmission.

ii. If the teletransmission states "full details to follow" (or words of similar effect) or states that the mail confirmation is to be the operative Credit instrument or the operative amendment, then the teletransmission will not be deemed to be the operative Credit instrument or the operative amendment. The Issuing Bank must forward the operative Credit instrument or the operative amendment to such Advising Bank without delay.

b. If a bank uses the services of an Advising Bank to have the Credit advised to the Beneficiary, it must also use the services of the same bank for advising an amendment(s).

c. A preliminary advise of the issuance or amendment of an irrevocable Credit (pre-advice), shall only be given by an Issuing Bank if such bank is prepared to issue the operative Credit instrument or the operative amendment thereto. Unless otherwise stated in such preliminary advice by the Issuing Bank, an Issuing Bank having given such pre-advice shall be irrevocably committed to issue or amend the Credit, in terms not inconsistent with the pre-advice, without delay.

Article 12
Incomplete or Unclear Instructions

If incomplete or unclear instructions are received to advise, confirm or amend a Credit, the bank requested to act on such instructions may give preliminary notification to the Beneficiary for information only and without responsibility. This preliminary notification should state clearly that the notification is provided for information only and without the responsibility of the Advising Bank. In any event, the Advising Bank must inform the Issuing Bank of the action taken and request it to provide the necessary information.
The Issuing Bank must provide the necessary information without delay. The Credit will be advised, confirmed or amended, only when complete and clear instructions have been received and if the Advising Bank is then prepared to act on the instructions.

Article 13
Standard for Examination of Documents

a. Banks must examine all documents stipulated in the Credit with reasonable care, to ascertain whether or not they appear, on their face, to be in compliance with the terms and conditions of the Credit. Compliance of the stipulated documents on their face with the terms and conditions of the Credit, shall be determined by international standard banking practice as reflected in these Articles. Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in compliance with the terms and conditions of the Credit.
Documents not stipulated in the Credit will not be examined by banks. If they receive such documents, they shall return them to the presenter or pass them on without responsibility.

b. The Issuing Bank, the Confirming Bank, if any, or a Nominated Bank acting on their behalf, shall each have a reasonable time, not to exceed seven banking days following the day of receipt of the documents, to examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly.

c. If a Credit contains conditions without stating the document(s) to be presented in compliance therewith, banks will deem such conditions as not stated and will disregard them.

Article 14
Discrepant Documents and Notice

a. When the Issuing Bank authorises another bank to pay, incur a deferred payment undertaking, accept Draft(s), or negotiate against documents which appear on their face to be in compliance with the terms and conditions of the Credit, the Issuing Bank and the Confirming Bank, if any, are bound:

- **i.** to reimburse the Nominated Bank which has paid, incurred a deferred payment undertaking, accepted Draft(s), or negotiated,
- **ii.** to take up the documents.

b. Upon Receipt of the documents the Issuing Bank and/or confirming Bank, if any or a Nominated Bank acting on their behalf, must determine on the basis of the documents alone whether or not they appear on their face to be in compliance with the terms and conditions of the Credit. If the documents appear on their face not to be in compliance with the terms and conditions of the Credit, such banks may refuse to take up the documents.

c. If the Issuing Bank determines that the documents appear on their face not to be in compliance with the terms and conditions of the Credit, it may in its sole judgment approach the Applicant for a waiver of the discrepancy(ies). This does not, however, extend the period mentioned in sub-Article 13 (b).

d. **i.** If the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, decides to refuse the documents, it must give notice to that effect by telecommunication, or if that is not possible, by other expeditious means, without delay but no later than the close of the seventh banking day following the day of receipt of the documents, or to the Beneficiary, if it received the documents direct from him.

ii. Such notice must state all discrepancies in respect of which the bank refuses the documents and must also state whether it is holding the documents at the disposal of, or is returning them to, the presenter.

iii. The Issuing Bank and/or confirming Bank, if any, shall then be entitled to claim from the remitting bank refund, with interest, of any reimbursement which has been made to that bank.

e. If the Issuing Bank and/or Confirming bank, if any, fails to act in accordance with the provisions of this Article and/or fails to hold the document at the disposal of, or return them to, the presenter, the Issuing Bank and/or Confirming Bank, if any, shall be precluded from claiming that the documents are not in compliance with the terms and conditions of the Credit.

f. If the remitting bank draws the attention of the Issuing Bank and/or Confirming Bank, if any, to any discrepancy(ies) in the document(s) or advises such banks that it has paid, incurred a deferred payment undertaking, accepted Draft(s) or negotiated under reserve or against an indemnity in respect of such discrepancy(ies), the Issuing Bank and/or Confirming Bank, if any, shall not be thereby relieved from any of their obligations under any provision of this Article. Such reserve or indemnity concerns only the relations between the remitting bank and the party towards whom the reserve was made, or from whom, or on whose behalf, the indemnity was obtained.

Article 15
Disclaimer on Effectiveness of Documents

Banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document(s), or for the general and/or particular conditions stipulated in the document(s) or superimposed thereon; nor do they assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods represented by any document(s), or for the good faith or acts and/or omissions, solvency, performance, or standing of the consignors, the carriers, the forwarders, the consignees or the insurers of the goods, or any other person whomsoever.

Article 16
Disclaimer on the Transmission of Messages

Banks assume no liability or responsibility for the consequences arising out of delay and/or loss in transit of any message(s), letter(s) or document(s) or for delay, mutilation or other error(s) arising in the transmission of any telecommunication. Banks assume no liability or responsibility for errors in translation and/or interpretation of technical terms, and reserve the right to transmit Credit terms without translating them.

Article 17
Force Majeure
Banks assume no liability or responsibility for the consequences arising out of the interruption of their business by Acts of God, riots, civil commotions, insurrections, wars or any other causes beyond their control, or by any strikes or lockouts. Unless specifically authorised, banks will not, upon resumption of their business, pay, incur a deferred payment undertaking, accept Draft(s) or negotiate under Credits which expired during such interruption of their business.

Article 18
Disclaimer for Acts of an Instructed Party

a. Banks utilizing the services of another bank or other banks for the purpose of giving effect to the instructions of the Applicant do so for the account and at the risk of such Applicant.

b. Banks assume no liability or responsibility should the instructions they transmit not be carried out, even if they have themselves taken the initiative in the choice of such other bank(s)

c. **i.** A party instructing another party to perform services is liable for any charges, including commissions, fees, costs or expenses incurred by the instructed party in connection with its instructions.

ii. Where a Credit stipulates that such changes are for the account of a party other than the instructing party, and charges cannot be collected, the instructing party remains ultimately liable for the payment thereof.

d. The Applicant shall be bound by and liable to indemnify the banks against all obligations and responsibilities imposed by foreign laws and usages.

Article 19
Bank-to-Bank Reimbursement Arrangements

a. If an Issuing Bank intends that the reimbursement to which a paying, accepting or negotiating bank is entitled, shall be obtained by such bank (the “Claiming Bank”), claiming on another party (the Reimbursing Bank) in good time with the proper instructions or authorisation to honour such reimbursement claims.

b. Issuing Banks shall not require a Claiming bank to Supply a certificate of compliance with the terms and conditions of the Credit to the Reimbursing Bank.

c. An issuing Bank shall not be relieved from any of its obligations to provide reimbursement if and when reimbursement is not received by the Claiming Bank from the Reimbursing Bank.

d. The Issuing Bank shall be responsible to the Claiming Bank for any loss of interest if reimbursement is not provided by the Reimbursing Bank on first demand, or as otherwise specified in the Credit, or mutually agreed, as the case may be.

e. The Reimbursing Bank’s charges should be for the account of the Issuing bank. However, in cases where the charges are for the account of another party, it is the responsibility of the Issuing Bank to so indicate in the original credit and in the reimbursement authorisation. In cases where the Reimbursing Bank's charges are for the account of another party they shall be collected from the Claiming Bank when the Credit is drawn under. In cases where the Credit is not drawn under, the Reimbursing Bank's charges remain the obligation of the Issuing Bank.

Article 20
Ambiguity as to the Issuers of Documents

a. Terms such as "first class", "well known", "qualified", "independent", "official", "competent", "local" and the like, shall not be used to describe the issuers of any document(s) to be presented under a Credit. If such terms are incorporated in the Credit, banks will accept the relative document(s) as presented, provided that it appears on its face to be in compliance with the other terms and conditions of the Credit and not to have been issued by the Beneficiary.

b. "Unless otherwise stipulated in the Credit, banks will also accept as an original document(s), a document(s) produced or appearing to have been produced:

- **i.** by reprographic, automated or computerized systems;
- **ii.** as carbon copies;

provided that it is marked as original and, where necessary, appears to be signed.

A document may be signed by handwriting, by facsimile signature, by perforated signature, by stamp, by symbol, or by any other mechanical or electronic method of authentication. "

c. **i.** Unless otherwise stipulated in the Credit, banks will accept as a copy(ies), a document(s) either labeled copy or not marked as an original – copy(ies) need not be signed.

ii. Credits that require multiple document(s) such as "duplicate", "two fold", "two copies" and the like, will be satisfied by the presentation of one original and the remaining number in copies except where the document itself indicates otherwise.

d. Unless otherwise stipulated in the Credit, a condition under a Credit calling for a document to be authenticated, validated, legalized, visaed, certified or indicating a similar requirement, will be satisfied by any signature, mark, stamp, or label on such document that on its face appears to satisfy the above condition.

Article 21
Unspecified Issuer or Content of Documents

When documents other than transport documents, insurance documents and commercial invoices are called for, the Credit should stipulate by whom such documents are to be issued and their wording or data content. If the Credit does not so stipulate, banks will accept such documents as presented, provided that their data content is not inconsistent with any other stipulated document presented.

Article 22
Issuance Date of Documents v. Credit date

Unless otherwise stipulated in the Credit, banks will accept a document bearing a date of issuance prior to that of the Credit, subject to such document being presented within the time limits set out in the Credit and in these Articles.

Article 23
Marine/Ocean Bill of Lading

a. If a Credit calls for a bill of lading covering a port-to-port shipment, banks will, unless otherwise stipulated in the Credit, accept a document, however named, which:

- **i.** appears on its face to indicate the name of the carrier and to have been signed or otherwise authenticated by:
  - the carrier or a named agent for or on behalf of the carrier, or
  - the master or a named agent for or on behalf of the master.

  Any signature or authentication of the carrier or master must be identified as carrier or master, as the case may be. An agent signing or authenticating for the carrier or master must also indicated the name and the capacity of the party, i.e. carrier or master, on whose behalf that agent is acting,

  and
- **ii.** indicates that the goods have been loaded on board, or shipped on a named vessel. Loading on board or shipment on a named vessel may be indicated by pre-printed wording on the bill of lading that the goods have been loaded on board a named vessel or shipped on a named vessel, in which case the date of issuance of the bill of lading will be deemed to be the date of loading on board and the date of shipment. In all other cases loading on board a named vessel must be evidenced by a notation on the bill of lading which gives the date on which the goods have been loaded on board, in which case the date of the on board notation will be deemed to be the date of shipment. If the bill of lading contains the indication "intended vessel" or similar qualification in relation to the vessel, loading on board a named vessel must be evidenced by an on board notation on the bill of lading, which, in addition to the date on which the goods have been loaded on board, also includes the name of the vessel on which the goods have been loaded, even if they have been loaded on the vessel named as the "intended vessel". If the bill of lading indicates a place of receipt or taking in charge different from the port of loading, the on board notation must also include the port of loading stipulated in the Credit and the name of the vessel on which the goods have been loaded, even if they have been loaded on the vessel named in the bill of lading. This provision also applies whenever loading on board the vessel is indicated by preprinted wording on the bill of lading,

  and
- **iii.** indicates the port of loading and the port of discharge stipulated in the Credit, notwithstanding that it:
  - **a.** indicates a place taking in charge different from that port of loading, and/or a place of final destination different from the port of discharge,

    and/or

b. contains the indication “intended” or similar qualification in relation to the port of loading and/or port of discharge as long as the document also states the port of loading and/or discharge stipulated in the Credit,
and

iv. consists of a sole original bill of lading or, if issued in more than one original, the full set as so issued,
and

v. appears to contain all of the terms and conditions of carriage, or some of such terms and conditions by reference to a source or document other than the bill of lading (short form/blank back bill of lading); banks will not examine the contents of such terms and conditions,
and

vi. contains no indication that it is subject to a charter party and/or no indication that the carrying vessel is propelled by sail only,
and

vii. in all other respects meets the stipulations of the Credit.

b. For the purpose of this Article, transhipment means unloading and reloading from one vessel to another vessel during the course of ocean carriage from the port of loading to the port of discharge stipulated in the Credit.

c. Unless transhipment is prohibited by the terms of the Credit, banks will accept a bill of lading which indicates that the goods will be transhipped, provided that the entire ocean carriage is covered by one and the same bill of lading.

d. Even if the Credit prohibits transhipment, banks will accept a bill of lading which:

i. indicates that transhipment will take place as long as the relevant cargo is shipped in Container(s), Trailer(s) and/or “LASH” barge(s) as evidenced by the non-negotiable sea waybill, provided that the entire ocean carriage is covered by one and the same non-negotiable sea waybill,
and/or

ii. incorporates clauses stating that the carrier reserves the right to tranship.

Article 24
Non-Negotiable Sea Waybill

a. If a Credit calls for a non-negotiable sea waybill covering a port-to-port shipment, banks will, unless otherwise stipulated in the Credit, accept a document, however named, which:

i. appears on its face to indicate the name of the carrier and to have been signed or otherwise authenticated by:

- the carrier or a named agent for or on behalf of the carrier, or
- the master or a named agent for or on behalf of the master,

Any signature or authentication of the carrier or master must be identified as carrier or master as the case may be. An agent signing or authenticating for the carrier or master must also indicate the name and the capacity of the party, i.e. carrier or master, on whose behalf that agent is acting,
and

ii. indicates that the goods have been loaded on board, or shipped on a named vessel.

Loading on board or shipment on a named vessel may be indicated by pre-printed wording on the non-negotiable sea waybill that the goods have been loaded on board a named vessel or shipped on a named vessel, in which case the date of issuance of the non-negotiable sea waybill will be deemed to be the date of loading on board and the date of shipment.

In all other cases loading on board a named vessel must be evidenced by a notation on the non-negotiable sea way bill which gives the date on which the goods have been loaded on board, in which case the date of the on board notation will be deemed to be the date of shipment.

If the non-negotiable sea waybill contains the indication "intended vessel", or similar qualification in relation to the vessel, loading on board a named vessel must be evidenced by an on board notation on the non-negotiable sea waybill which, in addition to the date on which the goods have been loaded on board, includes the name of the vessel on which the goods have been loaded, even if they have been loaded on the vessel named as the "intended vessel".

If the non-negotiable sea waybill indicates a place of receipt or taking in charge different from the port of loading, the on board notation must also include the port of loading stipulated in the Credit and the name of the vessel on which the goods have been loaded, even if they have been loaded on a vessel named in the non-negotiable sea waybill.This provision also applies whenever loading on board the vessel is indicated by pre-printed wording on the non-negotiable sea waybill,

and

iii. indicates the port of loading and the port of discharge stipulated in the Credit, notwithstanding that it:

- **a.** indicates a place of taking in charge different from the port of loading, and/or a place of final destination different from the port of discharge,

  and/or

- **b.** contains the indication "intended" or similar qualification in relation to the port of loading and/or port of discharge stipulated in the Credit,

  and

iv. consists of a sole original non-negotiable sea waybill, or if issued in more than one original, the full set as so issued,

v. appears to contain all of the terms and conditions of carriage, or some of such terms and conditions by reference to a source or document other than the non-negotiable sea waybill (short form/blank back non-negotiable sea waybill); banks will not examine the contents of such terms and conditions,

and

vi. contains no indication that it is subject to a charter party and/or no indication that the carrying vessel is propelled by sail only,

and

vii. in all other respects meets the stipulations of the Credit.

b. For the purpose of this Article, ‘transhipment means unloading and reloading from one vessel to another vessel during the course of ocean carriage from the port of loading to the port of discharge stipulated in the Credit.

c. Unless transhipment is prohibited by the terms of the Credit, banks will accept a non-negotiable sea waybill which indicates that the goods will be transhipped, provided that the entire ocean carriage is covered by one and the same non-negotiable sea waybill.

d. Even if the Credit prohibits transhipment, banks will accept a non-negotiable sea waybill which:

i. indicates that transhipment will take place as long as the relevant cargo is shipped in Container(s), Trailer(s) and/or “LASH” barge(s) as evidenced by the non-negotiable sea waybill, provided that the entire ocean carriage is covered by one and the same non-negotiable sea waybill,

and/or

ii. incorporates clauses stating that the carrier reserves the right to tranship.

Article 25

Charter Party Bill of Lading

a. If a Credit calls for or permits a charter party bill of lading, banks will, unless otherwise stipulated in the Credit, accept a document, however named, which:

- **i.** contains any indication that it is subject to a charter party,

  and

- **ii.** appears on its face to have been signed or otherwise authenticated by:
  - the master or a named agent for or on behalf of the master, or
  - the owner or a named agent for or on behalf of the owner.

  Any signature or authentication of the master or owner must be identified as master or owner as the case may be. An agent signing or authenticating for the master or owner must also indicate the name and the capacity of the party, i.e. master or owner, on whose behalf that agent is acting,

  and

- **iii.** does or does not indicate the name of the carrier,

  and

- **iv.** indicates that the goods have been loaded on board or shipped on a named vessel.

  Loading on board or shipment on a named vessel may be indicated by pre-printed wording on the bill of lading that the goods have been loaded on board a named vessel or shipped on a named vessel, in which case the date of issuance of the bill of lading will be deemed to be the date of loading on board and the date of shipment.

  In all other cases loading on board a named vessel must be evidenced by a notation on the bill of lading which gives the date on which the goods have been loaded on board, in which case the date of the on board notation will be deemed to be the date of shipment,

  and

- **v.** indicates the port of loading and the port of discharge stipulated in the credit,

  and

vi. consists of a sole original bill of lading or, if issued in more than one original, the full set as so issued,
and

vii. contains no indication that the carrying vessel is propelled by sail only,
and

viii. in all other respects meets the stipulations of the Credit.

b. Even if the Credit requires the presentation of a charter party contract in connection with a charter party bill of lading, banks will not examine such charter party contract, but will pass it on without responsibility on their part.

Article 26
Multimodal Transport Document

a. If a Credit calls for a transport document covering at least two different modes of transport(multimodal transport), banks will, unless otherwise stipulated in the Credit accept a document, however named, which:

i. appears on its face to indicate the name of the carrier or multimodal transport operator and to have been signed or otherwise authenticated by:
- the carrier or multimodal transport operator or a named agent for or on behalf of the carrier or multimodal transport operator, or
- the master or a named agent for or on behalf of the master.

Any signature or authentication of the carrier, multimodal transport operator or master must be identified as carrier, multimodal transport operator or master, as the case may be. An agent signing or authenticating for the carrier, multimodal transport operator or master must also indicate the name and the capacity of the party, i.e. carrier, multimodal transport operator or master, on whose behalf the agent is acting,
and

ii. indicates that the goods have been dispatched, taken in charge or loaded on board. Dispatch, taking in charge or loading on board may be indicated by wording to that effect on the multimodal transport document and the date of issuance will be deemed to be the date of dispatch, taking in charge or loading on board and the date of shipment. However, if the document indicates, by stamp or otherwise, a date of dispatch, taking in charge or loading on board, such date will be deemed to be the date of shipment,
and

iii. **a.** indicates the place of taking in charge stipulated in the Credit which may be different from the port, airport or place of loading, and the place of final destination stipulated in the Credit which may be different from the port, airport or place of discharge,
and/or

b. contains the indication "intended" or similar qualification in relation to the vessel and/or port of loading and/or port of discharge,
and

iv. consists of a sole original multimodal transport document or, if issued in more than one original the full set as so issued,

and

iv. appears to contain all of the terms and conditions of carriage, or some of such terms and conditions by reference to a source or document other than the multimodal transport document (short form/blank back multimodal transport document); banks will not examine the contents of such terms and conditions,

and

v. contains no indication that it is subject to a charter party and/or no indication that the carrying vessel is propelled by sail only,

vi. and

vi. in all other respects meets the stipulations of the Credit.

b. Even if the Credit prohibits transhipment, banks will accept a multimodal transport document which indicates that the transhipment will or may take place, provided that the entire carriage is covered by one and the same multimodal transport document.

Article 27
Air Transport Document

a. If a Credit calls for an air transport document, banks will, unless otherwise stipulated in the Credit, accept a document, however named, which:

i. appears on its face to indicate the name of the carrier and to have been signed or otherwise authenticated by:

- the carrier, or
- a named agent for or on behalf of the carrier.

Any signature or authentication of the carrier must be identified as carrier. An agent signing or authenticating for the carrier must also indicate the name and the capacity of the party, i.e. carrier, on whose behalf that agent is acting, and

ii. indicates that the goods have been accepted for carriage,

and

iii. where the Credit calls for an actual date of dispatch, indicates a specific notation of such date, the date of dispatch so indicated on the air transport document will be deemed to be the date of shipment.

For the purpose of this Article, the information appearing in the box on the air transport document (marked “for Carrier Use Only” or similar expression) relative to the flight number and date will not be considered as a specific notation of such date of dispatch.

In all other cases, the date of issuance of the air transport document will be deemed to be the date of shipment,

and

iv. indicates the airport of departure and the airport of destination stipulated in the Credit,

and

v. appears to be the original for consignor/shipper even if the Credit stipulates a full set of originals or similar expressions,

and

vi. appears to contain all of the terms and conditions of carriage, or some of such terms and conditions, by reference to a source or document other than the air transport document; banks will not examine the contents of such terms and conditions,

and

vii. in all other respects meets the stipulations of the Credit.

b. For the purpose of this Article, transhipment means unloading and reloading from one aircraft to another aircraft during the course of carriage from the airport of departure to the airport of destination stipulated in the Credit.

c. Even if the Credit prohibits transhipment, banks will accept an air transport document which indicates that transhipment will or may take place, provided that the entire carriage is covered by one and the same air transport document.

Article 28

Road, Rail or Inland Waterway Transport Documents

a. If a Credit calls for a road, rail, or inland waterway transport document, banks will, unless otherwise stipulated in the Credit, accept a document of the type called for, however named, which:

i. appears on its face to indicate the name of the carrier and to have been signed or otherwise authenticated by the carrier or a named agent for or on behalf of the carrier and/or to bear a reception stamp or other indication of receipt by the carrier or a named agent for or on behalf of the carrier. Any signature, authentication, reception stamp or other indication of receipt of the carrier, must be identified on its face as that of the carrier. An agent signing or authenticating for the carrier, must also indicate the name and the capacity of the party, i.e. the carrier, on whose behalf that agent is acting, and

ii. indicates that the goods have been received for shipment, dispatch or carriage or wording to this effect. The date of issuance will be deemed to be the date of shipment unless the transport document contains a reception stamp, in which case the date of the reception stamp will be deemed to be the date of shipment,

and

iii. indicates the place of shipment and the place of destination stipulated in the Credit,

and

iv. in all other respects meets the stipulations of the Credit.

b. In the absence of any indication on the transport document as to the numbers issued, banks will accept the transport document(s) presented as constituting a full set. Banks will accept as original(s) the transport document(s) whether marked as original(s) or not.

c. For the purpose of this Article, transhipment means unloading and reloading from one means of conveyance to another means of conveyance, in different modes of transport, during the course of carriage from the place of shipment to the place of destination stipulated in the Credit.

d. Even if the Credit prohibits transhipment, banks will accept a road, rail or inland waterway transport document which indicates that transhipment will or may take place, provided that the entire carriage is covered by one and the same transport document and within the same mode of transport.

