

A STUDY OF LETTER OF CREDIT OF NEPAL INVESTMENT BANK

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CHAPTER –I

INTRODUCTION

1.1 Background of the Study

A Letter of Credit is a legal undertaking in writing. This undertaking is issued by a bank (known as the issuing bank) given to the seller (beneficiary) at the request of the buyer (applicant), whereby the issuing bank undertakes to pay a certain sum of money to the named beneficiary upon presentation of compliant documents as stipulated in the Letter of Credit. The credit may call for the payment to be effected immediately known as sight LC. Alternatively, it may call for payment at a future date known as a deferred payment LC or for payment on the maturity of a duly accepted tenor Bills of Exchange known as acceptance LC (Parker, 1973:21).

A Letter of Credit is a payment term generally used for international sales transactions. It is basically a mechanism, which allows importers/buyers to offer secure terms of payment to exporters/sellers in which a bank (or more than one bank) gets involved. The technical term for Letter of credit is 'Documentary Credit'. At the very outset one must understand is that Letters of credit deal in documents, not goods. The idea in an international trade transaction is to shift the risk from the actual buyer to a bank. Thus a LC (as it is commonly referred to) is a payment undertaking given by a bank to the seller and is issued on behalf of the applicant i.e. the buyer. The Buyer is the Applicant and the Seller is the Beneficiary. The Bank that issues the LC is referred to as the Issuing Bank which is generally in the country of the Buyer. The Bank that Advises the LC to the Seller is called the Advising Bank which is generally in the country of the Seller (Parker, 1973:25).

The specified bank makes the payment upon the successful presentation of the required documents by the seller within the specified time frame. Note that the Bank scrutinizes the 'documents' and not the 'goods' for making payment. Thus the process works both in favor of both the buyer and the seller. The Seller gets assured that if documents are presented on time and in the way that they have been requested on the LC the payment will be made and

Buyer on the other hand is assured that the bank will thoroughly examine these presented documents and ensure that they meet the terms and conditions stipulated in the LC.

Keeping these facts in the mind, the study tries to prepare a strategic plan for setting up the L/C department and conducting the L/C operations in Nepal