Article 29
Courier and Post Receipts

a. If a Credit calls for a post receipt or certificate of posting, banks will, unless otherwise stipulated in the Credit, accept a post receipt or certificate of posting which:

- **i.** appears on its face to have been stamped or otherwise authenticated and dated in the place from which the Credit stipulates the goods are to be shipped or dispatched and such date will be deemed to be the date of shipment or dispatch, and
- **ii.** in all other respects meets the stipulations of the Credit.

b. If a Credit calls for a document issued by a courier or expedited delivery service evidencing receipt of the goods for delivery, banks will, unless otherwise stipulated in the Credit, accept a document, however named, which:

- **i.** appears on its face to indicate the name of the courier/service, and to have been stamped, signed or otherwise authenticated by such named courier/service (unless the Credit specifically calls for a document issued by a named Courier/Service, banks will accept a document issued by any Courier/Service,
  and
- **ii.** indicates a date of pick-up or of receipt or wording to this effect, such date being deemed to be the date of shipment or dispatch, and
  in all other respects meets the stipulations in the Credit.

Article 30
Transport Documents issued by Freight Forwarders

Unless otherwise authorised in the Credit, banks will only accept a transport document issued by a freight forwarder if it appears on its face to indicate:

- **i.** the name of the freight forwarder as a carrier or multimodal transport operator and to have been signed or otherwise authenticated by the freight forwarder as a carrier or multimodal transport operator,
  or
- **ii.** the name of the carrier or multimodal transport operator and to have been signed or otherwise authenticated by the freight forwarder as a named agent for or on behalf of the carrier or multimodal transport operator.

Article 31
"On Deck", "Shipper's Load and Count", Name of Consignor

Unless otherwise stipulated in the Credit, banks will accept a transport document which:

- **i.** does not indicate, in the case of carriage by sea or by more than one means of conveyance including carriage by sea, that the goods are or will be loaded on deck. Nevertheless, banks will accept a transport document which contains a provision that the goods may be carried on deck, provided that it does not specifically state that they are or will be loaded on deck,
  and/or
- **ii.** bears a clause on the face thereof such as "shipper's load and count" or "said by shipper to contain" or words of similar effect,

and/or

iii. indicates as the consignor of the goods a party other than the Beneficiary of the Credit.

Article 32
Clean Transport Documents

a. A clean transport document is one which bears no clause or notation which expressly declares a defective condition of the goods and/or the packaging.

b. Banks will not accept transport documents bearing such clauses or notations unless the Credit expressly stipulates the clauses or notations which may be accepted.

c. Banks will regard a requirement in a Credit for a transport document to bear the clause “clean on board” as complied with if such transport document meets the requirements of this Article and of Articles 23, 24, 25, 26, 27, 28 or 30.

Article 33
Freight Payable/Prepaid Transport Documents

a. Unless otherwise stipulated in the Credit, or inconsistent with any of the documents presented under the Credit, banks will accept transport documents stating that freight or transportation charges (hereafter referred to as “freight” have still to be paid.

b. If a Credit stipulates that the transport document has to indicate that freight has been paid or prepaid, banks will accept a transport document on which words clearly indicating payment or prepayment of freight appear by stamp or otherwise, or on which payment or prepayment of freight is indicated by other means. If the Credit requires courier charges to be paid or prepaid banks will also accept a transport document issued by a courier or expedited delivery service evidencing that courier charges are for the account of a party other than consignee.

c. The words “freight prepayable” or “freight to be prepaid” or words of similar effect, if appearing on transport documents, will not be accepted as constituting evidence of the payment of freight.

d. Banks will accept transport documents bearing reference by stamp or otherwise to costs additional to the freight, such as costs of, or disbursements incurred in connection with, loading, unloading or similar operations, unless the conditions of the Credit specifically prohibit such reference.

Article 34
Insurance Document

a. Insurance documents must appear on their face to be issued and signed by insurance companies or underwriters or their agents.

b. If the insurance document indicates that it has been issued in more than one original, all the originals must be presented unless otherwise authorised in the Credit.

c. Cover notes issued by brokers will not be accepted, unless specifically authorised in the Credit.

d. Unless otherwise stipulated in the Credit, banks will accept an insurance certificate or a declaration under an open cover pre-signed by insurance companies or underwriters or their agents. If a credit specifically calls for an insurance certificate or a declaration under an open cover, banks will accept, in lieu thereof, an insurance policy.

e. Unless otherwise stipulated in the Credit, or unless it appears from the insurance document that the cover is effective at the latest from the date of loading on board or dispatch or taking in charge of the goods, banks will not accept an insurance document which bears a date of issuance later than the date of loading on board or dispatch or taking in charge as indicated in such transport document.

f. **i.** Unless otherwise stipulated in the Credit, the insurance document must be expressed in the same currency as the Credit.

ii. Unless otherwise stipulated in the Credit, the minimum amount for which the insurance document must indicate the insurance cover to have been effected is the CIF (cost, insurance and freight(…"named port of destination")) or CIP (carriage and insurance paid to (…"named place of destination")) value of the goods, as the case may be, plus 10%, but only when the CIF or CIP value can be determined from the documents on their face. Otherwise, banks will accept as such minimum amount 110% of the amount for which payment, acceptance or negotiation is requested under the Credit, or 110% of the gross amount of the invoice, whichever is the greater.

Article 35
Type of Insurance cover

a. Credits should stipulate the type of insurance required and, if any, the additional risks which are to be covered. Imprecise terms such as "usual risks" or "customary risks" shall not be used; if they are used, banks will accept insurance documents as presented, without responsibility for any risks not being covered.

b. Failing specific stipulations in the Credit, banks will accept insurance documents as presented without responsibility for any risks not being covered.

c. Unless otherwise stipulated in the Credit, banks will accept an insurance document which indicates that the cover is subject to a franchise or an excess (deductible).

Article 36
All Risks Insurance Cover

Where a Credit stipulates "insurance against all risks", banks will accept an insurance document which contains any "all risks" notation or clause, whether or not bearing the heading "all risks", even if the insurance document indicates that certain risks are excluded, without responsibility for any risk(s) not being covered.

Article 37
Commercial Invoices

a. Unless otherwise stipulated in the Credit, commercial invoices

i. must appear on their face to be issued by the Beneficiary named in the credit (except as provided in Article 48),
and

ii. must be made out in the name of the Applicant, (except as provided in sub-Article 48(h)), and

iii. need not be signed

b. Unless otherwise stipulated in the Credit, banks may refuse commercial invoices issued for amounts in excess of the amount permitted by the Credit. Nevertheless, if a bank authorised to pay, incur a deferred payment undertaking, accept Draft(s), or negotiate under a Credit accepts such invoices, its decision will be binding upon all parties, provided that such bank has not paid, incurred a deferred payment undertaking, accepted Draft(s) or negotiated for an amount in excess of that permitted by the Credit.

c. The description of the goods in commercial invoice must correspond with the description in the Credit. In all other documents, the goods may be described in general terms not inconsistent with the description of the goods in the Credit.

Article 38
Other Documents

If a Credit calls for an attestation or certification of weight in the case of transport other than by sea, banks will accept a weight stamp or declaration of weight which appears to have been superimposed on the transport document by the carrier or his agent unless the Credit stipulates that the attestation or certification of weight must be by means of a separate document.

Article 39
Allowances in Credit Amount, Quantity and Unit price

a. The words “about”, “approximately” “circa” or similar expressions used in connection with the amount of the Credit or the quantity or the unit price stated in the Credit are to be construed as allowing a difference not to exceed 10% more or 10% less than the amount or the quantity or the unit price to which they refer.

b. Unless a Credit stipulates that the quantity of the goods specified must not be exceeded or reduced, a tolerance of 5% more or 5% less will be permissible, always provided that the amount of the drawings does not exceed the amount of the Credit. This tolerance does not apply when the Credit stipulates the quantity in terms of a stated number of packing units or individual items.

c. Unless a Credit which prohibits partial shipments stipulates otherwise, or unless sub-Article (b) above is applicable, a tolerance of 5% less in the amount of the drawing will be permissible, provided that if the Credit stipulates the quantity of the goods, such quantity of goods is shipped in full, and if the Credit stipulates a unit price, such price is not reduced. This provision does not apply when expressions referred to in sub-Article (a) above are used in the Credit.

Article 40
Partial Shipments/Drawings

a. Partial drawings and/or shipments are allowed, unless the Credit stipulates otherwise.

b. Transport documents which appear on their face to indicate that shipment has been made on the same means of conveyance and for the same journey, provided they indicate the same destination, will not be regarded as covering partial shipments, even if the transport documents indicate different dates of shipment and/or different ports of loading, places of taking in charge, or dispatch.

c. Shipments made by post or by courier will not be regarded as partial shipments if the post receipts or certificates of posting or courier's receipts or dispatch notes appear to have been stamped, signed or otherwise authenticated in the place from which the Credit stipulates the goods are to be dispatched, and on the same date.

Article 41
Instalment Shipments/Drawings

If drawings and/or shipments by instalments within given periods are stipulated in the Credit and any instalment is not drawn and/or shipped within the period allowed for that instalment, the Credit ceases to be available for that and any subsequent instalments, unless otherwise stipulated in the Credit.

Article 42
Expiry Date and Place for Presentation of Documents

a. All Credits must stipulate an expiry date and a place for presentation of documents for payment, acceptance, or with the exception of freely negotiable Credits, a place for presentation of documents for negotiation. An expiry date stipulated for payment, acceptance or negotiation will be construed to express an expiry date for presentation of documents.

b. Except as provided in sub-Article 44(a), documents must be presented on or before such expiry date.

c. If an Issuing Bank states that the Credit is to be available "for one month", "for six months", or the like, but does not specify the date from which the time is to run, the date of issuance of the Credit by the Issuing Bank will be deemed to be the first day from which such time is to run. Banks should not discourage indication of the expiry date of the Credit in this manner.

Article 43
Limitation on the Expiry Date

a. In addition to stipulating an expiry date for presentation of documents, every Credit which calls for a transport document(s) should also stipulate a specified period of time after the date of shipment during which presentation must be made in compliance with the terms and conditions of the Credit. If no such period of time is stipulated, banks will not accept documents presented to them later than 21 days after the date of shipment. In any event, however, documents must be presented not later than the expiry date of the Credit.

b. In cases in which sub-Article 40(b) applies, the date of shipment will be considered to be the latest shipment date on any of the transport documents presented.

Article 44
Extension of Expiry Date

a. If the expiry date of the Credit and/or the last day of the period of time for presentation of documents stipulated by the Credit or applicable by virtue of

Article 43 falls on a day on which the bank to which presentation has to be made is closed for reasons other than those referred to in Article 17, the stipulated expiry date and/or the last day of the period of time after the date of shipment for presentation of documents, as the case may be, shall be extended to the first following day on which such bank is open.

b. The latest date for shipment shall not be extended by reason of the extension of the expiry date and/or the period of time after the date of shipment for presentation of documents in accordance with sub-Article (a) above. If no such latest date for shipment is stipulated in the Credit or amendments thereto, banks will not accept transport documents indicating a date of shipment later than the expiry date stipulated in the Credit or amendments thereto.

c. The bank to which presentation is made on such first following business day must provide a statement that the documents were presented within the time limits extended in accordance with sub-Article 44(a) of the Uniform Customs and Practice for Documentary Credits, 1993 Revision, ICC Publication No. 500.

Article 45
Hours of Presentation

Banks are under no obligation to accept presentation of documents outside their banking hours.

Article 46
General Expressions as to Dates for Shipment

a. Unless otherwise stipulated in the Credit, the expression “shipment” used in stipulating an earliest and/or a latest date for shipment will be understood to include expressions such as “loading on board”, “dispatch”, “accepted for carriage”, “date of post receipt”, “date of pick-up”, and the like, and in the case of a Credit calling for a multimodal transport document the expression “taking in charge”.

b. Expressions such as “prompt”, “immediately”, “as soon as possible”, and the like should not be used. If they are used banks will disregard them.

c. If the expression “on or about” or similar expressions are used, banks will interpret them as a stipulation that shipment is to be made during the period from five days before to five days after the specified date, both end days included.

Article 47
Date Terminology for Periods of Shipment

a. The words “to”, “until”, “till”, “from” and words of similar import applying to any date or period in the Credit referring to shipment will be understood to include the date mentioned.

b. The word “after” will be understood to exclude the date mentioned.

c. The terms “first half”, “second half” of a month shall be construed respectively as the 1^{st} to the 15^{th}, and the 16^{th} to the last day of such month, all dates inclusive.

d. The terms “beginning”, “middle”, or “end” of a month shall be construed respectively as the 1^{st} to the 10^{th}, the 11^{th} to the 20^{th}, and the 21^{st} to the last day of such month, all dates inclusive.

Article 48
Transferable Credit

a. A transferable Credit is a Credit under which the Beneficiary (First Beneficiary) may request the bank authorised to pay, incur a deferred payment undertaking, accept or negotiate (the “Transferring Bank”), or in the case of a freely negotiable Credit, the bank specifically authorised in the Credit as a Transferring Bank, to make the Credit available in whole or in part to one or more other Beneficiary(ies)(second Beneficiary(ies)).

b. A Credit can be transferred only if it is expressly designated as “transferable” by the Issuing Bank. Terms such as “divisible”, “fractionable”, “assignable”, and “transmissible” do not render the Credit transferable. If such terms are used they shall be disregarded.

c. The Transferring Bank shall be under no obligation to effect such transfer except to the extent and in the manner expressly consented to by such bank.

d. At the time of making a request for transfer and prior to transfer of the Credit, the First Beneficiary must irrevocably instruct the Transferring Bank whether or not he retains the right to refuse to allow the Transferring Bank to advise amendments to the Second Beneficiary(ies). If the Transferring Bank consents to the transfer under these conditions, it must, at the time of transfer, advise the Second Beneficiary(ies) of the First Beneficiary’s instructions regarding amendments.

e. If a Credit is transferred to more than one Second Beneficiary(ies), refusal of an amendment by one or more Second Beneficiary(ies) does not invalidate the acceptance(s) by the other Second Beneficiary(ies) with respect to whom the Credit will be amended accordingly. With respect to the Second Beneficiary(ies) who rejected the amendment, the Credit will remain unamended.

f. Transferring Bank charges in respect of transfers including commissions, fees, costs or expenses are payable by the First Beneficiary, unless otherwise agreed. If the Transferring Bank agrees to transfer the Credit it shall be under no obligation to effect the transfer until such charges are paid.

g. Unless otherwise stated in the Credit, a transferable Credit can be transferred once only. Consequently, the Credit cannot be transferred at the request of the Second Beneficiary to any subsequent Third Beneficiary. For the purpose of this Article, a retransfer to the First Beneficiary does not constitute a prohibited transfer.

Fractions of a transferable Credit (not exceeding in the aggregate the amount of the Credit) can be transferred separately, provided partial shipments/drawings are not prohibited, and the aggregate of such transfers will be considered as constituting only one transfer of the Credit.

h. The credit can be transferred only on the terms and conditions specified in the original Credit, with the exception of:

- the amount of the Credit,
- any unit price stated therein,
- the expiry date,
- the last date for presentation of documents in accordance with Article 43,
- the period for shipment,

any or all of which may be reduced or curtailed.

The percentage for which insurance cover must be effected may be increased in such a way as to provide the amount of cover stipulated in the original Credit, or these Articles.

In addition, the name of the First Beneficiary can be substituted for that of the Applicant, but if the name of the Applicant is specifically required by the original Credit to appear in any document(s) other than the invoice, such requirement must be fulfilled.

i. The First Beneficiary has the right to substitute his own invoice(s)(and Draft(s)) for those of the Second Beneficiary(ies), for amounts not in excess of the original amount stipulated in the Credit and for the original unit prices if stipulated in the Credit, and upon such substitution of invoice(s)(and Draft(s)) the First Beneficiary can draw under the Credit for the difference, if any, between his invoice(s) and the Second Beneficiary's(ies') invoice(s).

When a Credit has been transferred and the First Beneficiary is to supply his own invoice(s) (and Draft(s)) in exchange for the Second Beneficiary's(ies') invoice(s) (and Draft(s)) but fails to do so on first demand, the Transferring Bank has the right to deliver to the Issuing Bank the documents received under the transferred Credit, including the Second Beneficiary's(ies) invoice(s) (and Draft(s)) without further responsibility to the First Beneficiary.

j. The First Beneficiary may request that payment or negotiation be effected to the Second Beneficiary(ies) at the place to which the Credit has been transferred up to and including the expiry date of the Credit, unless the original Credit expressly states that it may not be made available for payment or negotiation at a place other than that stipulated in the Credit. This is without prejudice to the First Beneficiary's right to substitute subsequently his own invoice(s) (and Draft(s)) for those of the Second Beneficiary(ies) and to claim any difference due to him.

Article 49

Assignment of Proceeds

The fact that a Credit is not stated to be transferable shall not affect the Beneficiary's right to assign any proceeds to which he may be, or may become, entitled under such Credit, in accordance with the provisions of the applicable law. This Article relates only to the assignment of proceeds and not to the assignment of the right to perform under the Credit itself.

Appendix 2

A.2 Text of the UCP 600

UCP 600

Article 1
Application of UCP
The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication no. 600 ("UCP") are rules that apply to any documentary credit ("credit") (including, to the extent to which they may be applicable, any standby letter of credit) when the text of the credit expressly indicates that it is subject to these rules. They are binding on all parties thereto unless expressly modified or excluded by the credit.

Article 2
Definitions
For the purpose of these rules:

Advising bank means the bank that advises the credit at the request of the issuing bank.

Applicant means the party on whose request the credit is issued.

Banking day means a day on which a bank is regularly open at the place at which an act subject to these rules is to be performed.

Beneficiary means the party in whose favour a credit is issued.

Complying presentation means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice.

Confirmation means a definite undertaking of the confirming bank, in addition to that of the issuing bank, to honour or negotiate a complying presentation.

Confirming bank means the bank that adds its confirmation to a credit upon the issuing bank's authorization or request.

Credit means any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation.

Honour means:
a. to pay at sight if the credit is available by sight payment.
b. to incur a deferred payment undertaking and pay at maturity if the credit is available by deferred payment.
c. to accept a bill of exchange ("draft") drawn by the beneficiary and pay at maturity if the credit is available by acceptance.

Issuing bank means the bank that issues a credit at the request of an applicant or on its own behalf.

Negotiation means the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.

Nominated bank means the bank with which the credit is available or any bank in the case of a credit available with any bank.

Presentation means either the delivery of documents under a credit to the issuing bank or nominated bank or the documents so delivered.

Presenter means a beneficiary, bank or other party that makes a presentation.

Article 3
Interpretations
For the purpose of these rules:

Where applicable, words in the singular include the plural and in the plural include the singular.

A credit is irrevocable even if there is no indication to that effect.

A document may be signed by handwriting, facsimile signature, perforated signature, stamp, symbol or any other mechanical or electronic method of authentication.

A requirement for a document to be legalized, visaed, certified or similar will be satisfied by any signature, mark, stamp or label on the document which appears to satisfy that requirement.

Branches of a bank in different countries are considered to be separate banks.

Terms such as "first class", "well known", "qualified", "independent", "official", "competent" or "local" used to describe the issuer of a document allow any issuer except the beneficiary to issue that document.

Unless required to be used in a document, words such as "prompt", "immediately" or "as soon as possible" will be disregarded.

The expression "on or about" or similar will be interpreted as a stipulation that an event is to occur during a period of five calendar days before until five calendar days after the specified date, both start and end dates included.

The words "to", "until", "till", "from" and "between" when used to determine a period of shipment include the date or dates mentioned, and the words "before" and "after" exclude the date mentioned.

The words "from" and "after" when used to determine a maturity date exclude the date mentioned.

The terms "first half" and "second half" of a month shall be construed respectively as the 1st to the 15th and the 16th to the last day of the month, all dates inclusive.

The terms "beginning", "middle" and "end" of a month shall be construed respectively as the 1st to the 10th, the 11th to the 20th and the 21 to the last day of the month, all dates inclusive.

Article 4
Credits v. Contracts

a. A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary.

A beneficiary can in no case avail itself of the contractual relationships existing between banks or between the applicant and the issuing bank.

b. An issuing bank should discourage any attempt by the applicant to include, as an integral part of the credit, copies of the underlying contract, proforma invoice and the like.

Article 5
Documents v. Goods, Services or Performance

Banks deal with documents and not with goods, services or performance to which the documents may relate.

Article 6
Availability, Expiry Date and Place for Presentation

a. A credit must state the bank with which it is available or whether it is available with any bank. A credit available with a nominated bank is also available with the issuing bank.

b. A credit must state whether it is available by sight payment, deferred payment, acceptance or negotiation.

c. A credit must not be issued available by a draft drawn on the applicant.

d. **i.** A credit must state an expiry date for presentation. An expiry date stated for honour or negotiation will be deemed to be an expiry date for presentation.

ii. The place of the bank with which the credit is available is the place for presentation. The place for presentation under a credit available with any bank is that of any bank. A place for presentation other than that of the issuing bank is in addition to the place of the issuing bank.

e. Except as provided in sub-article 29 (a), a presentation by or on behalf of the beneficiary must be made on or before the expiry date.

Article 7
Issuing Bank Undertaking

a. Provided that the stipulated documents are presented to the nominated bank or to the issuing bank and that they constitute a complying presentation, the issuing bank must honour if the credit is available by:
   - **i.** sight payment, deferred payment or acceptance with the issuing bank;
   - **ii.** sight payment with a nominated bank and that nominated bank does not pay;
   - **iii.** deferred payment with a nominated bank and that nominated bank does not incur its deferred payment undertaking or, having incurred its deferred payment undertaking, does not pay at maturity;
   - **iv.** acceptance with a nominated bank and that nominated bank does not accept a draft drawn on it or, having accepted a draft drawn on it, does not pay at maturity;
   - **v.** negotiation with a nominated bank and that nominated bank does not negotiate.

b. An issuing bank is irrevocably bound to honour as of the time it issues the credit.

c. An issuing bank undertakes to reimburse a nominated bank that has honoured or negotiated a complying presentation and forwarded the documents to the issuing bank. Reimbursement for the amount of a complying presentation under a credit available by acceptance or deferred payment is due at maturity, whether or not the nominated bank prepaid or purchased before maturity. An issuing bank's undertaking to reimburse a nominated bank is independent of the issuing bank's undertaking to the beneficiary.

Article 8
Confirming Bank Undertaking

a. Provided that the stipulated documents are presented to the confirming bank or to any other nominated bank and that they constitute a complying presentation, the confirming bank must:
   - **i.** honour, if the credit is available by
     - **a)** sight payment, deferred payment or acceptance with the confirming bank;
     - **b)** sight payment with another nominated bank and that nominated bank does not pay;
     - **c)** deferred payment with another nominated bank and that nominated bank does not incur its deferred payment undertaking or, having incurred its deferred payment undertaking, does not pay at maturity;
     - **d)** acceptance with another nominated bank and that nominated bank does not accept a draft drawn on it or, having accepted a draft drawn on it, does not pay at maturity;
     - **e)** negotiation with another nominated bank and that nominated bank does not negotiate.

ii. negotiate, without recourse, if the credit is available by negotiation with the confirming bank.

b. A confirming bank is irrevocably bound to honour or negotiate as of the time it adds its confirmation to the credit.

c. A confirming bank undertakes to reimburse another nominated bank that has honoured or negotiated a complying presentation and forwarded the documents to the confirming bank. Reimbursement for the amount of a complying presentation under a credit available by acceptance or deferred payment is due at maturity, whether or not another nominated bank prepaid or purchased before maturity. A confirming bank's undertaking to reimburse another nominated bank is independent of the confirming bank's undertaking to the beneficiary.

d. If a bank is authorized or requested by the issuing bank to confirm a credit but is not prepared to do so, it must inform the issuing bank without delay and may advise the credit without confirmation.

Article 9
Advising of Credits and Amendments

a. A credit and any amendment may be advised to a beneficiary through an advising bank. An advising bank that is not a confirming bank advises the credit and any amendment without any undertaking to honour or negotiate.

b. By advising the credit or amendment, the advising bank signifies that it has satisfied itself as to the apparent authenticity of the credit or amendment and that the advice accurately reflects the terms and conditions of the credit or amendment received.

c. An advising bank may utilize the services of another bank ("second advising bank") to advise the credit and any amendment to the beneficiary. By advising the credit or amendment, the second advising bank signifies that it has satisfied itself as to the apparent authenticity of the advice it has received and that the advice accurately reflects the terms and conditions of the credit or amendment received.

d. A bank utilizing the services of an advising bank or second advising bank to advise a credit must use the same bank to advise any amendment thereto.

e. If a bank is requested to advise a credit or amendment but elects not to do so, it must so inform, without delay, the bank from which the credit, amendment or advice has been received.

f. If a bank is requested to advise a credit or amendment but cannot satisfy itself as to the apparent authenticity of the credit, the amendment or the advice, it must so inform, without delay, the bank from which the instructions appear to have been received. If the advising bank or second advising bank elects nonetheless to advise the credit or amendment, it must inform the beneficiary or second advising bank that it has not been able to satisfy itself as to the apparent authenticity of the credit, the amendment or the advice.

Article 10
Amendments

a. Except as otherwise provided by article 38, a credit can neither be amended nor cancelled without the agreement of the issuing bank, the confirming bank, if any, and the beneficiary.

b. An issuing bank is irrevocably bound by an amendment as of the time it issues the amendment. A confirming bank may extend its confirmation to an amendment and will be irrevocably bound as of the time it advises the amendment. A confirming bank may, however, choose to advise an amendment without extending its confirmation and, if so, it must inform the issuing bank without delay and inform the beneficiary in its advice.

c. The terms and conditions of the original credit (or a credit incorporating previously accepted amendments) will remain in force for the beneficiary until the beneficiary communicates its acceptance of the amendment to the bank that advised such amendment. The beneficiary should give notification of acceptance or rejection of an amendment. If the beneficiary fails to give such notification, a presentation that complies with the credit and to any not yet accepted amendment will be deemed to be notification of acceptance by the beneficiary of such amendment. As of that moment the credit will be amended.

d. A bank that advises an amendment should inform the bank from which it received the amendment of any notification of acceptance or rejection.

e. Partial acceptance of an amendment is not allowed and will be deemed to be notification of rejection of the amendment.

f. A provision in an amendment to the effect that the amendment shall enter into force unless rejected by the beneficiary within a certain time shall be disregarded.

Article 11

Teletransmitted and Pre-Advised Credits and Amendments

a. An authenticated teletransmission of a credit or amendment will be deemed to be the operative credit or amendment, and any subsequent mail confirmation shall be disregarded.

If a teletransmission states "full details to follow" (or words of similar effect), or states that the mail confirmation is to be the operative credit or amendment, then the teletransmission will not be deemed to be the operative credit or amendment. The issuing bank must then issue the operative credit or amendment without delay in terms not inconsistent with the teletransmission.

b. A preliminary advice of the issuance of a credit or amendment ("pre-advice") shall only be sent if the issuing bank is prepared to issue the operative credit or amendment. An issuing bank that sends a pre-advice is irrevocably committed to issue the operative credit or amendment, without delay, in terms not inconsistent with the pre-advice.

Article 12

Nomination

a. Unless a nominated bank is the confirming bank, an authorization to honour or negotiate does not impose any obligation on that nominated bank to honour or negotiate, except when expressly agreed to by that nominated bank and so communicated to the beneficiary.

b. By nominating a bank to accept a draft or incur a deferred payment undertaking, an issuing bank authorizes that nominated bank to prepay or purchase a draft accepted or a deferred payment undertaking incurred by that nominated bank.

c. Receipt or examination and forwarding of documents by a nominated bank that is not a confirming bank does not make that nominated bank liable to honour or negotiate, nor does it constitute honour or negotiation.

Article 13
Bank-to-Bank Reimbursement Arrangements

a. If a credit states that reimbursement is to be obtained by a nominated bank ("claiming bank") claiming on another party ("reimbursing bank"), the credit must state if the reimbursement is subject to the ICC rules for bank-to-bank reimbursements in effect on the date of issuance of the credit.

b. If a credit does not state that reimbursement is subject to the ICC rules for bank-to-bank reimbursements, the following apply:

- **i.** An issuing bank must provide a reimbursing bank with a reimbursement authorization that conforms with the availability stated in the credit. The reimbursement authorization should not be subject to an expiry date.
- **ii.** A claiming bank shall not be required to supply a reimbursing bank with a certificate of compliance with the terms and conditions of the credit.
- **iii.** An issuing bank will be responsible for any loss of interest, together with any expenses incurred, if reimbursement is not provided on first demand by a reimbursing bank in accordance with the terms and conditions of the credit.
- **iv.** A reimbursing bank's charges are for the account of the issuing bank. However, if the charges are for the account of the beneficiary, it is the responsibility of an issuing bank to so indicate in the credit and in the reimbursement authorization. If a reimbursing bank's charges are for the account of the beneficiary, they shall be deducted from the amount due to a claiming bank when reimbursement is made. If no reimbursement is made, the reimbursing bank's charges remain the obligation of the issuing bank.

c. An issuing bank is not relieved of any of its obligations to provide reimbursement if reimbursement is not made by a reimbursing bank on first demand.

Article 14
Standard for Examination of Documents

a. A nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank must examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation.

b. A nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank shall each have a maximum of five banking days following the day of presentation to determine if a presentation is complying. This period is not curtailed or otherwise affected by the occurrence on or after the date of presentation of any expiry date or last day for presentation.

c. A presentation including one or more original transport documents subject to articles 19, 20, 21, 22, 23, 24 or 25 must be made by or on behalf of the beneficiary not later than 21 calendar days after the date of shipment as described in these rules, but in any event not later than the expiry date of the credit.

d. Data in a document, when read in context with the credit, the document itself and international standard banking practice, need not be identical to, but must not conflict with, data in that document, any other stipulated document or the credit.

e. In documents other than the commercial invoice, the description of the goods, services or performance, if stated, may be in general terms not conflicting with their description in the credit.

f. If a credit requires presentation of a document other than a transport document, insurance document or commercial invoice, without stipulating by whom the document is to be issued or its data content, banks will accept the document as presented if its content appears to fulfil the function of the required document and otherwise complies with sub-article 14 (d).

g. A document presented but not required by the credit will be disregarded and may be returned to the presenter.

h. If a credit contains a condition without stipulating the document to indicate compliance with the condition, banks will deem such condition as not stated and will disregard it.

i. A document may be dated prior to the issuance date of the credit, but must not be dated later than its date of presentation.

j. When the addresses of the beneficiary and the applicant appear in any stipulated document, they need not be the same as those stated in the credit or in any other stipulated document, but must be within the same country as the respective addresses mentioned in the credit. Contact details (telefax, telephone, email and the like) stated as part of the beneficiary's and the applicant's address will be disregarded. However, when the address and contact details of the applicant appear as part of the consignee or notify party details on a transport document subject to articles 19, 20, 21, 22, 23, 24 or 25, they must be as stated in the credit.

k. The shipper or consignor of the goods indicated on any document need not be the beneficiary of the credit.

l. A transport document may be issued by any party other than a carrier, owner, master or charterer provided that the transport document meets the requirements of articles 19, 20, 21, 22, 23 or 24 of these rules.

Article 15
Complying Presentation

a. When an issuing bank determines that a presentation is complying, it must honour.

b. When a confirming bank determines that a presentation is complying, it must honour or negotiate and forward the documents to the issuing bank.

c. When a nominated bank determines that a presentation is complying and honours or negotiates, it must forward the documents to the confirming bank or issuing bank.

Article 16
Discrepant Documents, Waiver and Notice

a. When a nominated bank acting on its nomination, a confirming bank, if any, or the issuing bank determines that a presentation does not comply, it may refuse to honour or negotiate.

b. When an issuing bank determines that a presentation does not comply, it may in its sole judgement approach the applicant for a waiver of the discrepancies. This does not, however, extend the period mentioned in sub-article 14 (b).

c. When a nominated bank acting on its nomination, a confirming bank, if any, or the issuing bank decides to refuse to honour or negotiate, it must give a single notice to that effect to the presenter.

The notice must state:

i. that the bank is refusing to honour or negotiate; and

ii. each discrepancy in respect of which the bank refuses to honour or negotiate; and

iii. **a)** that the bank is holding the documents pending further instructions from the presenter; or

b) that the issuing bank is holding the documents until it receives a waiver from the applicant and agrees to accept it, or receives further instructions from the presenter prior to agreeing to accept a waiver; or

c) that the bank is returning the documents; or

d) that the bank is acting in accordance with instructions previously received from the presenter.

d. The notice required in sub-article 16 (c) must be given by telecommunication or, if that is not possible, by other expeditious means no later than the close of the fifth banking day following the day of presentation.

e. A nominated bank acting on its nomination, a confirming bank, if any, or the issuing bank may, after providing notice required by sub-article 16 (c) (iii) (a) or (b), return the documents to the presenter at any time.

f. If an issuing bank or a confirming bank fails to act in accordance with the provisions of this article, it shall be precluded from claiming that the documents do not constitute a complying presentation.

g. When an issuing bank refuses to honour or a confirming bank refuses to honour or negotiate and has given notice to that effect in accordance with this article, it shall then be entitled to claim a refund, with interest, of any reimbursement made.

Article 17
Original Documents and Copies

a. At least one original of each document stipulated in the credit must be presented.

b. A bank shall treat as an original any document bearing an apparently original signature, mark, stamp, or label of the issuer of the document, unless the document itself indicates that it is not an original.

c. Unless a document indicates otherwise, a bank will also accept a document as original if it:

- **i.** appears to be written, typed, perforated or stamped by the document issuer's hand; or
- **ii.** appears to be on the document issuer's original stationery; or
- **iii.** states that it is original, unless the statement appears not to apply to the document presented.

d. If a credit requires presentation of copies of documents, presentation of either originals or copies is permitted.

e. If a credit requires presentation of multiple documents by using terms such as "in duplicate", "in two fold" or "in two copies", this will be satisfied by the presentation of at least one original and the remaining number in copies, except when the document itself indicates otherwise.

Article 18
Commercial Invoice

a. A commercial invoice:
- **i.** must appear to have been issued by the beneficiary (except as provided in article 38);
- **ii.** must be made out in the name of the applicant (except as provided in sub-article 38 (g));
- **iii.** must be made out in the same currency as the credit; and
- **iv.** need not be signed.

b. A nominated bank acting on its nomination, a confirming bank, if any, or the issuing bank may accept a commercial invoice issued for an amount in excess of the amount permitted by the credit, and its decision will be binding upon all parties, provided the bank in question has not honoured or negotiated for an amount in excess of that permitted by the credit.

c. The description of the goods, services or performance in a commercial invoice must correspond with that appearing in the credit.

Article 19
Transport Document Covering at Least Two Different Modes of Transport

a. A transport document covering at least two different modes of transport (multimodal or combined transport document), however named, must appear to:
- **i.** indicate the name of the carrier and be signed by:
  - the carrier or a named agent for or on behalf of the carrier, or
  - the master or a named agent for or on behalf of the master.

  Any signature by the carrier, master or agent must be identified as that of the carrier, master or agent.

  Any signature by an agent must indicate whether the agent has signed for or on behalf of the carrier or for or on behalf of the master.
- **ii.** indicate that the goods have been dispatched, taken in charge or shipped on board at the place stated in the credit, by:
  - pre-printed wording, or
  - a stamp or notation indicating the date on which the goods have been dispatched, taken in charge or shipped on board.

The date of issuance of the transport document will be deemed to be the date of dispatch, taking in charge or shipped on board, and the date of shipment. However, if the transport document indicates, by stamp or notation, a date of dispatch, taking in charge or shipped on board, this date will be deemed to be the date of shipment.

iii. indicate the place of dispatch, taking in charge or shipment and the place of final destination stated in the credit, even if:

a) the transport document states, in addition, a different place of dispatch, taking in charge or shipment or place of final destination, or

b) the transport document contains the indication "intended" or similar qualification in relation to the vessel, port of loading or port of discharge.

iv. be the sole original transport document or, if issued in more than one original, be the full set as indicated on the transport document.

v. contain terms and conditions of carriage or make reference to another source containing the terms and conditions of carriage (short form or blank back transport document). Contents of terms and conditions of carriage will not be examined.

vi. contain no indication that it is subject to a charter party.

b. For the purpose of this article, transhipment means unloading from one means of conveyance and reloading to another means of conveyance (whether or not in different modes of transport) during the carriage from the place of dispatch, taking in charge or shipment to the place of final destination stated in the credit.

c. **i.** A transport document may indicate that the goods will or may be transhipped provided that the entire carriage is covered by one and the same transport document.

ii. A transport document indicating that transhipment will or may take place is acceptable, even if the credit prohibits transhipment.

Article 20
Bill of Lading

a. A bill of lading, however named, must appear to:

i. indicate the name of the carrier and be signed by:

- the carrier or a named agent for or on behalf of the carrier, or
- the master or a named agent for or on behalf of the master.

Any signature by the carrier, master or agent must be identified as that of the carrier, master or agent.

Any signature by an agent must indicate whether the agent has signed for or on behalf of the carrier or for or on behalf of the master.

ii. indicate that the goods have been shipped on board a named vessel at the port of loading stated in the credit by:

- pre-printed wording, or
- an on board notation indicating the date on which the goods have been shipped on board.

The date of issuance of the bill of lading will be deemed to be the date of shipment unless the bill of lading contains an on board notation indicating the date of shipment, in which case the date stated in the on board notation will be deemed to be the date of shipment.

If the bill of lading contains the indication "intended vessel" or similar qualification in relation to the name of the vessel, an on board notation indicating the date of shipment and the name of the actual vessel is required.

iii. indicate shipment from the port of loading to the port of discharge stated in the credit.

If the bill of lading does not indicate the port of loading stated in the credit as the port of loading, or if it contains the indication "intended" or similar qualification in relation to the port of loading, an on board notation indicating the port of loading as stated in the credit, the date of shipment and the name of the vessel is required. This provision applies even when loading on board or shipment on a named vessel is indicated by preprinted wording on the bill of lading.

iv. be the sole original bill of lading or, if issued in more than one original, be the full set as indicated on the bill of lading.

v. contain terms and conditions of carriage or make reference to another source containing the terms and conditions of carriage (short form or blank back bill of lading). Contents of terms and conditions of carriage will not be examined.

vi. contain no indication that it is subject to a charter party.

b. For the purpose of this article, transhipment means unloading from one vessel and reloading to another vessel during the carriage from the port of loading to the port of discharge stated in the credit.

c. **i.** A bill of lading may indicate that the goods will or may be transshipped provided that the entire carriage is covered by one and the same bill of lading.

ii. A bill of lading indicating that transhipment will or may take place is acceptable, even if the credit prohibits transhipment, if the goods have been shipped in a container, trailer or LASH barge as evidenced by the bill of lading.

d. Clauses in a bill of lading stating that the carrier reserves the right to tranship will be disregarded.

Article 21
Non-Negotiable Sea Waybill

a. A non-negotiable sea waybill, however named, must appear to:

i. indicate the name of the carrier and be signed by:

- the carrier or a named agent for or on behalf of the carrier, or
- the master or a named agent for or on behalf of the master.

Any signature by the carrier, master or agent must be identified as that of the carrier, master or agent.

Any signature by an agent must indicate whether the agent has signed for or on behalf of the carrier or for or on behalf of the master.

ii. indicate that the goods have been shipped on board a named vessel at the port of loading stated in the credit by:

- pre-printed wording, or
- an on board notation indicating the date on which the goods have been shipped on board.

The date of issuance of the non-negotiable sea waybill will be deemed to be the date of shipment unless the non-negotiable sea waybill contains an on board notation indicating the date of shipment, in which case the date stated in the on board notation will be deemed to be the date of shipment.

If the non-negotiable sea waybill contains the indication "intended vessel" or similar qualification in relation to the name of the vessel, an on board notation indicating the date of shipment and the name of the actual vessel is required.

iii. indicate shipment from the port of loading to the port of discharge stated in the credit.

If the non-negotiable sea waybill does not indicate the port of loading stated in the credit as the port of loading, or if it contains the indication "intended" or similar qualification in relation to the port of loading, an on board notation indicating the port of loading as stated in the credit, the date of shipment and the name of the vessel is required. This provision applies even when loading on board or shipment on a named vessel is indicated by pre-printed wording on the non-negotiable sea waybill.

iv. be the sole original non-negotiable sea waybill or, if issued in more than one original, be the full set as indicated on the non-negotiable sea waybill.

v. contain terms and conditions of carriage or make reference to another source containing the terms and conditions of carriage (short form or blank back non-negotiable sea waybill). Contents of terms and conditions of carriage will not be examined.

vi. contain no indication that it is subject to a charter party.

b. For the purpose of this article, transhipment means unloading from one vessel and reloading to another vessel during the carriage from the port of loading to the port of discharge stated in the credit.

c. **i.** A non-negotiable sea waybill may indicate that the goods will or may be transhipped provided that the entire carriage is covered by one and the same non-negotiable sea waybill.

ii. A non-negotiable sea waybill indicating that transhipment will or may take place is acceptable, even if the credit prohibits transhipment, if the goods have been shipped in a container, trailer or LASH barge as evidenced by the non-negotiable sea waybill.

d. Clauses in a non-negotiable sea waybill stating that the carrier reserves the right to tranship will be disregarded.

Article 22
Charter Party Bill of Lading

a. A bill of lading, however named, containing an indication that it is subject to a charter party (charter party bill of lading), must appear to:

i. be signed by:

- the master or a named agent for or on behalf of the master, or
- the owner or a named agent for or on behalf of the owner, or
- the charterer or a named agent for or on behalf of the charterer.

Any signature by the master, owner, charterer or agent must be identified as that of the master, owner, charterer or agent.

Any signature by an agent must indicate whether the agent has signed for or on behalf of the master, owner or charterer.

An agent signing for or on behalf of the owner or charterer must indicate the name of the owner or charterer.

ii. indicate that the goods have been shipped on board a named vessel at the port of loading stated in the credit by:

- pre-printed wording, or
- an on board notation indicating the date on which the goods have been shipped on board.

The date of issuance of the charter party bill of lading will be deemed to be the date of shipment unless the charter party bill of lading contains an on board notation indicating the date of shipment, in which case the date stated in the on board notation will be deemed to be the date of shipment.

iii. indicate shipment from the port of loading to the port of discharge stated in the credit. The port of discharge may also be shown as a range of ports or a geographical area, as stated in the credit.

iv. be the sole original charter party bill of lading or, if issued in more than one original, be the full set as indicated on the charter party bill of lading.

b. A bank will not examine charter party contracts, even if they are required to be presented by the terms of the credit.

Article 23
Air Transport Document

a. An air transport document, however named, must appear to:

i. indicate the name of the carrier and be signed by:

- the carrier, or
- a named agent for or on behalf of the carrier.

Any signature by the carrier or agent must be identified as that of the carrier or agent.

Any signature by an agent must indicate that the agent has signed for or on behalf of the carrier.

ii. indicate that the goods have been accepted for carriage.

iii. indicate the date of issuance. This date will be deemed to be the date of shipment unless the air transport document contains a specific notation of the actual date of shipment, in which case the date stated in the notation will be deemed to be the date of shipment.

Any other information appearing on the air transport document relative to the flight number and date will not be considered in determining the date of shipment.

iv. indicate the airport of departure and the airport of destination stated in the credit.

v. be the original for consignor or shipper, even if the credit stipulates a full set of originals.

vi. contain terms and conditions of carriage or make reference to another source containing the terms and conditions of carriage. Contents of terms and conditions of carriage will not be examined.

b. For the purpose of this article, transhipment means unloading from one aircraft and reloading to another aircraft during the carriage from the airport of departure to the airport of destination stated in the credit.

c. **i.** An air transport document may indicate that the goods will or may be transhipped, provided that the entire carriage is covered by one and the same air transport document.

ii. An air transport document indicating that transhipment will or may take place is acceptable, even if the credit prohibits transhipment.

Article 24
Road, Rail or Inland Waterway Transport Documents

a. A road, rail or inland waterway transport document, however named, must appear to:

i. indicate the name of the carrier and:

- be signed by the carrier or a named agent for or on behalf of the carrier, or
- indicate receipt of the goods by signature, stamp or notation by the carrier or a named agent for or on behalf of the carrier.

Any signature, stamp or notation of receipt of the goods by the carrier or agent must be identified as that of the carrier or agent.

Any signature, stamp or notation of receipt of the goods by the agent must indicate that the agent has signed or acted for or on behalf of the carrier.

If a rail transport document does not identify the carrier, any signature or stamp of the railway company will be accepted as evidence of the document being signed by the carrier.

ii. indicate the date of shipment or the date the goods have been received for shipment, dispatch or carriage at the place stated in the credit. Unless the transport document contains a dated reception stamp, an indication of the date of receipt or a date of shipment, the date of issuance of the transport document will be deemed to be the date of shipment.

iii. indicate the place of shipment and the place of destination stated in the credit.

b. **i.** A road transport document must appear to be the original for consignor or shipper or bear no marking indicating for whom the document has been prepared.

ii. A rail transport document marked "duplicate" will be accepted as an original.

iii. A rail or inland waterway transport document will be accepted as an original whether marked as an original or not.

c. In the absence of an indication on the transport document as to the number of originals issued, the number presented will be deemed to constitute a full set.

d. For the purpose of this article, transhipment means unloading from one means of conveyance and reloading to another means of conveyance, within the same mode of transport, during the carriage from the place of shipment, dispatch or carriage to the place of destination stated in the credit.

e. **i.** A road, rail or inland waterway transport document may indicate that the goods will or may be transhipped provided that the entire carriage is covered by one and the same transport document.

ii. A road, rail or inland waterway transport document indicating that transhipment will or may take place is acceptable, even if the credit prohibits transhipment.

Article 25
Courier Receipt, Post Receipt or Certificate of Posting

a. A courier receipt, however named, evidencing receipt of goods for transport, must appear to:

i. indicate the name of the courier service and be stamped or signed by the named courier service at the place from which the credit states the goods are to be shipped; and

ii. indicate a date of pick-up or of receipt or wording to this effect. This date will be deemed to be the date of shipment.

b. A requirement that courier charges are to be paid or prepaid may be satisfied by a transport document issued by a courier service evidencing that courier charges are for the account of a party other than the consignee.

c. A post receipt or certificate of posting, however named, evidencing receipt of goods for transport, must appear to be stamped or signed and dated at the place from which the credit states the goods are to be shipped. This date will be deemed to be the date of shipment.

Article 26
"On Deck", "Shipper's Load and Count", "Said by Shipper to Contain" and Charges Additional to Freight

a. A transport document must not indicate that the goods are or will be loaded on deck. A clause on a transport document stating that the goods may be loaded on deck is acceptable.

b. A transport document bearing a clause such as "shipper's load and count" and "said by shipper to contain" is acceptable.

c. A transport document may bear a reference, by stamp or otherwise, to charges additional to the freight.

Article 27

Clean Transport Document

A bank will only accept a clean transport document. A clean transport document is one bearing no clause or notation expressly declaring a defective condition of the goods or their packaging. The word "clean" need not appear on a transport document, even if a credit has a requirement for that transport document to be "clean on board".

Article 28

Insurance Document and Coverage

a. An insurance document, such as an insurance policy, an insurance certificate or a declaration under an open cover, must appear to be issued and signed by an insurance company, an underwriter or their agents or their proxies.

Any signature by an agent or proxy must indicate whether the agent or proxy has signed for or on behalf of the insurance company or underwriter.

b. When the insurance document indicates that it has been issued in more than one original, all originals must be presented.

c. Cover notes will not be accepted.

d. An insurance policy is acceptable in lieu of an insurance certificate or a declaration under an open cover.

e. The date of the insurance document must be no later than the date of shipment, unless it appears from the insurance document that the cover is effective from a date not later than the date of shipment.

f. **i.** The insurance document must indicate the amount of insurance coverage and be in the same currency as the credit.

ii. A requirement in the credit for insurance coverage to be for a percentage of the value of the goods, of the invoice value or similar is deemed to be the minimum amount of coverage required.

If there is no indication in the credit of the insurance coverage required, the amount of insurance coverage must be at least 110% of the CIF or CIP value of the goods.

When the CIF or CIP value cannot be determined from the documents, the amount of insurance coverage must be calculated on the basis of the amount for which honour or negotiation is requested or the gross value of the goods as shown on the invoice, whichever is greater.

iii. The insurance document must indicate that risks are covered at least between the place of taking in charge or shipment and the place of discharge or final destination as stated in the credit.

g. A credit should state the type of insurance required and, if any, the additional risks to be covered. An insurance document will be accepted without regard to any risks that are not covered if the credit uses imprecise terms such as "usual risks" or "customary risks".

h. When a credit requires insurance against "all risks" and an insurance document is presented containing any "all risks" notation or clause, whether or not bearing the heading "all risks", the insurance document will be accepted without regard to any risks stated to be excluded.

i. An insurance document may contain reference to any exclusion clause.

j. An insurance document may indicate that the cover is subject to a franchise or excess (deductible).

Article 29

Extension of Expiry Date or Last Day for Presentation

a. If the expiry date of a credit or the last day for presentation falls on a day when the bank to which presentation is to be made is closed for reasons other than those referred to in article 36, the expiry date or the last day for presentation, as the case may be, will be extended to the first following banking day.

b. If presentation is made on the first following banking day, a nominated bank must provide the issuing bank or confirming bank with a statement on its covering schedule that the presentation was made within the time limits extended in accordance with sub-article 29 (a).

c. The latest date for shipment will not be extended as a result of sub-article 29 (a).

Article 30

Tolerance in Credit Amount, Quantity and Unit Prices

a. The words "about" or "approximately" used in connection with the amount of the credit or the quantity or the unit price stated in the credit are to be construed as allowing a tolerance not to exceed 10% more or 10% less than the amount, the quantity or the unit price to which they refer.

b. A tolerance not to exceed 5% more or 5% less than the quantity of the goods is allowed, provided the credit does not state the quantity in terms of a stipulated number of packing units or individual items and the total amount of the drawings does not exceed the amount of the credit.

c. Even when partial shipments are not allowed, a tolerance not to exceed 5% less than the amount of the credit is allowed, provided that the quantity of the goods, if stated in the credit, is shipped in full and a unit price, if stated in the credit, is not reduced or that sub-article 30 (b) is not applicable. This tolerance does not apply when the credit stipulates a specific tolerance or uses the expressions referred to in sub-article 30 (a).

Article 31

Partial Drawings or Shipments

a. Partial drawings or shipments are allowed.

b. A presentation consisting of more than one set of transport documents evidencing shipment commencing on the same means of conveyance and for the same journey, provided they indicate the same destination, will not be regarded as covering a partial shipment, even if they indicate different dates of shipment or different ports of loading, places of taking in charge or dispatch. If the presentation consists of more than one set of transport documents, the latest date of shipment as evidenced on any of the sets of transport documents will be regarded as the date of shipment.

A presentation consisting of one or more sets of transport documents evidencing shipment on more than one means of conveyance within the same mode of transport will be regarded as covering a partial shipment, even if the means of conveyance leave on the same day for the same destination.

c. A presentation consisting of more than one courier receipt, post receipt or certificate of posting will not be regarded as a partial shipment if the courier receipts, post receipts or certificates of posting appear to have been stamped or signed by the same courier or postal service at the same place and date and for the same destination.

Article 32
Instalment Drawings or Shipments

If a drawing or shipment by instalments within given periods is stipulated in the credit and any instalment is not drawn or shipped within the period allowed for that instalment, the credit ceases to be available for that and any subsequent instalment.

Article 33
Hours of Presentation

A bank has no obligation to accept a presentation outside of its banking hours.

Article 34
Disclaimer on Effectiveness of Documents

A bank assumes no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document, or for the general or particular conditions stipulated in a document or superimposed thereon; nor does it assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods, services or other performance represented by any document, or for the good faith or acts or omissions, solvency, performance or standing of the consignor, the carrier, the forwarder, the consignee or the insurer of the goods or any other person.

Article 35
Disclaimer on Transmission and Translation

A bank assumes no liability or responsibility for the consequences arising out of delay, loss in transit, mutilation or other errors arising in the transmission of any messages or delivery of letters or documents, when such messages, letters or documents are transmitted or sent according to the requirements stated in the credit, or when the bank may have taken the initiative in the choice of the delivery service in the absence of such instructions in the credit.

If a nominated bank determines that a presentation is complying and forwards the documents to the issuing bank or confirming bank, whether or not the nominated bank has honoured or negotiated, an issuing bank or confirming bank must honour or negotiate, or reimburse that nominated bank, even when the documents have been lost in transit between the nominated bank and the issuing bank or confirming bank, or between the confirming bank and the issuing bank.

A bank assumes no liability or responsibility for errors in translation or interpretation of technical terms and may transmit credit terms without translating them.

Article 36
Force Majeure
A bank assumes no liability or responsibility for the consequences arising out of the interruption of its business by Acts of God, riots, civil commotions, insurrections, wars, acts of terrorism, or by any strikes or lockouts or any other causes beyond its control.

A bank will not, upon resumption of its business, honour or negotiate under a credit that expired during such interruption of its business.

Article 37
Disclaimer for Acts of an Instructed Party

a. A bank utilizing the services of another bank for the purpose of giving effect to the instructions of the applicant does so for the account and at the risk of the applicant.

b. An issuing bank or advising bank assumes no liability or responsibility should the instructions it transmits to another bank not be carried out, even if it has taken the initiative in the choice of that other bank.

c. A bank instructing another bank to perform services is liable for any commissions, fees, costs or expenses ("charges") incurred by that bank in connection with its instructions.

If a credit states that charges are for the account of the beneficiary and charges cannot be collected or deducted from proceeds, the issuing bank remains liable for payment of charges.

A credit or amendment should not stipulate that the advising to a beneficiary is conditional upon the receipt by the advising bank or second advising bank of its charges.

d. The applicant shall be bound by and liable to indemnify a bank against all obligations and responsibilities imposed by foreign laws and usages.

Article 38
Transferable Credits

a. A bank is under no obligation to transfer a credit except to the extent and in the manner expressly consented to by that bank.

b. For the purpose of this article:

Transferable credit means a credit that specifically states it is "transferable". A transferable credit may be made available in whole or in part to another beneficiary ("second beneficiary") at the request of the beneficiary ("first beneficiary").

Transferring bank means a nominated bank that transfers the credit or, in a credit available with any bank, a bank that is specifically authorized by the issuing bank to transfer and that transfers the credit. An issuing bank may be a transferring bank.

Transferred credit means a credit that has been made available by the transferring bank to a second beneficiary.

c. Unless otherwise agreed at the time of transfer, all charges (such as commissions, fees, costs or expenses) incurred in respect of a transfer must be paid by the first beneficiary.

d. A credit may be transferred in part to more than one second beneficiary provided partial drawings or shipments are allowed.

A transferred credit cannot be transferred at the request of a second beneficiary to any subsequent beneficiary. The first beneficiary is not considered to be a subsequent beneficiary.

e. Any request for transfer must indicate if and under what conditions amendments may be advised to the second beneficiary. The transferred credit must clearly indicate those conditions.

f. If a credit is transferred to more than one second beneficiary, rejection of an amendment by one or more second beneficiary does not invalidate the acceptance by any other second beneficiary, with respect to which the transferred credit will be amended accordingly. For any second beneficiary that rejected the amendment, the transferred credit will remain unamended.

g. The transferred credit must accurately reflect the terms and conditions of the credit, including confirmation, if any, with the exception of:

- the amount of the credit,
- any unit price stated therein,
- the expiry date,
- the period for presentation, or
- the latest shipment date or given period for shipment,

any or all of which may be reduced or curtailed.

The percentage for which insurance cover must be effected may be increased to provide the amount of cover stipulated in the credit or these articles.

The name of the first beneficiary may be substituted for that of the applicant in the credit.

If the name of the applicant is specifically required by the credit to appear in any document other than the invoice, such requirement must be reflected in the transferred credit.

h. The first beneficiary has the right to substitute its own invoice and draft, if any, for those of a second beneficiary for an amount not in excess of that stipulated in the credit, and upon such substitution the first beneficiary can draw under the credit for the difference, if any, between its invoice and the invoice of a second beneficiary.

i. If the first beneficiary is to present its own invoice and draft, if any, but fails to do so on first demand, or if the invoices presented by the first beneficiary create discrepancies that did not exist in the presentation made by the second beneficiary and the first beneficiary fails to correct them on first demand, the transferring bank has the right to present the documents as received from the second beneficiary to the issuing bank, without further responsibility to the first beneficiary.

j. The first beneficiary may, in its request for transfer, indicate that honour or negotiation is to be effected to a second beneficiary at the place to which the credit has been transferred, up to and including the expiry date of the credit. This is without prejudice to the right of the first beneficiary in accordance with sub-article 38 (h).

k. Presentation of documents by or on behalf of a second beneficiary must be made to the transferring bank.

Article 39
Assignment of Proceeds

The fact that a credit is not stated to be transferable shall not affect the right of the beneficiary to assign any proceeds to which it may be or may become entitled under the credit, in accordance with the provisions of applicable law. This article relates only to the assignment of proceeds and not to the assignment of the right to perform under the credit.

Appendix 3

A.3.1 Survey Instrument: Exporters

VICTORIA UNIVERSITY OF TECHNOLOGY

The Chartered Institute of Logistics & Transport
Australia - Victorian Section

Dear Sir/Madam,

Risk Management in Australian Manufacturing Exports: the case of Letters of Credit to ASEAN
(A survey of the use of Letters of Credit and problems with documentary discrepancies)

I am writing to you as a Ph. D. candidate of Victoria University, Melbourne, undertaking research on export Letters of Credit.

A survey and willingness to be interviewed form have been included and you are asked to voluntarily contribute to this research that I believe has a number of important aspects to it.

I am investigating the use of export Letters of Credit to ASEAN and, in particular, the difficulties associated with such transactions and the associated risk management practices that Australian exporters currently use.

My research has received the support of the Chartered Institute of Logistics and Transport in Australia (Victoria Section), in recognition of its potential importance for Australian exporters.

I wish to map current practices and compare these with those reported in the literature to see if there are any existing gaps and make suggestions about changes.

The data provided by you will of great assistance in being able to formulate such a mapping exercise and it is my expectation that the findings will generally assist current exporters in strategic decision making.

Additionally, the Federal Government, through Austrade, is currently embarked on a project to double the number of exporters in the next two years. Necessarily this will mean new, inexperienced entrants into the exports markets. As a previous practising exporter, I can appreciate the difficulties of initial exports. I believe that my research findings, through the completion of this survey by you, will enable me to develop a framework that will be of assistance to new exporters.

This survey is being conducted in accordance with the rules of Victoria University Human Ethics Committee. The results will be used only in aggregate form and therefore your anonymity and the confidentiality of your responses are assured. The completed surveys will be securely stored and available only to myself and supervisors. The surveys have been coded for administrative purposes, to avoid duplication and unnecessary reminders.

Victoria University of Technology, P.O. Box 14428 MCMC Vic 8001
Telephone: (03) 9919 4000

Your co-operation in completing this survey would be greatly appreciated.

Once the survey has been completed, please return it in the pre-paid envelope provided.

If you have any enquiries about the questionnaire, please do not hesitate to contact:

Mr Roberto Bergami
School of Applied Economics
Victoria University of Technology
Telephone: (03) 9919 5002
Email: Roberto.Bergami@vu.edu.au

Professor Bob Clift
School of Accounting and Finance
Victoria University of Technology
Telephone: (03) 9919 4561
Email: robert.clift@rmit.edu.au

If you have any concerns about the manner in which this research has been conducted, please contact the Human Research Ethics Committee at the following address:

The Secretary
Victoria University of Technology
Office for Research
6 Geelong Road, Footscray
Victoria 3011 Australia
Telephone: (03) 96884710

Thank you.

Roberto Bergami
Ph. D. Candidate

VICTORIA UNIVERSITY OF TECHNOLOGY

Project PQ ☐☐☐☐

The Chartered Institute of Logistics & Transport

Australia - Victorian Section

Risk Management in Australian Manufacturing Exports: the case of Letters of Credit to ASEAN

A SURVEY OF THE USE OF LETTERS OF CREDIT AND PROBLEMS WITH DOCUMENTARY DISCREPANCIES

SECTION 1. EXPORT DETAILS

1. Are you over 18 years of age?

   ☐ Yes ☐ No. If No please return the survey without completing it.

2. Does your firm export Australian origin manufactured goods to ASEAN countries? (Brunei, Burma (Myanmar), Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand, Vietnam)

   ☐ Yes ☐ No. If No please return the survey without completing it.

3. How many employees work in your firm?

   .... no. of employees

4. How many employees are directly employed in export documentation functions?

   .... no. of employees

5. What approximate percentage of your firm's export documentation employees have received specific Letter of Credit training?

   0-25% ☐ *26-50%* ☐ *51-75%* ☐ *76-100%* ☐

6. On average how long have the export documentation employees been dealing with export Letters of Credit?

   ☐ 0 – 1 years ☐ 2 – 3 years ☐ 4 to 5 years ☐ more than five years

7. Please indicate the manufacturing industry segment(s) of your exports to ASEAN. (List the ones that apply).

   ....

   ....

8. How long has your firm been exporting to ASEAN?

…………… years

9. To which of the countries listed below does your firm export? (Choose all that apply)

☐ Brunei ☐ Burma (Myanmar) ☐ Cambodia ☐ Indonesia ☐ Laos

☐ Malaysia ☐ Philippines ☐ Singapore ☐ Thailand ☐ Vietnam

10. What was the approximate total export sales value (for financial year 2003/04) to ASEAN (in AUD equivalent)?

☐ less that 1 Million ☐ 1 – 5 Million ☐ 5 – 10 Million ☐ Above 10 Million

11. What is the approximate percentage of export sales (for financial year 2003/04) to ASEAN based on total sales?

0-25%	*26-50%*	*51-75%*	*76-100%*
☐	☐	☐	☐

12. What is the approximate percentage of export sales to ASEAN against each method used?

☐ Prepayment (………………%) ☐ Letter of Credit (……………… %)

☐ Bill of Exchange (………………%) ☐ Open Account (……………… %)

☐ Other. Please indicate ………………………………………………………… (%)

13. What credit terms does your firm use for export Letter of Credit transactions to ASEAN? Please indicate the options that apply in percentage of transactions.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Letter of Credit drawn at Sight	☐	☐	☐	☐
Letter of Credit drawn at future payment date				
1 - 30 days	☐	☐	☐	☐
61 - 90 days	☐	☐	☐	☐
91 – 120 days	☐	☐	☐	☐
121 – 150 days	☐	☐	☐	☐
151 – 180 days	☐	☐	☐	☐

14. What types of export Letter of Credit does your firm use in the ASEAN Trade? (Choose all that apply). Please estimate the percentage based on financial year 2003/04 export sales.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Standard Irrevocable Letter of Credit	☐	☐	☐	☐
Red Clause Letter of Credit	☐	☐	☐	☐
Transferable Letter of Credit	☐	☐	☐	☐
Back-to-Back (Head and Counter) Letter of Credit	☐	☐	☐	☐
Revolving Letter of Credit	☐	☐	☐	☐
Other. Please indicate ……………………………………..	☐	☐	☐	☐
Other. Please indicate ……………………………………..	☐	☐	☐	☐

15. What is the approximate percentage of Letter of Credit exports to ASEAN, based on total export sales for financial year 2003/04 (in AUD equivalent)? (Choose all that apply)

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Brunei	☐	☐	☐	☐
Burma (Myanmar)	☐	☐	☐	☐
Cambodia	☐	☐	☐	☐
Indonesia	☐	☐	☐	☐
Laos	☐	☐	☐	☐
Malaysia	☐	☐	☐	☐
Philippines	☐	☐	☐	☐
Singapore	☐	☐	☐	☐
Thailand	☐	☐	☐	☐
Vietnam	☐	☐	☐	☐

16. What was the approximate number of export Letter of Credit transactions in ASEAN trade for financial year 2003/04?

   …………………… number

SECTION 2. EXPORT TRADING RISKS

17. Please indicate what method(s) your firm uses to assess country risk/customer risk in exporting to ASEAN countries?

   ☐ Checklist Approach ☐ Delphi Technique
   ☐ Quantitative Analysis ☐ Inspection Visits
   ☐ Combination of techniques ☐ Austrade Services
   ☐ Other. Please specify ……………………………………………………………………………
   ……………………………………………………………………………

18. Why is the Letter of Credit chosen as a method of payment when exporting to ASEAN countries?

   ☐ Importing Country Regulations ☐ Unacceptable Country Risk
   ☐ Unacceptable Customer Risk ☐ Value of Export Sale
   ☐ Other. Please specify ……………………………………………………………………………
   ……………………………………………………………………………

19. Where it is not mandatory, who decides on export Letter of Credit as the payment method of choice for ASEAN trade?

   ☐ Sales ☐ Marketing ☐ Finance ☐ Combination
   ☐ Other. Please indicate ……………………………………………………………………………

20. Does your firm use the services of a mercantile/credit agency to assist with country risk/customer risk assessment to ASEAN?

☐ Yes. Please indicate the name ....

☐ No

21. Does your firm utilise the services of a credit insurance agency for exports to ASEAN?

☐ Yes. Please indicate the name ....

☐ No

22. Does your firm use confirmed export Letter of Credit for the ASEAN trade?

☐ Yes. Please indicate the approximate value (in AUD equivalent) value based on total exports for financial year 2003/04 ....AUD equivalent

☐ No. Please go to Question 25

23. Does your firm use "silent confirmation" for any export Letter of Credit in the ASEAN trade? (This is where your firm arranges for confirmation of the export Letter of Credit without the buyer's (applicant) knowledge).

☐ Yes. Please indicate the approximate value (in AUD equivalent) value based on total exports for financial year 2003/04 ....AUD equivalent

☐ No. Please go to question 25

24. To which of the countries listed below does silent confirmation of export Letter of Credit apply? (Choose the ones that apply).

☐ Brunei	☐ Burma (Myanmar)	☐ Cambodia	☐ Indonesia	☐ Laos
☐ Malaysia	☐ Philippines	☐ Singapore	☐ Thailand	☐ Vietnam

25. What is the major currency your firm uses in ASEAN export Letter of Credit transactions?

....

26. Where foreign currency export Letter of Credit transactions for the ASEAN trade are used by your firm, what are the mechanisms employed to reduce/eliminate exchange risk exposure?

☐ The Export Department (or similar) enters into Forward Exchange contract to all foreign exchange transactions

☐ The Export Department (or similar) enters into Forward Exchange contract only where the transaction value is above the equivalent of .... AUD. (Please indicate the amount).

☐ Finance/Treasury department is responsible for the firm's exchange risk exposure

☐ Foreign exchange risk exposure is managed directly by the firm's bank, according to stipulated guidelines

☐ There is no specific foreign exchange risk management strategy in place

☐ Other. Please indicate ....

....

SECTION 3. LETTER OF CREDIT OPERATIONS

27. Please rank the following attributes in relation to preparing export Letter of Credit documentation for exports to ASEAN?

Detailed knowledge of the UCP 500	☐
Understanding of the Letter of Credit process	☐
Prior experience in Letter of Credit transactions	☐
Formal education in a relevant area	☐
The relationship between the beneficiary and the applicant	☐
The country of export	☐
Prior trading history	☐
The supply-demand market forces	☐
The relationship with the presenting bank	☐
Common industry practices	☐

28. How are export Letters of Credit from ASEAN received by your firm?

	Always	Sometimes	Never
☐ Through your own bank	☐	☐	☐
☐ Through other banks	☐	☐	☐

29. Please indicate the Incoterms 2000 (terms of delivery) that your firm uses ASEAN trade. (Choose the ones that apply). Please indicate the approximate percentage based on ASEAN export transactions for the financial year 2003/04.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
EXW (Ex Works)	☐	☐	☐	☐
FAS (Free Alongside Ship)	☐	☐	☐	☐
FCA (Free Carrier)	☐	☐	☐	☐
FOB (Free on Board)	☐	☐	☐	☐
CFR (Cost and Freight)	☐	☐	☐	☐
CIF (Cost, Insurance and Freight)	☐	☐	☐	☐
CPT (Carriage Paid To)	☐	☐	☐	☐
CIP (Carriage and Insurance Paid To)	☐	☐	☐	☐
DAF (Delivered At Frontier)	☐	☐	☐	☐
DES (Delivered Ex-Ship)	☐	☐	☐	☐
DEQ (Delivered Ex-Quay)	☐	☐	☐	☐
DDU (Delivered Duty Unpaid)	☐	☐	☐	☐
DDP (Delivered Duty Paid)	☐	☐	☐	☐

30. Does your firm operate with cargo insurance cover on an Open Policy basis enabling Certificates of Insurance to be issued in-house?

☐ Yes. Please indicate the insurance company/broker details ....

☐ No.

31. How often do export Letters of Credit for ASEAN trade require presentation of third party documents?

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Bill of Lading	☐	☐	☐	☐
Sea Waybill / Express Waybill/Non Negotiable Sea Waybill	☐	☐	☐	☐
Air Waybill	☐	☐	☐	☐
Certificate of Origin issued by a Chamber of Commerce or other Designated Issuing Authority	☐	☐	☐	☐
Inspection Certificate, e.g. SGS, Bureau Veritas, etc.	☐	☐	☐	☐
Government Certification, e.g. Quarantine	☐	☐	☐	☐
Other. Please indicate	☐	☐	☐	☐
Other. Please indicate	☐	☐	☐	☐
Other. Please indicate	☐	☐	☐	☐
Other. Please indicate	☐	☐	☐	☐

32. Does your firm use the services of a freight forwarder/logistics provider for exports to ASEAN?

☐ Yes. Please indicate the freight forwarder/logistics provider details ....

☐ No.

33. How do consignments exported to ASEAN leave your warehouse? (Choose the ones that apply)

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Delivered directly to carriers (air/sea/post or combined transport)	☐	☐	☐	☐
Delivered directly to a freight forwarder/logistics provider	☐	☐	☐	☐
Collected by a freight forwarder/logistics provider	☐	☐	☐	☐

Other. Please indicate ....

....

34. What is the mode(s) of transport used for exports to ASEAN? Please indicate the percentage based on numbers of annual consignments.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Air	☐	☐	☐	☐
Sea	☐	☐	☐	☐
Post	☐	☐	☐	☐
Combined (Multimodal) transport	☐	☐	☐	☐

35. How does your firm instruct external document producers in relation to the required data contents on Letter of Credit documentation for ASEAN trade?

- ☐ Paper based instructions on service provider's letterhead, e.g. Forwarding Instructions or Shipper's Letter of Instruction
- ☐ Electronic instructions, e.g. FWB (air), or PRA (sea)

36. Who prepares your documents against your Letter of Credit transactions for ASEAN trade? Please do not consider documents that are issued by third parties in this answer, e.g. Certificate of Origin, or Inspection Certificate, etc, or intermediate documents, e.g. forwarding instructions/shipper's letter of instruction.

- ☐ Internally prepared by employees. If so please indicate how:
  - ☐ Specific department/dedicated personnel **OR** ☐ General administration staff
- ☐ Outsourced (under contract to a service provider, e.g. a documentation bureau). Please describe the arrangements you have for the outsourcing

  ....

  ....

37. What method of document production does your firm use?

- ☐ Manually prepared documentation – without the use of a specific purpose documentation software package
- ☐ Computer generated documentation using
  - ☐ Internally designed programs **OR** ☐ Commercial software, e.g. OZDOCS
  - ☐ Are these electronic systems integrated with other internal processing systems, e.g. linked to the computer main frame?

☐ Yes ☐ No ☐ Not Applicable (firm does not utilise a main frame)

- ☐ Are these electronic systems integrated with external systems, e.g. linked to bank processing systems, such as ANZ EE BOOK and ANZ ONLINE?

  ☐ Yes **OR** ☐ No

- ☐ Other methods. Please indicate: ....

38. To which bank does your firm present export Letter of Credit documentation for ASEAN trade?

- ☐ Own bank only. Please indicate ....
- ☐ Advising Bank (the local bank who originally advised the details of the Letter of Credit advice)
- ☐ Any bank

39. In your firm, who decides which bank receives your export Letter of Credit documents for ASEAN trade?

☐ Company policy ☐ Sales/Marketing ☐ Finance

☐ Documentation staff ☐ Other. Please indicate

....

40. Does your firm consult with the relevant local bank before lodging documents against export Letter of Credit for ASEAN trade?

- ☐ Yes. Please indicate the percentage of transactions .... %
- ☐ No.

41. Approximately how many days after lodgement of ASEAN export Letter of Credit documents does your firm receive notification (from the bank) about acceptance/rejection of documents?

.... days

42. Have export Letter of Credit documents lodged by your firm against ASEAN transactions ever been rejected?

☐ Yes.

☐ No. If No please go to question xx

43. In percentage terms, what is your firm's approximate documentary rejection rate against export Letter of Credit transactions for ASEAN trade?

.... %

44. Where documents are rejected in the circumstance described above (Questions 43), what action takes place. (Choose the ones that apply)

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Local bank argues on you firm's behalf against issuing bank	☐	☐	☐	☐
Local bank refers matter to your firm without further involvement	☐	☐	☐	☐
Direct negotiation takes place between your firm and Letter of Credit applicant (buyer) to have documents accepted	☐	☐	☐	☐
Other. Please indicate	☐	☐	☐	☐

45. What are your firm's documentary discrepancies in export Letter of Credit transactions for ASEAN trade? Please choose the ones that apply.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Errors in the Bill of Exchange	☐	☐	☐	☐
Errors in the Commercial Invoice	☐	☐	☐	☐
Errors in the Packing List	☐	☐	☐	☐
Errors in the Transport Document	☐	☐	☐	☐
Errors in the Insurance Document	☐	☐	☐	☐
Errors in the Inspection Certificate	☐	☐	☐	☐
Errors in the Certificate of Origin (or similar document)	☐	☐	☐	☐
Errors in the Government Certification, e.g. Quarantine	☐	☐	☐	☐
Late Shipment	☐	☐	☐	☐
Missed Consignment in a predetermined Delivery Schedule	☐	☐	☐	☐
Documents lodged outside allowed presentation period	☐	☐	☐	☐
Documents presented after Letter of Credit expiry	☐	☐	☐	☐
Missing documents (required, but not presented)	☐	☐	☐	☐
Incorrect shipment/partial shipment	☐	☐	☐	☐

Other factors. Please indicate

…………………………………………………………	☐	☐	☐	☐
…………………………………………………………	☐	☐	☐	☐
…………………………………………………………	☐	☐	☐	☐

46. In ASEAN export Letter of Credit trade have there been any instances where your firm's documents have been accepted by the local (advising) bank as compliant, but subsequently rejected by the overseas bank (issuing) as non-compliant?

☐ Yes. Please indicate the percentage of transactions …………………….. %

☐ No.

47. Does your firm follow any specific practices in the preparation and lodgement of documents under export Letter of Credit transactions for ASEAN trade?

☐ Yes

☐ Standard Operating Procedures

☐ Department/Company Policies. Please indicate ………………………………………………………

………

☐ Others. Please indicate ……………………………………………………………………………..

………

☐ No.

48. In the case of documentary discrepancies on first presentations, in what percentage of ASEAN export Letter of Credit transactions can your firm successfully resubmit compliant documents?

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Successful resubmission of documents	☐	☐	☐	☐

49. In cases where it is not possible to rectify documentary discrepancies, what are the results of the ASEAN export Letter of Credit transaction? Please indicate the frequency of these events.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Importer accepts documents and pays as originally planned, regardless of discrepancies	☐	☐	☐	☐
Importer seeks variation to Letter of Credit terms				
Extended payment terms	☐	☐	☐	☐
Reduction in price	☐	☐	☐	☐
Other. Please indicate ……………………………… …………………………………………………………	☐	☐	☐	☐

50. What is the average total percentage of bad debts in ASEAN trade that your firm has experienced for the past five years, based on total export sales?

…………………………….. %

51. What has been the average percentage of bad debts resulting from discrepant documents under export Letter of Credit transaction to ASEAN for the past five years?

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Bad debts resulting from discrepant documents	☐	☐	☐	☐

52. In which ASEAN countries has your firm experienced bad debts as a result of discrepant documents against export Letter of Credit? (Choose all that apply)

☐ Brunei ☐ Burma (Myanmar) ☐ Cambodia ☐ Indonesia ☐ Laos

☐ Malaysia ☐ Philippines ☐ Singapore ☐ Thailand ☐ Vietnam

53. What is your estimate of the cost of rectifying documentary discrepancies per transaction for an ASEAN export Letter of Credit? Please indicate this in hours and/or AUD equivalent.

……………………………… hours **AND / OR** AUD equivalent ………………………………..

54. Does you firm discount (sell the document to the bank to receive advance payment) the ASEAN export Letter of Credit proceeds?

☐ Yes. Please indicate the following for the financial year 2003/04:

Approximate total number of Letter of Credit transactions discounted …………..

Approximate total value of Letter of Credit transactions discounted in AUD equivalent ………….

☐ No. If No please go to question xx

55. Why does your firm discount export Letter of Credit proceeds in the ASEAN trade? (Choose the ones that apply).

☐ Cash flow considerations

☐ Other. Please indicate ………………………………………………………………………………………..

………………………………………………………………………………………..

SECTION 4. PERSONAL QUESTIONS

56. What is your gender?

☐ Male ☐ Female

57. What is your age group?

☐ 18-30 ☐ 31-40 ☐ 41-50 ☐ 51-60 ☐ 60+

58. What is your level of education?

☐ Secondary ☐ TAFE ☐ University

☐ Other. Please specify

....

59. Have you undertaken any specific education or training in respect of Letter of Credit transactions?

☐ Yes. Please specify details in the space provided below.

Year	Name of course	Duration (weeks)	Institution
....	....	....	....
....	....	....	....
....	....	....	....
....	....	....	....
....	....	....	....
....	....	....	....
....	....	....	....
....	....	....	....

☐ No

60. How many years of experience do you have with Letter of Credit transactions in total?

.... years

61. What is your current job title?

....

62. How many years have you been employed in your current job?

....

Thank you for completing this survey

VICTORIA UNIVERSITY OF TECHNOLOGY

The Chartered Institute of Logistics & Transport

Australia - Victorian Section

WILLINGNESS TO BE INTERVIEWED

If you are willing to be interviewed in relation to this survey, please provide your details below.

Title (Mr, Mrs, Ms, Dr): ....

Family name: ....

First name: ....

Company name: ....

Telephone number: ....

A.3.2 Survey Instrument: Banks

VICTORIA UNIVERSITY | A NEW SCHOOL OF THOUGHT

ICC AUSTRALIA International Chamber of Commerce

8 September 2006

Dear Sir/Madam,

Risk Management in Australian Manufacturing Exports: the case of Letters of Credit to ASEAN
(A survey of the use of Letters of Credit and problems with documentary discrepancies)

I am writing to you as a Ph. D. candidate of Victoria University, Melbourne, undertaking research on export Letters of Credit.

A survey and willingness to be interviewed form have been included and you are asked to voluntarily contribute to this research that I believe has a number of important aspects to it.

I am investigating the use of export Letters of Credit to ASEAN and, in particular, the difficulties associated with such transactions and the associated risk management practices that Australian exporters currently use.

My research has received the support of the International Chamber of Commerce Australia, in recognition of its potential importance for Australian exporters.

I wish to map current practices and compare these with those reported in the literature to see if there are any existing gaps and make suggestions about changes.

The data provided by you will of great assistance in being able to formulate such a mapping exercise and it is my expectation that the findings will generally assist current exporters in strategic decision making.

Additionally, the Federal Government, through Austrade, is currently embarked on a project to double the number of exporters in the next two years. Necessarily this will mean new, inexperienced entrants into the exports markets. As a previous practising exporter, I can appreciate the difficulties of initial exports. I believe that my research findings, through the completion of this survey by you, will enable me to develop a framework that will be of assistance to new exporters.

Victoria University of Technology, P.O. Box 14428 MCMC Vic 8001
Telephone: (03) 9919 4000

This survey is being conducted in accordance with the rules of Victoria University Human Ethics Committee. The results will be used only in aggregate form and therefore your anonymity and the confidentiality of your responses are assured. The completed surveys will be securely stored and available only to myself and supervisors. The surveys have been coded for administrative purposes, to avoid duplication and unnecessary reminders.

Your co-operation in completing this survey would be greatly appreciated.

Once the survey has been completed, please return it in the pre-paid envelope provided.

If you have any enquiries about the questionnaire, please do not hesitate to contact:

Mr Roberto Bergami
School of Applied Economics
Victoria University of Technology
Telephone: (03) 9919 5002
Email: Roberto.Bergami@vu.edu.au

Professor Bob Clift
School of Accounting and Finance
Victoria University of Technology
Telephone: (03) 9919 4561
Email: robert.clift@rmit.edu.au

If you have any concerns about the manner in which this research has been conducted, please contact the Human Research Ethics Committee at the following address:

The Secretary
Victoria University of Technology
Office for Research
6 Geelong Road, Footscray
Victoria 3011 Australia
Telephone: (03) 96884710

Thank you.

Roberto Bergami
Ph. D. Candidate

Project PB ☐☐☐☐

VICTORIA UNIVERSITY | A NEW SCHOOL OF THOUGHT

ICC AUSTRALIA International Chamber of Commerce

Risk Management in Australian Manufacturing Exports: the case of Letters of Credit to ASEAN

A SURVEY OF THE USE OF LETTERS OF CREDIT AND PROBLEMS WITH DOCUMENTARY DISCREPANCIES

SECTION 1. EXPORT DETAILS

1. Are you over 18 years of age?

   ☐ Yes ☐ No. If No please return the survey without completing it.

2. Does your bank deal with documents/instructions for transactions involving the export of Australian origin manufactured goods to ASEAN countries? (Brunei, Burma (Myanmar), Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand, Vietnam)

   ☐ Yes ☐ No. If No please return the survey without completing it.

3. Approximately how many employees work in your bank?

   .... no. of employees

4. Approximately how many employees are directly employed in export documentation functions?

   .... no. of employees

5. What approximate percentage of your bank's export documentation employees have received specific Letter of Credit training?

0-25%	*26-50%*	*51-75%*	*76-100%*
☐	☐	☐	☐

6. On average how long have the export documentation employees been dealing with export Letters of Credit?

   ☐ 0 – 1 years ☐ 2 – 3 years ☐ 4 to 5 years ☐ more than five years

7. Approximately for how many years has your bank been dealing with export transactions to ASEAN?

   .... years

8. Approximately how many export customers does your bank deal with on an annual basis?

   ....

9. Approximately how many of these customers deal with ASEAN countries?

10. To which of the countries listed below does your bank handle export transactions? (Choose all that apply)

☐ Brunei ☐ Burma (Myanmar) ☐ Cambodia ☐ Indonesia ☐ Laos

☐ Malaysia ☐ Philippines ☐ Singapore ☐ Thailand ☐ Vietnam

11. What was the approximate total export transactions value (for financial year 2003/04) to ASEAN (in AUD equivalent)?

☐ less that 1 Million ☐ 1 – 5 Million ☐ 5 – 10 Million ☐ Above 10 Million

12. What is the approximate percentage of export transactions (for financial year 2003/04) that your bank handled to ASEAN, based on total transactions values?

0-25%	*26-50%*	*51-75%*	*76-100%*
☐	☐	☐	☐

13. What is the approximate percentage of export transactions to ASEAN that your bank handles against each method used?

☐ Prepayment (.................%) ☐ Letter of Credit (................. %)

☐ Bill of Exchange (.................%) ☐ Open Account (................. %)

☐ Other. Please indicate .... (%)

14. What credit terms do your customers use for export Letter of Credit transactions to ASEAN? Please indicate the options that apply in percentage of transactions.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Letter of Credit drawn at Sight	☐	☐	☐	☐
Letter of Credit drawn at future payment date				
1 - 30 days	☐	☐	☐	☐
61 - 90 days	☐	☐	☐	☐
91 – 120 days	☐	☐	☐	☐
121 – 150 days	☐	☐	☐	☐
151 – 180 days	☐	☐	☐	☐
Other. Please specify	☐	☐	☐	☐

15. What types of export Letter of Credit do your customers use in the ASEAN Trade? (Choose all that apply). Please estimate the percentage based on financial year 2003/04 export sales.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Standard Irrevocable Letter of Credit	☐	☐	☐	☐
Red Clause Letter of Credit	☐	☐	☐	☐
Transferable Letter of Credit	☐	☐	☐	☐
Back-to-Back (Head and Counter) Letter of Credit	☐	☐	☐	☐
Revolving Letter of Credit	☐	☐	☐	☐
Other. Please indicate	☐	☐	☐	☐
Other. Please indicate	☐	☐	☐	☐

16. What is the approximate percentage of Letter of Credit exports to ASEAN, based on total export business handled by your bank for financial year 2003/04 (in AUD equivalent)? (Choose all that apply)

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Brunei	☐	☐	☐	☐
Burma (Myanmar)	☐	☐	☐	☐
Cambodia	☐	☐	☐	☐
Indonesia	☐	☐	☐	☐
Laos	☐	☐	☐	☐
Malaysia	☐	☐	☐	☐
Philippines	☐	☐	☐	☐
Singapore	☐	☐	☐	☐
Thailand	☐	☐	☐	☐
Vietnam	☐	☐	☐	☐

17. What was the approximate number of export Letter of Credit transactions in ASEAN trade that your bank handled for financial year 2003/04?

.... number

SECTION 2. EXPORT TRADING RISKS

18. Please indicate what method(s) your bank uses to assess country risk/customer risk in exporting to ASEAN countries?

☐ Checklist Approach ☐ Delphi Technique

☐ Quantitative Analysis ☐ Inspection Visits

☐ Combination of techniques ☐ Austrade Services

☐ Other. Please specify ....
....

19. Why is the Letter of Credit chosen by your customers as a method of payment when exporting to ASEAN countries?

☐ Importing Country Regulations ☐ Unacceptable Country Risk

☐ Unacceptable Customer Risk ☐ Value of Export Sale

☐ Other. Please specify ....
....

☐ Don't know

20. Where it is not mandatory, in your customer's firm who do you believe decides on export Letter of Credit as the payment method of choice for ASEAN trade?

☐ Sales ☐ Marketing ☐ Finance ☐ Combination

☐ Other. Please indicate ....

☐ Don't know

21. Does your bank use the services of a mercantile/credit agency to assist with country risk/customer risk assessment to ASEAN?

☐ Yes. Please indicate the name ....
☐ No

22. Does your bank utilise the services of a credit insurance agency for exports to ASEAN?

☐ Yes. Please indicate the name ....

☐ No

23. Do your customers use confirmed export Letter of Credit for the ASEAN trade?

☐ Yes. Please indicate the approximate value (in AUD equivalent) value based on total exports for financial year 2003/04 ....AUD equivalent

☐ No. Please go to Question 26

☐ Don't know. Please go to Question 26

24. Do your customers use "silent confirmation" for any export Letter of Credit in the ASEAN trade? (This is where your customer arranges for confirmation of the export Letter of Credit without the buyer's (applicant) knowledge).

☐ Yes. Please indicate the approximate value (in AUD equivalent) value based on total exports for financial year 2003/04 ....AUD equivalent

☐ No. Please go to question 26

25. To which of the countries listed below does silent confirmation of export Letter of Credit apply? (Choose the ones that apply).

☐ Brunei ☐ Burma (Myanmar) ☐ Cambodia ☐ Indonesia ☐ Laos

☐ Malaysia ☐ Philippines ☐ Singapore ☐ Thailand ☐ Vietnam

26. What is the major currency your customers use in ASEAN export Letter of Credit transactions?

....

27. Where foreign currency export Letter of Credit transactions for the ASEAN trade are used by your customers, what are the main mechanisms employed to reduce/eliminate exchange risk exposure?

☐ The customer's Export Department (or similar) enters into Forward Exchange contract for all foreign exchange transactions

☐ The Export Department (or similar) enters into Forward Exchange contract only where the transaction value is above the equivalent of .... AUD. (Please indicate the amount).

☐ Foreign exchange risk exposure is managed directly by your bank, according to stipulated guidelines

☐ There is no specific foreign exchange risk management strategy in place

☐ Other. Please indicate ....

SECTION 3. LETTER OF CREDIT OPERATIONS

28. From your bank's perspective, please rank the following attributes in the context of preparing Letter of Credit documentation for exports to ASEAN. (1 is the most important and 10 is the least important)

Detailed knowledge of the UCP 500	☐
Understanding of the Letter of Credit process	☐
Prior experience in Letter of Credit transactions	☐
Formal education in a relevant area	☐
The relationship between the beneficiary and the applicant	☐
The country of export	☐
Prior trading history	☐
The supply-demand market forces	☐
The relationship with the presenting bank	☐
Common industry practices	☐

29. How are export Letters of Credit from ASEAN received by your customers?

	Always	Sometimes	Never
☐ Through your own bank	☐	☐	☐
☐ Through other banks	☐	☐	☐

30. Please indicate the Incoterms 2000 (terms of delivery) that your customers use in ASEAN trade. (Choose the ones that apply). Please indicate the approximate percentage based on ASEAN export transactions for the financial year 2003/04.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
EXW (Ex Works)	☐	☐	☐	☐
FAS (Free Alongside Ship)	☐	☐	☐	☐
FCA (Free Carrier)	☐	☐	☐	☐
FOB (Free on Board)	☐	☐	☐	☐
CFR (Cost and Freight)	☐	☐	☐	☐
CIF (Cost, Insurance and Freight)	☐	☐	☐	☐
CPT (Carriage Paid To)	☐	☐	☐	☐
CIP (Carriage and Insurance Paid To)	☐	☐	☐	☐
DAF (Delivered At Frontier)	☐	☐	☐	☐
DES (Delivered Ex-Ship)	☐	☐	☐	☐
DEQ (Delivered Ex-Quay)	☐	☐	☐	☐
DDU (Delivered Duty Unpaid)	☐	☐	☐	☐
DDP (Delivered Duty Paid)	☐	☐	☐	☐

31. What are the typical cargo insurance arrangements chosen by your export customers in Letter of Credit transactions to ASEAN?

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Export Open Insurance Policy (In house certificates)	☐	☐	☐	☐
Insurance – buyer's care	☐	☐	☐	☐
Insurance provided through your bank	☐	☐	☐	☐

32. How often do export Letters of Credit for ASEAN trade that your bank handles require presentation of third party documents?

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Bill of Lading	☐	☐	☐	☐
Sea Waybill / Express Waybill/Non Negotiable Sea Waybill	☐	☐	☐	☐
Air Waybill	☐	☐	☐	☐
Certificate of Origin issued by a Chamber of Commerce or other Designated Issuing Authority	☐	☐	☐	☐
Inspection Certificate, e.g. SGS, Bureau Veritas, etc.	☐	☐	☐	☐
Government Certification, e.g. Quarantine	☐	☐	☐	☐
Other. Please indicate	☐	☐	☐	☐
Other. Please indicate	☐	☐	☐	☐
Other. Please indicate	☐	☐	☐	☐
Other. Please indicate	☐	☐	☐	☐

33. Do you know whether your customers typically use the services of a freight forwarder/logistics provider for exports to ASEAN?

☐ Yes. Please indicate the freight forwarder/logistics provider details ....

☐ No.

☐ Don't know.

34. What is the mode(s) of transport used by your customers for Letter of Credit exports to ASEAN? Please indicate the approximate percentage based on numbers of annual transactions.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Air	☐	☐	☐	☐
Sea	☐	☐	☐	☐
Post	☐	☐	☐	☐
Combined (Multimodal) transport	☐	☐	☐	☐

35. What method of document production do your customers routinely use?

☐ Manually prepared documentation – without the use of a specific purpose documentation software package

☐ Internally designed computer generated documentation

☐ Electronic systems integrated with bank processing

☐ Other methods. Please indicate: ....

36. To which bank does your customer usually present export Letter of Credit documentation for ASEAN trade?

☐ Own bank only. Please indicate …………………………………………………………………………………….

☐ Advising Bank (the local bank who originally advised the details of the Letter of Credit advice)

☐ Any bank

37. Do your customers usually consult with your bank before lodging documents against export Letter of Credit for ASEAN trade?

☐ Yes. Please indicate the percentage of transactions …………………….. %

☐ No.

38. Approximately how many days after lodgement of ASEAN export Letter of Credit documents do your customers receive notification (from the bank) about acceptance/rejection of documents?

………………………………… days

39. Have export Letter of Credit documents lodged by your customers against ASEAN transactions ever been rejected?

☐ Yes.

☐ No. If No please go to question 42

40. In percentage terms, what is your total customers' approximate documentary rejection rate against export Letter of Credit transactions for ASEAN trade?

………………………………… %

41. Where documents are rejected, what action takes place. (Choose the ones that apply)

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Local bank argues on customer's behalf against issuing bank	☐	☐	☐	☐
Local bank refers matter to customer without further involvement	☐	☐	☐	☐
Direct negotiation takes place between your customer and Letter of Credit applicant (buyer) to have documents accepted	☐	☐	☐	☐
Other. Please indicate ……………………………………………. ……………………………………………………………….	☐	☐	☐	☐

42. What are your customer's common documentary discrepancies in export Letter of Credit transactions for ASEAN trade? Please choose the ones that apply.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Errors in the Bill of Exchange	☐	☐	☐	☐
Errors in the Commercial Invoice	☐	☐	☐	☐
Errors in the Packing List	☐	☐	☐	☐
Errors in the Transport Document	☐	☐	☐	☐
Errors in the Insurance Document	☐	☐	☐	☐
Errors in the Inspection Certificate	☐	☐	☐	☐
Errors in the Certificate of Origin (or similar document)	☐	☐	☐	☐
Errors in the Government Certification, e.g. Quarantine	☐	☐	☐	☐
Late Shipment	☐	☐	☐	☐
Missed Consignment in a predetermined Delivery Schedule	☐	☐	☐	☐
Documents lodged outside allowed presentation period	☐	☐	☐	☐
Documents presented after Letter of Credit expiry	☐	☐	☐	☐
Missing documents (required, but not presented)	☐	☐	☐	☐
Incorrect shipment/partial shipment	☐	☐	☐	☐
Other factors. Please indicate				
....	☐	☐	☐	☐
....	☐	☐	☐	☐
....	☐	☐	☐	☐

43. In ASEAN export Letter of Credit trade have there been any instances where your customer's documents have been accepted by the local (advising) bank (your bank) as compliant, but subsequently rejected by the overseas bank (issuing) as non-compliant?

☐ Yes. Please indicate the percentage of transactions .... %

☐ No.

44. In the case of documentary discrepancies on first presentations, in what percentage of ASEAN export Letter of Credit transactions can your customers successfully resubmit compliant documents?

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Successful resubmission of documents	☐	☐	☐	☐

45. In cases where it is not possible to rectify documentary discrepancies, what are the results of the ASEAN export Letter of Credit transactions? Please indicate the frequency of these events.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Importer accepts documents and pays as originally planned, regardless of discrepancies	☐	☐	☐	☐
Importer seeks variation to Letter of Credit terms				
Extended payment terms	☐	☐	☐	☐
Reduction in price	☐	☐	☐	☐
Other. Please indicate ……………………………… ……………………………………………………………	☐	☐	☐	☐

46. What is your estimate of total percentage of bad debts that your customers might have experienced in Letter of Credit transactions in ASEAN trade over the past five years, based on total export transactions values?

…………………………….. %

47. What is your estimate of the percentage of bad debts resulting from discrepant documents under export Letter of Credit transactions to ASEAN for the past five years?

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Bad debts resulting from discrepant documents	☐	☐	☐	☐

48. In which ASEAN countries have your customers experienced bad debts as a result of discrepant documents against export Letter of Credit? (Choose all that apply)

☐ Brunei ☐ Burma (Myanmar) ☐ Cambodia ☐ Indonesia ☐ Laos

☐ Malaysia ☐ Philippines ☐ Singapore ☐ Thailand ☐ Vietnam

49. What is your estimate of the cost of rectifying documentary discrepancies per transaction for an ASEAN export Letter of Credit? Please indicate this in hours and/or AUD equivalent.

……….……………………. hours **AND / OR** AUD equivalent ………………………………..

50. Do your customers discount (sell the document to your bank to receive advance payment) the ASEAN export Letter of Credit?

☐ Yes. Please indicate the following for the financial year 2003/04:

Approximate total number of Letter of Credit transactions discounted …………..

Approximate total value of Letter of Credit transactions discounted in AUD equivalent ….……….

☐ No. If No please go to question 52 (on the next page).

51. Why do your customers discount export Letter of Credit proceeds in the ASEAN trade? (Choose the ones that apply).

☐ Cash flow considerations

☐ Other. Please indicate ………………………………………………………………………………………..

………………………………………………………………………………………..

☐ Don't know

SECTION 4. PERSONAL QUESTIONS

52. What is your gender?

☐ Male ☐ Female

53. What is your age group?

☐ 18-30 ☐ 31-40 ☐ 41-50 ☐ 51-60 ☐ 60+

54. What is your highest level of education?

☐ Secondary ☐ TAFE ☐ University

☐ Other. Please specify ....

55. Have you undertaken any specific education or training in respect of Letter of Credit transactions?

☐ Yes. Please specify details in the space provided below.

Year	Name of course	Duration (weeks)	Institution
....	....	....	....
....	....	....	....
....	....	....	....
....	....	....	....
....	....	....	....
....	....	....	....
....	....	....	....
....	....	....	....

☐ No

56. How many years of experience do you have with Letter of Credit transactions in total?

.... years

57. What is your current job title?

....

58. How many years have you been employed in your current job?

....

Thank you for completing this survey

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ICC AUSTRALIA International Chamber of Commerce

WILLINGNESS TO BE INTERVIEWED

If you are willing to be interviewed in relation to this survey, please provide your details below.

Title (Mr, Mrs, Ms, Dr): ………………………………………….

Family name: ………………………………………………………………………………………

First name: ………………………………………………………………………………………

Company name: ………………………………………………………………………………………

Telephone number: ……………………………………………………………………………………………

A.3.3 Survey Instrument: Service Providers

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CBFCA
AUSTRALIA
Communicate. Innovate
Customs Brokers & Forwarders Council of Australia Inc.

Dear Sir/Madam,

Risk Management in Australian Manufacturing Exports: the case of Letters of Credit to ASEAN
(A survey of the use of Letters of Credit and problems with documentary discrepancies)

I am writing to you as a Ph. D. candidate of Victoria University, Melbourne, undertaking research on export Letters of Credit.

A survey and willingness to be interviewed form have been included and you are asked to voluntarily contribute to this research that I believe has a number of important aspects to it.

I am investigating the use of export Letters of Credit to ASEAN and, in particular, the difficulties associated with such transactions and the associated risk management practices that Australian exporters currently use.

My research has received the support of the International Chamber of Commerce Australia, in recognition of its potential importance for Australian exporters.

I wish to map current practices and compare these with those reported in the literature to see if there are any existing gaps and make suggestions about changes.

The data provided by you will of great assistance in being able to formulate such a mapping exercise and it is my expectation that the findings will generally assist current exporters in strategic decision making.

Additionally, the Federal Government, through Austrade, is currently embarked on a project to double the number of exporters in the next two years. Necessarily this will mean new, inexperienced entrants into the exports markets. As a previous practising exporter, I can appreciate the difficulties of initial exports. I believe that my research findings, through the completion of this survey by you, will enable me to develop a framework that will be of assistance to new exporters.

Victoria University of Technology, P.O. Box 14428 MCMC Vic 8001
Telephone: (03) 9919 4000

This survey is being conducted in accordance with the rules of Victoria University Human Ethics Committee. The results will be used only in aggregate form and therefore your anonymity and the confidentiality of your responses are assured. The completed surveys will be securely stored and available only to myself and supervisors. The surveys have been coded for administrative purposes, to avoid duplication and unnecessary reminders.

Your co-operation in completing this survey would be greatly appreciated.

Once the survey has been completed, please return it in the pre-paid envelope provided.

If you have any enquiries about the questionnaire, please do not hesitate to contact:

Mr Roberto Bergami
School of Applied Economics
Victoria University of Technology
Telephone: (03) 9919 5002
Email: Roberto.Bergami@vu.edu.au

Professor Bob Clift
School of Accounting and Finance
Victoria University of Technology
Telephone: (03) 9919 4561
Email: robert.clift@rmit.edu.au

If you have any concerns about the manner in which this research has been conducted, please contact the Human Research Ethics Committee at the following address:

The Secretary
Victoria University of Technology
Office for Research
6 Geelong Road, Footscray
Victoria 3011 Australia
Telephone: (03) 96884710

Thank you.

Roberto Bergami
Ph. D. Candidate

Project PF ☐☐☐☐

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Customs Brokers & Forwarders Council of Australia Inc.

Risk Management in Australian Manufacturing Exports: the case of Letters of Credit to ASEAN

A SURVEY OF THE USE OF LETTERS OF CREDIT AND PROBLEMS WITH DOCUMENTARY DISCREPANCIES

SECTION 1. EXPORT DETAILS

1. Are you over 18 years of age?

☐ Yes ☐ No. If No please return the survey without completing it.

2. Does your firm deal with transaction involving the export of Australian origin manufactured goods to ASEAN countries? (Brunei, Burma (Myanmar), Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand, Vietnam)

☐ Yes ☐ No. If No please return the survey without completing it.

3. How many employees work in your firm?

.... no. of employees

4. How many employees are directly employed in export documentation functions?

.... no. of employees

5. What approximate percentage of your firm's export documentation employees have received specific Letter of Credit training?

0-25%	*26-50%*	*51-75%*	*76-100%*
☐	☐	☐	☐

6. On average, in your firm, how long have the export documentation employees been dealing with export Letters of Credit?

☐ 0 – 1 years ☐ 2 – 3 years ☐ 4 to 5 years ☐ more than five years

7. How long has your firm been dealing with export transactions to ASEAN?

   …………… years

8. Approximately how many export customers does your firm deal with on an annual basis and how many total transactions per annum?

   Total yearly customers (number)……………… Total yearly transactions (number)……………

9. Approximately how many of these customers deal with ASEAN countries and how many transactions?

   Total yearly customers (number)……………… Total yearly transactions (number)……………

10. To which of the countries listed below does your firm handle export transactions? (Choose all that apply)

    ☐ Brunei ☐ Burma (Myanmar) ☐ Cambodia ☐ Indonesia ☐ Laos

    ☐ Malaysia ☐ Philippines ☐ Singapore ☐ Thailand ☐ Vietnam

11. What was the approximate total export transactions value (for financial year 2003/04) to ASEAN (in AUD equivalent) that your firm handled?

    ☐ less that 1 Million ☐ 1 – 5 Million ☐ 5 – 10 Million ☐ Above 10 Million

12. What is the approximate percentage of export transactions (for financial year 2003/04) to ASEAN based on total FOB value (for financial year 2003/04)?

0-25%	*26-50%*	*51-75%*	*76-100%*
☐	☐	☐	☐

13. Please indicate the approximate percentage of export payment terms used by your customers against transactions to ASEAN.

    ☐ Prepayment (……………..%) ☐ Letter of Credit (…………….. %)

    ☐ Bill of Exchange (……………..%) ☐ Open Account (…………….. %)

    ☐ Other. Please indicate ………………………………………………………. (%)

14. What credit terms do your customers use for export Letter of Credit transactions to ASEAN? Please indicate the options that apply in percentage of transactions.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Letter of Credit drawn at Sight	☐	☐	☐	☐
Letter of Credit drawn at future payment date				
1 - 30 days	☐	☐	☐	☐
61 - 90 days	☐	☐	☐	☐
91 – 120 days	☐	☐	☐	☐
121 – 150 days	☐	☐	☐	☐
151 – 180 days	☐	☐	☐	☐

☐ Don't know

15. What types of export Letter of Credit do your customers use in the ASEAN Trade? (Choose all that apply). Please estimate the percentage based on financial year 2003/04 export customs value.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Standard Irrevocable Letter of Credit	☐	☐	☐	☐
Red Clause Letter of Credit	☐	☐	☐	☐
Transferable Letter of Credit	☐	☐	☐	☐
Back-to-Back (Head and Counter) Letter of Credit	☐	☐	☐	☐
Revolving Letter of Credit	☐	☐	☐	☐
Other. Please indicate	☐	☐	☐	☐

☐ Don't know

16. What is the approximate percentage of Letter of Credit exports to ASEAN, based on total export business handled by your firm for financial year 2003/04 (in AUD equivalent)? (Choose all that apply)

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Brunei	☐	☐	☐	☐
Burma (Myanmar)	☐	☐	☐	☐
Cambodia	☐	☐	☐	☐
Indonesia	☐	☐	☐	☐
Laos	☐	☐	☐	☐
Malaysia	☐	☐	☐	☐
Philippines	☐	☐	☐	☐
Singapore	☐	☐	☐	☐
Thailand	☐	☐	☐	☐
Vietnam	☐	☐	☐	☐

17. What was the approximate number of export Letter of Credit transactions in ASEAN trade for financial year 2003/04?

.... number

SECTION 2. EXPORT TRADING RISKS

18. Please indicate what method(s) your customers routinely use to assess country risk/customer risk in exporting to ASEAN countries?

☐ Checklist Approach ☐ Delphi Technique ☐ Quantitative Analysis

☐ Inspection Visits ☐ Combination of techniques ☐ Austrade Services

☐ Other. Please specify ....

☐ Don't know

19. Why is the Letter of Credit chosen by your customers as a method of payment when exporting to ASEAN countries?

☐ Importing Country Regulations ☐ Unacceptable Country Risk

☐ Unacceptable Customer Risk ☐ Value of Export Sale

☐ Other. Please specify ....
....

☐ Don't know

20. Where it is not mandatory (e.g. a government regulation), who in your customer's firm decides on export Letter of Credit as the payment method of choice for ASEAN trade?

☐ Sales ☐ Marketing ☐ Finance ☐ Combination

☐ Other. Please indicate ....

☐ Don't know

21. Do your customers use the services of a mercantile/credit agency to assist with country risk/customer risk assessment to ASEAN?

☐ Yes. Please indicate the name ....

☐ No

☐ Don't know

22. What is the major currency used by your customers in ASEAN export Letter of Credit transactions?

....

SECTION 3. LETTER OF CREDIT OPERATIONS

23. Please rank the following attributes in relation to preparing export Letter of Credit documentation for exports to ASEAN?

Detailed knowledge of the UCP 500 ☐

Understanding of the Letter of Credit process ☐

Prior experience in Letter of Credit transactions ☐

Formal education in a relevant area ☐

The relationship between the beneficiary and the applicant ☐

The country of export ☐

Prior trading history ☐

The supply-demand market forces ☐

The relationship with the banks ☐

Common industry practices ☐

24. Please indicate the Incoterms 2000 (terms of delivery) that your customers use in ASEAN trade. (Choose the ones that apply). Please indicate the approximate percentage based on ASEAN export transactions for the financial year 2003/04.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
EXW (Ex Works)	☐	☐	☐	☐
FAS (Free Alongside Ship)	☐	☐	☐	☐
FCA (Free Carrier)	☐	☐	☐	☐
FOB (Free on Board)	☐	☐	☐	☐
CFR (Cost and Freight)	☐	☐	☐	☐
CIF (Cost, Insurance and Freight)	☐	☐	☐	☐
CPT (Carriage Paid To)	☐	☐	☐	☐
CIP (Carriage and Insurance Paid To)	☐	☐	☐	☐
DAF (Delivered At Frontier)	☐	☐	☐	☐
DES (Delivered Ex-Ship)	☐	☐	☐	☐
DEQ (Delivered Ex-Quay)	☐	☐	☐	☐
DDU (Delivered Duty Unpaid)	☐	☐	☐	☐
DDP (Delivered Duty Paid)	☐	☐	☐	☐

25. Who arranges for international cargo insurance cover on consignments handled by your firm for exports to ASEAN countries? Please indicate the percentages that apply to each based on total number of consignments for financial year 2003/04.

☐ Insurance arranged by the export client: …..…… %

☐ Insurance arranged by our firm on behalf of export client: ……………%

☐ Other (Please specify: …………………………………………………………..) ………………..%

26. How often do export Letters of Credit for ASEAN trade require presentation of third party documents?

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Bill of Lading	☐	☐	☐	☐
Sea Waybill / Express Waybill/Non Negotiable Sea Waybill	☐	☐	☐	☐
Air Waybill	☐	☐	☐	☐
Certificate of Origin issued by a Chamber of Commerce or other Designated Issuing Authority	☐	☐	☐	☐
Inspection Certificate, e.g. SGS, Bureau Veritas, etc.	☐	☐	☐	☐
Government Certification, e.g. Quarantine	☐	☐	☐	☐
Other. Please indicate ……………………………………	☐	☐	☐	☐
Other. Please indicate ……………………………………	☐	☐	☐	☐
Other. Please indicate ……………………………………	☐	☐	☐	☐
Other. Please indicate ……………………………………	☐	☐	☐	☐

27. How do consignments exported to ASEAN leave your customers' warehouse? (Choose the ones that apply)

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Delivered directly to carriers (air/sea/post or combined transport)	☐	☐	☐	☐
Delivered directly to your premises	☐	☐	☐	☐
Collected from the exporter's premises by your firm	☐	☐	☐	☐
Other. Please indicate	☐	☐	☐	☐

28. What is the mode(s) of transport used by your customers for exports to ASEAN? Please indicate the percentage based on numbers of annual consignments.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Air	☐	☐	☐	☐
Sea	☐	☐	☐	☐
Post	☐	☐	☐	☐
Combined (Multimodal) transport	☐	☐	☐	☐

29. How do your customers instruct your firm in relation to the required data contents on Letter of Credit documentation for ASEAN trade?

☐ Paper based instructions on service provider's letterhead, e.g. Forwarding Instructions or Shipper's Letter of Instruction

☐ Electronic instructions, e.g. FWB (air), or PRA (sea)

☐ Customer provides a copy of the Letter of Credit and our firm interprets requirements and provides appropriate transport documents

30. What method of document production do your customers routinely use?

☐ Manually prepared documentation – without the use of a specific purpose documentation software package

☐ Computer generated documentation

☐ Other methods. Please indicate: ....

31. Have export Letter of Credit documents lodged by your customers against ASEAN transactions ever been rejected?

☐ Yes.

☐ No. If No please go to question xx

32. In percentage terms, what do you believe to be your customers' approximate documentary rejection rate against export Letter of Credit transactions for ASEAN trade?

.... %

☐ Don't know

33. What do you believe are your customer's common documentary discrepancies in export Letter of Credit transactions for ASEAN trade? Please choose the ones that apply.

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Errors in the Commercial Invoice	☐	☐	☐	☐
Errors in the Packing List	☐	☐	☐	☐
Errors in the Transport Document	☐	☐	☐	☐
Errors in the Insurance Document	☐	☐	☐	☐
Errors in the Inspection Certificate	☐	☐	☐	☐
Errors in the Government Certification, e.g. Quarantine	☐	☐	☐	☐
Late Shipment	☐	☐	☐	☐
Missed Consignment in a predetermined Delivery Schedule	☐	☐	☐	☐
Incorrect shipment/partial shipment	☐	☐	☐	☐
Other factors. Please indicate				
....	☐	☐	☐	☐
....	☐	☐	☐	☐

34. Do your customers follow any specific practices in the preparation and lodgement of documents under export Letter of Credit transactions for ASEAN trade?

☐ Yes

☐ Standard Operating Procedures

☐ Department/Company Policies. Please indicate ....

☐ Others. Please indicate ....

☐ Don't know

35. What do you believe to be the average percentage of bad debts resulting from discrepant documents under export Letter of Credit transaction to ASEAN for the past five years?

These values are expressed in percentage (%) terms	*0-25*	*26-50*	*51-75*	*76-100*
Bad debts resulting from discrepant documents	☐	☐	☐	☐

☐ Don't know

36. In which ASEAN countries have your customers experienced bad debts as a result of discrepant documents against export Letter of Credit? (Choose all that apply)

☐ Brunei	☐ Burma (Myanmar)	☐ Cambodia	☐ Indonesia	☐ Laos
☐ Malaysia	☐ Philippines	☐ Singapore	☐ Thailand	☐ Vietnam

37. What is the estimated cost to your firm of rectifying discrepancies on documents you produce for ASEAN export Letter of Credit consignments? Please indicate this on a per transaction basis in either hours and/or AUD equivalent.

.... hours **AND / OR** AUD equivalent ....

SECTION 4. PERSONAL QUESTIONS

38. What is your gender?

☐ Male ☐ Female

39. What is your age group?

☐ 18-30 ☐ 31-40 ☐ 41-50 ☐ 51-60 ☐ 60+

40. What is your highest level of education?

☐ Secondary ☐ TAFE ☐ University

☐ Other. Please specify ....

41. Have you undertaken any specific education or training in respect of Letter of Credit transactions?

☐ Yes. Please specify details in the space provided below.

Year	Name of course	Duration (weeks)	Institution
....	....	....	....
....	....	....	....
....	....	....	....
....	....	....	....

☐ No

42. How many years of experience do you have with Letter of Credit transactions in total?

.... years

43. What is your current job title?

....

44. How many years have you been employed in your current job?

....

Thank you for completing this survey

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WILLINGNESS TO BE INTERVIEWED

If you are willing to be interviewed in relation to this survey, please provide your details below.

Title (Mr, Mrs, Ms, Dr): ....

Family name: ....

First name: ....

Company name: ....

Telephone number: ....

Appendix 4

A.4.1 Detailed Data

Table A6.6: Detailed data for Table 6.6

Statistics					
Q3 No.Employees					
N	Valid	127			
	Missing	5			
Q3 No.Employees					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	1	0.8	0.8	0.8
	2	1	0.8	0.8	1.6
	3	6	4.5	4.7	6.3
	4	4	3.0	3.1	9.4
	5	3	2.3	2.4	11.8
	6	4	3.0	3.1	15.0
	7	1	0.8	0.8	15.7
	8	4	3.0	3.1	18.9
	9	3	2.3	2.4	21.3
	10	4	3.0	3.1	24.4
	12	5	3.8	3.9	28.3
	14	1	0.8	0.8	29.1
	15	4	3.0	3.1	32.3
	16	2	1.5	1.6	33.9
	17	1	0.8	0.8	34.6
	18	2	1.5	1.6	36.2
	19	2	1.5	1.6	37.8
	20	6	4.5	4.7	42.5
	22	2	1.5	1.6	44.1
	24	2	1.5	1.6	45.7
	25	5	3.8	3.9	49.6
	30	6	4.5	4.7	54.3
	35	1	0.8	0.8	55.1
	36	2	1.5	1.6	56.7
	37	2	1.5	1.6	58.3
	40	2	1.5	1.6	59.8
	41	1	0.8	0.8	60.6
	45	1	0.8	0.8	61.4
	50	4	3.0	3.1	64.6
	53	1	0.8	0.8	65.4
	60	2	1.5	1.6	66.9
	61	1	0.8	0.8	67.7
	65	1	0.8	0.8	68.5
	75	3	2.3	2.4	70.9

	80	2	1.5	1.6	72.4
	100	2	1.5	1.6	74.0
	101	1	0.8	0.8	74.8
	120	2	1.5	1.6	76.4
	130	1	0.8	0.8	77.2
	150	2	1.5	1.6	78.7
	200	3	2.3	2.4	81.1
	240	1	0.8	0.8	81.9
	270	1	0.8	0.8	82.7
	330	1	0.8	0.8	83.5
	350	2	1.5	1.6	85.0
	400	1	0.8	0.8	85.8
	450	3	2.3	2.4	88.2
	800	2	1.5	1.6	89.8
	900	1	0.8	0.8	90.6
	1,000	3	2.3	2.4	92.9
	1,300	1	0.8	0.8	93.7
	4,300	1	0.8	0.8	94.5
	10,000	1	0.8	0.8	95.3
	989,898	6	4.5	4.7	100.0
	Total	127	96.2	100.0	
Missing	System	5	3.8		
Total		132	100.0		

Note: n = 121

Table A6.7: Detailed data for Table 6.7

Q8 Export period					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	2.0	6	5.7	5.7	5.7
	3.0	4	3.8	3.8	9.5
	4.0	5	4.8	4.8	14.3
	5.0	11	10.5	10.5	24.8
	6.0	3	2.9	2.9	27.6
	7.0	4	3.8	3.8	31.4
	8.0	2	1.9	1.9	33.3
	9.0	1	1.0	1.0	34.3
	10.0	21	20.0	20.0	54.3
	11.0	1	1.0	1.0	55.2
	12.0	1	1.0	1.0	56.2
	13.0	1	1.0	1.0	57.1
	14.0	1	1.0	1.0	58.1
	15.0	10	9.5	9.5	67.6
	16.0	2	1.9	1.9	69.5
	17.0	1	1.0	1.0	70.5
	20.0	14	13.3	13.3	83.8
	25.0	2	1.9	1.9	85.7
	26.0	1	1.0	1.0	86.7
	30.0	8	7.6	7.6	94.3
	35.0	3	2.9	2.9	97.1
	40.0	2	1.9	1.9	99.0
	50.0	1	1.0	1.0	100.0
	Total	105	100.0	100.0	

Q8 Export period * Size Crosstabulation							
			Size				Total
			Micro	Small	Medium	Large	
Q8 Export period	2.0	Count	3	2	0	1	6
		% of Total	2.9%	1.9%	.0%	1.0%	5.7%
	3.0	Count	1	2	0	1	4
		% of Total	1.0%	1.9%	.0%	1.0%	3.8%
	4.0	Count	2	1	0	2	5
		% of Total	1.9%	1.0%	.0%	1.9%	4.8%
	5.0	Count	5	3	2	1	11
		% of Total	4.8%	2.9%	1.9%	1.0%	10.5%
	6.0	Count	1	1	1	0	3
		% of Total	1.0%	1.0%	1.0%	.0%	2.9%
	7.0	Count	3	1	0	0	4
		% of Total	2.9%	1.0%	.0%	.0%	3.8%
	8.0	Count	0	2	0	0	2
		% of Total	.0%	1.9%	.0%	.0%	1.9%
	9.0	Count	1	0	0	0	1
		% of Total	1.0%	.0%	.0%	.0%	1.0%
	10.0	Count	4	9	6	2	21
		% of Total	3.8%	8.6%	5.7%	1.9%	20.0%
	11.0	Count	0	1	0	0	1
		% of Total	.0%	1.0%	.0%	.0%	1.0%
	12.0	Count	0	0	1	0	1
		% of Total	.0%	.0%	1.0%	.0%	1.0%
	13.0	Count	0	1	0	0	1
		% of Total	.0%	1.0%	.0%	.0%	1.0%
	14.0	Count	0	1	0	0	1
		% of Total	.0%	1.0%	.0%	.0%	1.0%
	15.0	Count	2	3	3	2	10
		% of Total	1.9%	2.9%	2.9%	1.9%	9.5%
	16.0	Count	0	1	1	0	2
		% of Total	.0%	1.0%	1.0%	.0%	1.9%
	17.0	Count	0	0	1	0	1
		% of Total	.0%	.0%	1.0%	.0%	1.0%
	20.0	Count	3	6	3	2	14
		% of Total	2.9%	5.7%	2.9%	1.9%	13.3%
	25.0	Count	0	1	0	1	2
		% of Total	.0%	1.0%	.0%	1.0%	1.9%
	26.0	Count	0	0	1	0	1
		% of Total	.0%	.0%	1.0%	.0%	1.0%
	30.0	Count	0	4	3	1	8
		% of Total	.0%	3.8%	2.9%	1.0%	7.6%
	35.0	Count	1	1	0	1	3
		% of Total	1.0%	1.0%	.0%	1.0%	2.9%
	40.0	Count	0	1	1	0	2
		% of Total	.0%	1.0%	1.0%	.0%	1.9%
	50.0	Count	0	0	0	1	1
		% of Total	.0%	.0%	.0%	1.0%	1.0%
Total		Count	26	41	23	15	105
		% of Total	24.8%	39.0%	21.9%	14.3%	100.0%

Table A6.8: Detailed data for Table 6.8

Q7 Sector					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	12	9.8	9.8	9.8
	2	21	17.1	17.1	26.8
	3	11	8.9	8.9	35.8
	4	31	25.2	25.2	61.0
	5	14	11.4	11.4	72.4
	6	34	27.6	27.6	100.0
	Total	123	100.0	100.0	

Table A6.10: Detailed data for Table 6.10

Statistics											
		Q9 Brunei	Q9 Burma	Q9 Cambodia	Q9 Indonesia	Q9 Laos	Q9 Malaysia	Q9 Philippines	Q9 Singapore	Q9 Thailand	Q9 Vietnam
N	Valid	109	109	109	110	109	109	109	109	109	109
	Missing	23	23	23	22	23	23	23	23	23	23
Frequency Table											
Q9 Brunei											
		Frequency	Percent	Valid Percent	Cumulative Percent						
Valid	yes	11	8.3	10.1	10.1						
	no	98	74.2	89.9	100.0						
	Total	109	82.6	100.0							
Missing	System	23	17.4								
Total		132	100.0								
Q9 Burma											
		Frequency	Percent	Valid Percent	Cumulative Percent						
Valid	yes	9	6.8	8.3	8.3						
	no	100	75.8	91.7	100.0						
	Total	109	82.6	100.0							
Missing	System	23	17.4								
Total		132	100.0								

Q9 Cambodia											
		Frequency	Percent	Valid Percent	Cumulative Percent						
Valid	yes	4	3.0	3.7	3.7						
	no	105	79.5	96.3	100.0						
	Total	109	82.6	100.0							
Missing	System	23	17.4								
Total		132	100.0								
Q9 Indonesia											
		Frequency	Percent	Valid Percent	Cumulative Percent						
Valid	yes	69	52.3	62.7	62.7						
	no	41	31.1	37.3	100.0						
	Total	110	83.3	100.0							
Missing	System	22	16.7								
Total		132	100.0								
Q9 Laos											
		Frequency	Percent	Valid Percent	Cumulative Percent						
Valid	yes	4	3.0	3.7	3.7						
	no	105	79.5	96.3	100.0						
	Total	109	82.6	100.0							
Missing	System	23	17.4								
Total		132	100.0								

Q9 Malaysia											
		Frequency	Percent	Valid Percent	Cumulative Percent						
Valid	yes	76	57.6	69.7	69.7						
	no	33	25.0	30.3	100.0						
	Total	109	82.6	100.0							
Missing	System	23	17.4								
Total		132	100.0								
Q9 Philippines											
		Frequency	Percent	Valid Percent	Cumulative Percent						
Valid	yes	62	47.0	56.9	56.9						
	no	47	35.6	43.1	100.0						
	Total	109	82.6	100.0							
Missing	System	23	17.4								
Total		132	100.0								
Q9 Singapore											
		Frequency	Percent	Valid Percent	Cumulative Percent						
Valid	yes	78	59.1	71.6	71.6						
	no	31	23.5	28.4	100.0						
	Total	109	82.6	100.0							
Missing	System	23	17.4								
Total		132	100.0								

Q9 Thailand											
		Frequency	Percent	Valid Percent	Cumulative Percent						
Valid	yes	74	56.1	67.9	67.9						
	no	35	26.5	32.1	100.0						
	Total	109	82.6	100.0							
Missing	System	23	17.4								
Total		132	100.0								
Q9 Vietnam											
		Frequency	Percent	Valid Percent	Cumulative Percent						
Valid	yes	39	29.5	35.8	35.8						
	no	70	53.0	64.2	100.0						
	Total	109	82.6	100.0							
Missing	System	23	17.4								
Total		132	100.0								

Table A6.12: Detailed data for Table 6.12

mrq9*Q10 Crosstabulation				
Country	Export sales value (AUD equivalent)			Total
	1-5 M	6-10 M	Above 10M	
Brunei	17	6	8	31
Myanmar	19	5	5	29
Cambodia	22	5	7	34
Indonesia	7	0	1	8
Laos	21	5	8	34
Malaysia	4	0	1	5
Philippines	6	2	0	8
Singapore	8	0	1	9
Thailand	5	0	1	6
Vietnam	8	2	2	12

Table A6.14: Detailed data for Table 6.14

mrq17 Frequencies				
		Responses		Percent of Cases
		N	Percent	
Q17 Group[a]	Checklist	12	9.6%	12.6%
	Quantitative	7	5.6%	7.4%
	Inspection visits	21	16.8%	22.1%
	Combination	40	32.0%	42.1%
	Austrade services	45	36.0%	47.4%
Total		125	100.0%	131.6%

Figure A6.1: Detailed data for Figure 6.1

Size	Payment		0-25%	26-50%	51-75%	76-100%
Micro	Prepayment	Micro	10	6	1	9
Small		Small	21	11	3	6
Medium		Medium	20	1	0	3
Large		Large	11	2	0	1
Micro	Letter of Credit	Micro	16	4	0	6
Small		Small	31	3	2	5
Medium		Medium	13	2	2	7
Large		Large	9	1	3	1
Micro	Bill of Exchange	Micro	24	1	0	1
Small		Small	40	0	0	1
Medium		Medium	22	1	0	1
Large		Large	13	1	0	0
Micro	Open Account	Micro	21	3	1	1
Small		Small	19	7	2	13
Medium		Medium	13	2	6	3
Large		Large	5	2	2	5

Figure A6.2: Detailed data for Figure 6.2

Q7 Sector * Q12 Prepayment Crosstabulation							
			q12g1				
			0-25%	26-50%	51-75%	76-100%	Total
Q7a	Food and Equipment	Count	8	1	0	2	11
		% of Total	7.4%	.9%	.0%	1.9%	10.2%
	health and equipment and allied chemicals	Count	9	4	2	3	18
		% of Total	8.3%	3.7%	1.9%	2.8%	16.7%
	Building and related products	Count	5	2	0	3	10
		% of Total	4.6%	1.9%	.0%	2.8%	9.3%
	Machinery, Automotive, steel, metals	Count	19	6	1	4	30
		% of Total	17.6%	5.6%	.9%	3.7%	27.8%
	Forestry, mining, drilling and equipment	Count	8	1	1	2	12
		% of Total	7.4%	.9%	.9%	1.9%	11.1%
	Others	Count	12	7	0	8	27
		% of Total	11.1%	6.5%	.0%	7.4%	25.0%
	Total	Count	61	21	4	22	108
		% of Total	56.5%	19.4%	3.7%	20.4%	100.0%

Q7 Sector * Q12 LC Crosstabulation							
			q12g2				
			0-25%	26-50%	51-75%	76-100%	Total
Q7a	Food and Equipment	Count	6	0	1	4	11
		% of Total	5.6%	.0%	.9%	3.7%	10.2%
	health and equipment and allied chemicals	Count	14	3	0	1	18
		% of Total	13.0%	2.8%	.0%	.9%	16.7%
	Building and related products	Count	5	1	2	2	10
		% of Total	4.6%	.9%	1.9%	1.9%	9.3%
	Machinery, Automotive, steel, metals	Count	19	5	1	5	30
		% of Total	17.6%	4.6%	.9%	4.6%	27.8%
	Forestry, mining, drilling and equipment	Count	6	0	1	5	12
		% of Total	5.6%	.0%	.9%	4.6%	11.1%
	Others	Count	23	1	2	1	27
		% of Total	21.3%	.9%	1.9%	.9%	25.0%
	Total	Count	73	10	7	18	108
		% of Total	67.6%	9.3%	6.5%	16.7%	100.0%

Q7 Sector * Q12 Bill of Exchange Crosstabulation						
			q12g3			
			0-25%	26-50%	76-100%	Total
Q7a	Food and Equipment	Count	10	1	0	11
		% of Total	9.3%	.9%	.0%	10.2%
	health and equipment and allied chemicals	Count	17	0	1	18
		% of Total	15.7%	.0%	.9%	16.7%
	Building and related products	Count	10	0	0	10
		% of Total	9.3%	.0%	.0%	9.3%
	Machinery, Automotive, steel, metals	Count	28	1	1	30
		% of Total	25.9%	.9%	.9%	27.8%
	Forestry, mining, drilling and equipment	Count	12	0	0	12
		% of Total	11.1%	.0%	.0%	11.1%
	Others	Count	25	1	1	27
		% of Total	23.1%	.9%	.9%	25.0%
	Total	Count	102	3	3	108
		% of Total	94.4%	2.8%	2.8%	100.0%

Q7 Sector * Q12 Open Account Crosstabulation							
			q12g4				
			0-25%	26-50%	51-75%	76-100%	Total
Q7a	Food and Equipment	Count	7	2	1	1	11
		% of Total	6.5%	1.9%	.9%	.9%	10.2%
	health and equipment and allied chemicals	Count	9	1	4	4	18
		% of Total	8.3%	.9%	3.7%	3.7%	16.7%
	Building and related products	Count	7	2	0	1	10
		% of Total	6.5%	1.9%	.0%	.9%	9.3%
	Machinery, Automotive, steel, metals	Count	15	4	3	8	30
		% of Total	13.9%	3.7%	2.8%	7.4%	27.8%
	Forestry, mining, drilling and equipment	Count	9	1	0	2	12
		% of Total	8.3%	.9%	.0%	1.9%	11.1%
	Others	Count	13	5	3	6	27
		% of Total	12.0%	4.6%	2.8%	5.6%	25.0%
	Total	Count	60	15	11	22	108
		% of Total	55.6%	13.9%	10.2%	20.4%	100.0%

Figure A6.3: Detailed data for Figure 6.3

Export Sales	Payment		0-25%	26-50%	51-75%	76-100%
< 1m	Prepayment	< 1m	36	14	4	15
1-5m		1-5m	14	5	0	3
5-10m		5-10m	6	0	0	0
>10m		>10m	6	1	0	1
less than 1 m	LC	< 1m	50	5	4	10
1-5m		1-5m	13	3	0	6
5-10m		5-10m	3	1	1	1
above 10m		>10m	3	1	2	2
less than 1 m	Bill of Exchange	< 1m	66	1	0	2
1-5m		1-5m	20	1	0	1
5-10m		5-10m	6	0	0	0
above 10m		>10m	7	1	0	0
less than 1 m	Open Account	< 1m	39	9	6	15
1-5m		1-5m	12	3	2	5
5-10m		5-10m	3	0	1	2
above 10m		>10m	4	2	2	0

Table A6.12a: Detailed data for output of cross-tabulation of variables: size, length of export activity (years) and method of payment usage

Crosstabs

Size * q8b * Q12 Prepayment Crosstabulation						
Q12 Prepayment				q8b		Total
				<=10 yrs	>10 yrs	
0-25%	Size	Micro	Count	7	3	10
			% of Total	11.5%	4.9%	16.4%
		Small	Count	9	11	20
			% of Total	14.8%	18.0%	32.8%
		Medium	Count	7	13	20
			% of Total	11.5%	21.3%	32.8%
		Large	Count	6	5	11
			% of Total	9.8%	8.2%	18.0%
	Total		Count	29	32	61
			% of Total	47.5%	52.5%	100.0%
26-50%	Size	Micro	Count	5	1	6
			% of Total	23.8%	4.8%	28.6%
		Small	Count	6	5	11
			% of Total	28.6%	23.8%	52.4%
		Medium	Count	0	1	1
			% of Total	.0%	4.8%	4.8%
		Large	Count	1	2	3
			% of Total	4.8%	9.5%	14.3%
	Total		Count	12	9	21
			% of Total	57.1%	42.9%	100.0%
51-75%	Size	Micro	Count	1	0	1
			% of Total	25.0%	.0%	25.0%
		Small	Count	0	3	3
			% of Total	.0%	75.0%	75.0%
	Total		Count	1	3	4
			% of Total	25.0%	75.0%	100.0%
76-100%	Size	Micro	Count	7	2	9
			% of Total	36.8%	10.5%	47.4%
		Small	Count	6	1	7
			% of Total	31.6%	5.3%	36.8%
		Medium	Count	2	0	2
			% of Total	10.5%	.0%	10.5%
		Large	Count	0	1	1

			% of Total	.0%	5.3%	5.3%
	Total		Count	15	4	19
			% of Total	78.9%	21.1%	100.0%

Size * q8b * Q12 LC Crosstabulation

Q12 LC				q8b		Total
				<=10 yrs	>10 yrs	
0-25%	Size	Micro	Count	13	3	16
			% of Total	18.8%	4.3%	23.2%
		Small	Count	14	17	31
			% of Total	20.3%	24.6%	44.9%
		Medium	Count	5	7	12
			% of Total	7.2%	10.1%	17.4%
		Large	Count	4	6	10
			% of Total	5.8%	8.7%	14.5%
	Total		Count	36	33	69
			% of Total	52.2%	47.8%	100.0%
26-50%	Size	Micro	Count	3	1	4
			% of Total	30.0%	10.0%	40.0%
		Small	Count	2	1	3
			% of Total	20.0%	10.0%	30.0%
		Medium	Count	0	2	2
			% of Total	.0%	20.0%	20.0%
		Large	Count	0	1	1
			% of Total	.0%	10.0%	10.0%
	Total		Count	5	5	10
			% of Total	50.0%	50.0%	100.0%
51-75%	Size	Small	Count	1	1	2
			% of Total	14.3%	14.3%	28.6%
		Medium	Count	1	1	2
			% of Total	14.3%	14.3%	28.6%
		Large	Count	2	1	3
			% of Total	28.6%	14.3%	42.9%
	Total		Count	4	3	7
			% of Total	57.1%	42.9%	100.0%
76-100%	Size	Micro	Count	4	2	6
			% of Total	21.1%	10.5%	31.6%
		Small	Count	4	1	5
			% of Total	21.1%	5.3%	26.3%

		Medium	Count	3	4	7
			% of Total	15.8%	21.1%	36.8%
		Large	Count	1	0	1
			% of Total	5.3%	.0%	5.3%
	Total		Count	12	7	19
			% of Total	63.2%	36.8%	100.0%

Size * q8b * Q12 Bill of Exchange Crosstabulation

Q12 Bill of Exchange				q8b		Total
				<=10 yrs	>10 yrs	
0-25%	Size	Micro	Count	19	5	24
			% of Total	19.2%	5.1%	24.2%
		Small	Count	21	19	40
			% of Total	21.2%	19.2%	40.4%
		Medium	Count	9	12	21
			% of Total	9.1%	12.1%	21.2%
		Large	Count	7	7	14
			% of Total	7.1%	7.1%	14.1%
	Total		Count	56	43	99
			% of Total	56.6%	43.4%	100.0%
26-50%	Size	Micro	Count		1	1
			% of Total		33.3%	33.3%
		Medium	Count		1	1
			% of Total		33.3%	33.3%
		Large	Count		1	1
			% of Total		33.3%	33.3%
	Total		Count		3	3
			% of Total		100.0%	100.0%
76-100%	Size	Micro	Count	1	0	1
			% of Total	33.3%	.0%	33.3%
		Small	Count	0	1	1
			% of Total	.0%	33.3%	33.3%
		Medium	Count	0	1	1
			% of Total	.0%	33.3%	33.3%
	Total		Count	1	2	3
			% of Total	33.3%	66.7%	100.0%

Size * q8b * Q12 Open Account Crosstabulation						
Q12 Open Account				q8b		Total
				<=10 yrs	>10 yrs	
0-25%	Size	Micro	Count	15	6	21
			% of Total	26.3%	10.5%	36.8%
		Small	Count	12	7	19
			% of Total	21.1%	12.3%	33.3%
		Medium	Count	6	6	12
			% of Total	10.5%	10.5%	21.1%
		Large	Count	3	2	5
			% of Total	5.3%	3.5%	8.8%
	Total		Count	36	21	57
			% of Total	63.2%	36.8%	100.0%
26-50%	Size	Micro	Count	3	0	3
			% of Total	20.0%	.0%	20.0%
		Small	Count	4	3	7
			% of Total	26.7%	20.0%	46.7%
		Medium	Count	0	2	2
			% of Total	.0%	13.3%	13.3%
		Large	Count	1	2	3
			% of Total	6.7%	13.3%	20.0%
	Total		Count	8	7	15
			% of Total	53.3%	46.7%	100.0%
51-75%	Size	Micro	Count	1	0	1
			% of Total	9.1%	.0%	9.1%
		Small	Count	1	1	2
			% of Total	9.1%	9.1%	18.2%
		Medium	Count	2	4	6
			% of Total	18.2%	36.4%	54.5%
		Large	Count	0	2	2
			% of Total	.0%	18.2%	18.2%
	Total		Count	4	7	11
			% of Total	36.4%	63.6%	100.0%
76-100%	Size	Micro	Count	1	0	1
			% of Total	4.5%	.0%	4.5%
		Small	Count	4	9	13
			% of Total	18.2%	40.9%	59.1%
		Medium	Count	1	2	3
			% of Total	4.5%	9.1%	13.6%
		Large	Count	3	2	5

			% of Total	13.6%	9.1%	22.7%
	Total		Count	9	13	22
			% of Total	40.9%	59.1%	100.0%

Table A6.13a: Detailed data for Table 6.13

Descriptive Statistics				
	N	Minimum	Maximum	Mean
lcv	113	.00	1237.50	84.8274
lcvav	101	.00	121.50	8.0650
Valid N (listwise)	101			

Figure A6.4a: Detailed data for Figure 6.4

lcvav * Size			
lcvav			
Size	Mean	N	Std. Deviation
Micro	15.5084	22	29.33437
Small	4.8356	40	8.47431
Medium	9.4777	20	24.02093
Large	5.6503	16	7.6439
Total	8.3119	98	18.85215

FigureA6.5: Detailed data for Figure 6.5

lcvav * Size			
lcvav			
Size	Mean	N	Std. Deviation
Micro	15.5084	22	29.33437
Small	4.8356	40	8.47431
Medium	9.4777	20	24.02093
Large	5.6503	16	7.6439
Total	8.3119	98	18.85215

FigureA6.6: Detailed data for Figure 6.6

lcvav * Q7 Sector			
Lcvav			
Q7 Sector	Mean	N	Std. Deviation
Food and Equipment	24.5824	8	42.13469
Health and Equipment and Allied Cemicals	1.875	16	2.70613
Building and Related Products	5.2781	10	9.30813
Machinery, Automotive, Steel, Metals	8.3118	29	14.31666
Forestry, Mining, Drilling and Equipment	19.4762	9	34.00651

Table A6.15: Detailed data for Table 6.15

Q7 Sector * Size * Q17 Checklist Crosstabulation								
Q17 Checklist				Size				Total
				Micro	Small	Medium	Large	
Checklist	Q7 Sector	Food and Equipment	Count	0	0	1	0	1
			% of Total	.0%	.0%	8.3%	.0%	8.3%
		health and equipment and allied chemicals	Count	0	1	0	0	1
			% of Total	.0%	8.3%	.0%	.0%	8.3%
		Machinery, Automotive, steel, metals	Count	2	1	1	1	5
			% of Total	16.7%	8.3%	8.3%	8.3%	41.7%
		Forestry, mining, drilling and equipment	Count	0	0	1	0	1
			% of Total	.0%	.0%	8.3%	.0%	8.3%
		Others	Count	1	1	1	1	4
			% of Total	8.3%	8.3%	8.3%	8.3%	33.3%
	Total		Count	3	3	4	2	12
			% of Total	25.0%	25.0%	33.3%	16.7%	100.0%

Q7 Sector * Size * Q17 Quantitative Crosstabulation							
Q17 Quantitative				Size			Total
				Micro	Small	Medium	
Quantitative	Q7 Sector	Food and Equipment	Count	0	0	1	1
			% of Total	.0%	.0%	14.3%	14.3%
		Machinery, Automotive, steel, metals	Count	0	2	1	3
			% of Total	.0%	28.6%	14.3%	42.9%
		Others	Count	1	1	1	3
			% of Total	14.3%	14.3%	14.3%	42.9%
	Total		Count	1	3	3	7
			% of Total	14.3%	42.9%	42.9%	100.0%

Q7 Sector * Size * Q17 Inspection visits Crosstabulation								
Q17 Inspection visits				Size				Total
				Micro	Small	Medium	Large	
Inspection visits	Q7 Sector	Food and Equipment	Count	0	1	1	0	2
			% of Total	.0%	5.0%	5.0%	.0%	10.0%
		health and equipment and allied chemicals	Count	1	2	0	1	4
			% of Total	5.0%	10.0%	.0%	5.0%	20.0%
		Building and related products	Count	0	1	0	0	1
			% of Total	.0%	5.0%	.0%	.0%	5.0%
		Machinery, Automotive, steel, metals	Count	3	2	1	0	6
			% of Total	15.0%	10.0%	5.0%	.0%	30.0%
		Forestry, mining, drilling and equipment	Count	1	1	1	1	4
			% of Total	5.0%	5.0%	5.0%	5.0%	20.0%
		Others	Count	0	3	0	0	3
			% of Total	.0%	15.0%	.0%	.0%	15.0%
	Total		Count	5	10	3	2	20
			% of Total	25.0%	50.0%	15.0%	10.0%	100.0%

Q7 Sector * Size * Q17 Combination Crosstabulation								
Q17 Combination				Size				Total
				Micro	Small	Medium	Large	
Combination	Q7 Sector	Food and Equipment	Count	2	0	0	1	3
			% of Total	5.1%	.0%	.0%	2.6%	7.7%
		health and equipment and allied chemicals	Count	1	1	3	0	5
			% of Total	2.6%	2.6%	7.7%	.0%	12.8%
		Building and related products	Count	0	1	1	1	3
			% of Total	.0%	2.6%	2.6%	2.6%	7.7%
		Machinery, Automotive, steel, metals	Count	3	5	2	4	14
			% of Total	7.7%	12.8%	5.1%	10.3%	35.9%
		Forestry, mining, drilling and equipment	Count	1	1	3	0	5
			% of Total	2.6%	2.6%	7.7%	.0%	12.8%
		Others	Count	2	4	0	3	9
			% of Total	5.1%	10.3%	.0%	7.7%	23.1%
	Total		Count	9	12	9	9	39
			% of Total	23.1%	30.8%	23.1%	23.1%	100.0%

Q7 Sector * Size * Q17 Austrade services Crosstabulation								
Q17 Austrade services				Size				Total
				Micro	Small	Medium	Large	
Austrade services	Q7 Sector	Food and Equipment	Count	0	1	1	1	3
			% of Total	.0%	2.2%	2.2%	2.2%	6.7%
		health and equipment and allied chemicals	Count	4	1	1	1	7
			% of Total	8.9%	2.2%	2.2%	2.2%	15.6%
		Building and related products	Count	0	3	2	0	5
			% of Total	.0%	6.7%	4.4%	.0%	11.1%
		Machinery, Automotive, steel, metals	Count	3	7	2	1	13
			% of Total	6.7%	15.6%	4.4%	2.2%	28.9%
		Forestry, mining, drilling and equipment	Count	0	2	2	1	5
			% of Total	.0%	4.4%	4.4%	2.2%	11.1%
		Others	Count	0	7	3	2	12
			% of Total	.0%	15.6%	6.7%	4.4%	26.7%
	Total		Count	7	21	11	6	45
			% of Total	15.6%	46.7%	24.4%	13.3%	100.0%

Table A6.16: Detailed data for Table 6.16

Q7 Sector * Size * Q18 Importing country regulations Crosstabulation							
Q18 Importing country regulations				Size			Total
				Micro	Small	Medium	
Importing country regulations	Q7 Sector	health and equipment and allied chemicals	Count	0	0	2	2
			% of Total	.0%	.0%	33.3%	33.3%
		Machinery, Automotive, steel, metals	Count	2	1	0	3
			% of Total	33.3%	16.7%	.0%	50.0%
		Others	Count	0	1	0	1
			% of Total	.0%	16.7%	.0%	16.7%
	Total		Count	2	2	2	6
			% of Total	33.3%	33.3%	33.3%	100.0%

Q7 Sector * Size * Q18 Unacceptable country risk Crosstabulation								
Q18 Unacceptable country risk				Size				Total
				Micro	Small	Medium	Large	
Unacceptable country risk	Q7 Sector	Food and Equipment	Count	0	0	2	0	2
			% of Total	.0%	.0%	11.1%	.0%	11.1%
		health and equipment and allied chemicals	Count	0	1	1	0	2
			% of Total	.0%	5.6%	5.6%	.0%	11.1%
		Building and related products	Count	0	0	1	1	2
			% of Total	.0%	.0%	5.6%	5.6%	11.1%
		Machinery, Automotive, steel, metals	Count	0	3	0	1	4
			% of Total	.0%	16.7%	.0%	5.6%	22.2%
		Forestry, mining, drilling and equipment	Count	1	1	1	1	4
			% of Total	5.6%	5.6%	5.6%	5.6%	22.2%
		Others	Count	1	0	3	0	4
			% of Total	5.6%	.0%	16.7%	.0%	22.2%
	Total		Count	2	5	8	3	18
			% of Total	11.1%	27.8%	44.4%	16.7%	100.0%

Q7 Sector * Size * Q18 Unacceptable customer risk Crosstabulation								
Q18 Unacceptable customer risk				Size				Total
				Micro	Small	Medium	Large	
Unacceptable customer risk	Q7 Sector	Food and Equipment	Count	3	0	2	1	6
			% of Total	5.8%	.0%	3.8%	1.9%	11.5%
		health and equipment and allied chemicals	Count	2	1	2	1	6
			% of Total	3.8%	1.9%	3.8%	1.9%	11.5%
		Building and related products	Count	0	3	2	0	5
			% of Total	.0%	5.8%	3.8%	.0%	9.6%
		Machinery, Automotive, steel, metals	Count	2	8	4	3	17
			% of Total	3.8%	15.4%	7.7%	5.8%	32.7%
		Forestry, mining, drilling and equipment	Count	1	0	3	1	5
			% of Total	1.9%	.0%	5.8%	1.9%	9.6%
		Others	Count	1	5	2	5	13
			% of Total	1.9%	9.6%	3.8%	9.6%	25.0%
	Total		Count	9	17	15	11	52
			% of Total	17.3%	32.7%	28.8%	21.2%	100.0%

Q7 Sector * Size * Q18 Value of export sale Crosstabulation								
Q18 Value of export sale				Size				Total
				Micro	Small	Medium	Large	
Value of export sale	Q7 Sector	Food and Equipment	Count	1	1	0	0	2
			% of Total	5.6%	5.6%	.0%	.0%	11.1%
		health and equipment and allied chemicals	Count	1	1	0	0	2
			% of Total	5.6%	5.6%	.0%	.0%	11.1%
		Building and related products	Count	0	1	2	0	3
			% of Total	.0%	5.6%	11.1%	.0%	16.7%
		Machinery, Automotive, steel, metals	Count	0	4	1	1	6
			% of Total	.0%	22.2%	5.6%	5.6%	33.3%
		Forestry, mining, drilling and equipment	Count	1	0	2	1	4
			% of Total	5.6%	.0%	11.1%	5.6%	22.2%
		Others	Count	0	0	1	0	1
			% of Total	.0%	.0%	5.6%	.0%	5.6%
	Total		Count	3	7	6	2	18
			% of Total	16.7%	38.9%	33.3%	11.1%	100.0%

Table A6.17: Detailed data for Table 6.17

Q19 Not mandatory who decides LC					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	sales	16	12.1	19.3	19.3
	marketing	1	.8	1.2	20.5
	finance	18	13.6	21.7	42.2
	combination	32	24.2	38.6	80.7
	other	16	12.1	19.3	100.0
	Total	83	62.9	100.0	
Missing	System	49	37.1		
Total		132	100.0		

Q19 Other					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid		110	83.3	83.3	83.3
	buyer	1	.8	.8	84.1
	company policy	1	.8	.8	84.8
	credit manager	1	.8	.8	85.6
	customer	1	.8	.8	86.4
	depends on client	1	.8	.8	87.1
	director	1	.8	.8	87.9
	Directors	1	.8	.8	88.6
	export manager	1	.8	.8	89.4
	finance	4	3.0	3.0	92.4
	finance (credit with sales input)	1	.8	.8	93.2
	General Manger or Managind Director	1	.8	.8	93.9
	Manager	1	.8	.8	94.7
	managing director	1	.8	.8	95.5
	Managing Director	2	1.5	1.5	97.0
	overseas government	1	.8	.8	97.7
	project department	1	.8	.8	98.5
	sales, finance, ceo	1	.8	.8	99.2
	Trading Partner	1	.8	.8	100.0
	Total	132	100.0	100.0	

Table A6.18: Detailed data for Table 6.18

Q7 Sector * Size * Q20 Mercantile/credit agency use Crosstabulation								
Q20 Mercantile/credit agency use				Size				Total
				Micro	Small	Medium	Large	
yes	Q7 Sector	Food and Equipment	Count		1	1	0	2
			% of Total		5.9%	5.9%	.0%	11.8%
		health and equipment and allied chemicals	Count		1	1	1	3
			% of Total		5.9%	5.9%	5.9%	17.6%
		Building and related products	Count		1	3	0	4
			% of Total		5.9%	17.6%	.0%	23.5%
		Machinery, Automotive, steel, metals	Count		0	1	3	4
			% of Total		.0%	5.9%	17.6%	23.5%
		Forestry, mining, drilling and equipment	Count		1	2	1	4
			% of Total		5.9%	11.8%	5.9%	23.5%
	Total		Count		4	8	5	17
			% of Total		23.5%	47.1%	29.4%	100.0%
no	Q7 Sector	Food and Equipment	Count	4	2	2	1	9
			% of Total	5.0%	2.5%	2.5%	1.3%	11.3%
		health and equipment and allied chemicals	Count	7	4	3	1	15
			% of Total	8.8%	5.0%	3.8%	1.3%	18.8%
		Building and related products	Count	0	3	0	1	4
			% of Total	.0%	3.8%	.0%	1.3%	5.0%
		Machinery, Automotive, steel, metals	Count	7	11	4	2	24
			% of Total	8.8%	13.8%	5.0%	2.5%	30.0%

		Forestry, mining, drilling and equipment	Count	2	3	1	0	6
			% of Total	2.5%	3.8%	1.3%	.0%	7.5%
		Others	Count	4	10	3	5	22
			% of Total	5.0%	12.5%	3.8%	6.3%	27.5%
	Total		Count	24	33	13	10	80
			% of Total	30.0%	41.3%	16.3%	12.5%	100.0%

Table A6.19: Detailed data for Table 6.19

Q7 Sector * Size * Q21 Credit insurance agency Crosstabulation								
Q21 Credit insurance agency				Size				Total
				Micro	Small	Medium	Large	
yes	Q7 Sector	Food and Equipment	Count	2	2	1	0	5
			% of Total	10.0%	10.0%	5.0%	.0%	25.0%
		health and equipment and allied chemicals	Count	0	1	1	0	2
			% of Total	.0%	5.0%	5.0%	.0%	10.0%
		Building and related products	Count	0	1	2	0	3
			% of Total	.0%	5.0%	10.0%	.0%	15.0%
		Machinery, Automotive, steel, metals	Count	0	0	2	2	4
			% of Total	.0%	.0%	10.0%	10.0%	20.0%
		Forestry, mining, drilling and equipment	Count	0	1	0	1	2
			% of Total	.0%	5.0%	.0%	5.0%	10.0%
		Others	Count	0	1	2	1	4
			% of Total	.0%	5.0%	10.0%	5.0%	20.0%
	Total		Count	2	6	8	4	20
			% of Total	10.0%	30.0%	40.0%	20.0%	100.0%
no	Q7 Sector	Food and Equipment	Count	2	1	2	1	6
			% of Total	2.6%	1.3%	2.6%	1.3%	7.8%
		health and equipment and allied chemicals	Count	7	4	3	2	16
			% of Total	9.1%	5.2%	3.9%	2.6%	20.8%
		Building and related products	Count	0	3	1	1	5
			% of Total	.0%	3.9%	1.3%	1.3%	6.5%

		Machinery, Automotive, steel, metals	Count	7	11	3	3	24
			% of Total	9.1%	14.3%	3.9%	3.9%	31.2%
		Forestry, mining, drilling and equipment	Count	2	3	3	0	8
			% of Total	2.6%	3.9%	3.9%	.0%	10.4%
		Others	Count	4	9	1	4	18
			% of Total	5.2%	11.7%	1.3%	5.2%	23.4%
	Total		Count	22	31	13	11	77
			% of Total	28.6%	40.3%	16.9%	14.3%	100.0%

Table A6.20: Detailed data for Table 6.20

Q22 Confirmed export LC					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	yes	24	18.2	24.5	24.5
	no	74	56.1	75.5	100.0
	Total	98	74.2	100.0	
Missing	System	34	25.8		
Total		132	100.0		

Table A6.20a

Q22 Total exports value 2003/04 AUD					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	10000	1	.8	5.6	5.6
	16000	1	.8	5.6	11.1
	36000	1	.8	5.6	16.7
	50000	1	.8	5.6	22.2
	100000	3	2.3	16.7	38.9
	180000	1	.8	5.6	44.4
	200000	1	.8	5.6	50.0
	220000	1	.8	5.6	55.6
	250000	3	2.3	16.7	72.2
	300000	1	.8	5.6	77.8
	500000	1	.8	5.6	83.3
	3000000	1	.8	5.6	88.9
	10000000	1	.8	5.6	94.4
	25000000	1	.8	5.6	100.0
	Total	18	13.6	100.0	
Missing	System	114	86.4		
Total		132	100.0		

Table A6.20b

Q23 Silent confirmation					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	yes	5	3.8	20.8	20.8
	no	19	14.4	79.2	100.0
	Total	24	18.2	100.0	
Missing	System	108	81.8		
Total		132	100.0		

Q23 Total exports value 2003/04 AUD m					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	16000	1	.8	33.3	33.3
	2000000	1	.8	33.3	66.7
	3000000	1	.8	33.3	100.0
	Total	3	2.3	100.0	
Missing	System	129	97.7		
Total		132	100.0		

Q24 Brunei					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	28	21.2	100.0	100.0
Missing	System	104	78.8		
Total		132	100.0		

Q24 Burma					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	28	21.2	100.0	100.0
Missing	System	104	78.8		
Total		132	100.0		

Q24 Cambodia					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	28	21.2	100.0	100.0
Missing	System	104	78.8		
Total		132	100.0		

Q24 Indonesia					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	25	18.9	89.3	89.3
	Indonesia	3	2.3	10.7	100.0
	Total	28	21.2	100.0	
Missing	System	104	78.8		
Total		132	100.0		

Q24 Laos					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	28	21.2	100.0	100.0
Missing	System	104	78.8		
Total		132	100.0		

Q24 Malaysia					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	26	19.7	92.9	92.9
	Malaysia	2	1.5	7.1	100.0
	Total	28	21.2	100.0	
Missing	System	104	78.8		
Total		132	100.0		

Q24 Philippines					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	24	18.2	85.7	85.7
	Philippines	4	3.0	14.3	100.0
	Total	28	21.2	100.0	
Missing	System	104	78.8		
Total		132	100.0		

Q24 Singapore					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	27	20.5	96.4	96.4
	Singapore	1	.8	3.6	100.0
	Total	28	21.2	100.0	
Missing	System	104	78.8		
Total		132	100.0		

Q24 Thailand					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	26	19.7	92.9	92.9
	Thailand	2	1.5	7.1	100.0
	Total	28	21.2	100.0	
Missing	System	104	78.8		
Total		132	100.0		

Q24 Vietnam					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	25	18.9	89.3	89.3
	Vietnam	3	2.3	10.7	100.0
	Total	28	21.2	100.0	
Missing	System	104	78.8		
Total		132	100.0		

Figure A6.7: Detailed data for Figure 6.7

Q29 EXW					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	18	13.6	46.2	46.2
	26-50	6	4.5	15.4	61.5
	51-75	4	3.0	10.3	71.8
	76-100	11	8.3	28.2	100.0
	Total	39	29.5	100.0	
Missing	System	93	70.5		
Total		132	100.0		

Q29 FAS					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	6	4.5	85.7	85.7
	26-50	1	.8	14.3	100.0
	Total	7	5.3	100.0	
Missing	System	125	94.7		
Total		132	100.0		

Q29 FCA					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	8	6.1	88.9	88.9
	51-75	1	.8	11.1	100.0
	Total	9	6.8	100.0	
Missing	System	123	93.2		
Total		132	100.0		

Q29 FOB					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	15	11.4	44.1	44.1
	26-50	4	3.0	11.8	55.9
	51-75	5	3.8	14.7	70.6
	76-100	10	7.6	29.4	100.0
	Total	34	25.8	100.0	
Missing	System	98	74.2		
Total		132	100.0		

Q29 CFR					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	10	7.6	32.3	32.3
	26-50	7	5.3	22.6	54.8
	51-75	4	3.0	12.9	67.7
	76-100	10	7.6	32.3	100.0
	Total	31	23.5	100.0	
Missing	System	101	76.5		
Total		132	100.0		

Q29 CIF					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	12	9.1	20.0	20.0
	26-50	12	9.1	20.0	40.0
	51-75	10	7.6	16.7	56.7
	76-100	26	19.7	43.3	100.0
	Total	60	45.5	100.0	
Missing	System	72	54.5		
Total		132	100.0		

Q29 CPT					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	6	4.5	100.0	100.0
Missing	System	126	95.5		
Total		132	100.0		

Q29 CIP					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	7	5.3	70.0	70.0
	26-50	2	1.5	20.0	90.0
	51-75	1	.8	10.0	100.0
	Total	10	7.6	100.0	
Missing	System	122	92.4		
Total		132	100.0		

Q29 DAF					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	5	3.8	100.0	100.0
Missing	System	127	96.2		
Total		132	100.0		

Q29 DES					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	5	3.8	100.0	100.0
Missing	System	127	96.2		
Total		132	100.0		

Q29 DEQ					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	5	3.8	100.0	100.0
Missing	System	127	96.2		
Total		132	100.0		

Q29 DDU					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	10	7.6	83.3	83.3
	76-100	2	1.5	16.7	100.0
	Total	12	9.1	100.0	
Missing	System	120	90.9		
Total		132	100.0		

Figure A6.8: Detailed data for Figure 6.8

Q31Bill of Lading					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	12	9.1	18.2	18.2
	26-50	5	3.8	7.6	25.8
	51-75	1	.8	1.5	27.3
	76-100	48	36.4	72.7	100.0
	Total	66	50.0	100.0	
Missing	System	66	50.0		
Total		132	100.0		

Q31 Sea waybill/express waybill/non-neg					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	14	10.6	48.3	48.3
	26-50	3	2.3	10.3	58.6
	51-75	1	.8	3.4	62.1
	76-100	11	8.3	37.9	100.0
	Total	29	22.0	100.0	
Missing	System	103	78.0		
Total		132	100.0		

Q31 Air waybill					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	17	12.9	38.6	38.6
	26-50	5	3.8	11.4	50.0
	76-100	22	16.7	50.0	100.0
	Total	44	33.3	100.0	
Missing	System	88	66.7		
Total		132	100.0		

Q31 Certificate of origin					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	23	17.4	37.7	37.7
	26-50	7	5.3	11.5	49.2
	51-75	7	5.3	11.5	60.7
	76-100	24	18.2	39.3	100.0
	Total	61	46.2	100.0	
Missing	System	71	53.8		
Total		132	100.0		

Q31 Inspection certificate					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	27	20.5	64.3	64.3
	26-50	7	5.3	16.7	81.0
	51-75	2	1.5	4.8	85.7
	76-100	6	4.5	14.3	100.0
	Total	42	31.8	100.0	
Missing	System	90	68.2		
Total		132	100.0		

Q31 Government certification (Quarantine)					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	20	15.2	64.5	64.5
	26-50	4	3.0	12.9	77.4
	51-75	2	1.5	6.5	83.9
	76-100	5	3.8	16.1	100.0
	Total	31	23.5	100.0	
Missing	System	101	76.5		
Total		132	100.0		

Q31 Other					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	1	.8	14.3	14.3
	26-50	1	.8	14.3	28.6
	76-100	5	3.8	71.4	100.0
	Total	7	5.3	100.0	
Missing	System	125	94.7		
Total		132	100.0		

Q31 Details for Q31g					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid		125	94.7	94.7	94.7
	989898	3	2.3	2.3	97.0
	inspection certifica	1	.8	.8	97.7
	Packing List	1	.8	.8	98.5
	Packing Lists	1	.8	.8	99.2
	Test Certificate	1	.8	.8	100.0
	Total	132	100.0	100.0	

Q31 Other					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	2.00	2	1.5	50.0	50.0
	3.00	1	.8	25.0	75.0
	989898.00	1	.8	25.0	100.0
	Total	4	3.0	100.0	
Missing	System	128	97.0		
Total		132	100.0		

Q31 Details for Q31i					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid		128	97.0	97.0	97.0
	989898	1	.8	.8	97.7
	Insurance Certificat	2	1.5	1.5	99.2
	Shipping Line Letter	1	.8	.8	100.0
	Total	132	100.0	100.0	

Q31 Other					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	3.00	2	1.5	66.7	66.7
	989898.00	1	.8	33.3	100.0
	Total	3	2.3	100.0	
Missing	System	129	97.7		
Total		132	100.0		

Q31Details for Q31k					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid		129	97.7	97.7	97.7
	989898	1	.8	.8	98.5
	Commercial Invoice	1	.8	.8	99.2
	Shipped Below Deck letters	1	.8	.8	100.0
	Total	132	100.0	100.0	

Table A6.23: Detailed data for Table 6.23

Q8 Export period * Q31 Inspection certificate Crosstabulation

Export Period		Inspection certificate				Total
		0-25	26-50	51-75	76-100	
2.0	Count	2	0	0	0	2
	% of Total	5.0%	.0%	.0%	.0%	5.0%
3.0	Count	1	1	1	0	3
	% of Total	2.5%	2.5%	2.5%	.0%	7.5%
4.0	Count	1	0	0	1	2
	% of Total	2.5%	.0%	.0%	2.5%	5.0%
5.0	Count	0	0	0	1	1
	% of Total	.0%	.0%	.0%	2.5%	2.5%
7.0	Count	2	0	0	0	2
	% of Total	5.0%	.0%	.0%	.0%	5.0%
8.0	Count	0	1	0	0	1
	% of Total	.0%	2.5%	.0%	.0%	2.5%
9.0	Count	1	0	0	0	1
	% of Total	2.5%	.0%	.0%	.0%	2.5%
10.0	Count	4	2	0	1	7
	% of Total	10.0%	5.0%	.0%	2.5%	17.5%
12.0	Count	1	0	0	0	1
	% of Total	2.5%	.0%	.0%	.0%	2.5%
15.0	Count	5	0	0	0	5
	% of Total	12.5%	.0%	.0%	.0%	12.5%
16.0	Count	1	0	0	0	1
	% of Total	2.5%	.0%	.0%	.0%	2.5%
20.0	Count	4	1	0	1	6
	% of Total	10.0%	2.5%	.0%	2.5%	15.0%
25.0	Count	1	0	0	1	2
	% of Total	2.5%	.0%	.0%	2.5%	5.0%
26.0	Count	1	0	0	0	1
	% of Total	2.5%	.0%	.0%	.0%	2.5%
30.0	Count	1	1	0	0	2
	% of Total	2.5%	2.5%	.0%	.0%	5.0%
35.0	Count	1	0	0	0	1
	% of Total	2.5%	.0%	.0%	.0%	2.5%
40.0	Count	0	1	0	1	2
	% of Total	.0%	2.5%	.0%	2.5%	5.0%
Total	Count	26	7	1	6	40
	% of Total	65.0%	17.5%	2.5%	15.0%	100.0%

Table A6.24: Detailed data for Table 6.24

Q29 CIF * Q30 Cargo Insurance-open policy Crosstabulation					
			Q30 Cargo Insurance-open policy		Total
			yes	no	
Q29 CIF	0-25	Count	5	7	12
		% of Total	8.3%	11.7%	20.0%
	26-50	Count	8	4	12
		% of Total	13.3%	6.7%	20.0%
	51-75	Count	7	3	10
		% of Total	11.7%	5.0%	16.7%
	76-100	Count	18	8	26
		% of Total	30.0%	13.3%	43.3%
Total		Count	38	22	60
		% of Total	63.3%	36.7%	100.0%

Q29 CIP * Q30 Cargo Insurance-open policy Crosstabulation					
			Q30 Cargo Insurance-open policy		Total
			yes	no	
Q29 CIP	0-25	Count	4	3	7
		% of Total	40.0%	30.0%	70.0%
	26-50	Count	2	0	2
		% of Total	20.0%	.0%	20.0%
	51-75	Count	1	0	1
		% of Total	10.0%	.0%	10.0%
Total		Count	7	3	10
		% of Total	70.0%	30.0%	100.0%

Figure A6.10: Detailed data for Figure 6.10

Q33 Delivered directly to carriers				
	Frequency	Percent	Valid Percent	Cumulative Percent
0-25	6	4.5	18.8	18.8
26-50	2	1.5	6.3	25.0
51-75	2	1.5	6.3	31.3
76-100	22	16.7	68.8	100.0
Total	32	24.2	100.0	
Missing System	100	75.8		
Total	132	100.0		

Q33 Delivered directly to freight forwarder					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	3	2.3	10.0	10.0
	26-50	4	3.0	13.3	23.3
	51-75	4	3.0	13.3	36.7
	76-100	19	14.4	63.3	100.0
	Total	30	22.7	100.0	
Missing	System	102	77.3		
Total		132	100.0		

Q33Collected by a freight forwarder					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-25	10	7.6	16.4	16.4
	26-50	4	3.0	6.6	23.0
	51-75	4	3.0	6.6	29.5
	76-100	43	32.6	70.5	100.0
	Total	61	46.2	100.0	
Missing	System	71	53.8		
Total		132	100.0		

Table A6.44: Detailed data for Table 6.44

Q53 Estimating cost * Q53 Estimating time Crosstabulation												
		50	70	100	200	300	500	600	200*	Total		
0.5	Count	1	0	1	0	0	0	0	0	2	1	
1	Count	1	1	0	0	0	0	0	0	2	2	
2	Count	0	0	1	1	1	0	0	0	3	6	
3	Count	0	0	0	0	0	1	0	0	1	3	
5	Count	0	0	0	0	1	1	0	0	2	10	
6	Count	0	0	0	0	0	0	1	0	1	6	
8	Count	0	0	0	1	0	0	0	1	2	16	
Total	Count	2	1	2	2	2	2	1	1	14	**44**	**3.14**
		100	70	200	400	600	1000	600	200	**3170**		
												72.05

Number or errors		14	
Total time spent rectifying errors		44 hrs	
Total cost		$4,970	
Average time per error	approx	3 hrs	3 hrs
Average cost per error	approx	$113	$72

* One response indicated a cost of rectifying documentary errors with a value of $ 2000. For the purposes of the analysis this figure has been amended to be $ 200, as it is an aberration and inconsistent with other data. The most likely explanation is that the respondent erroneously inserted an extra zero in the value of the response.

If the $2000 is actually $200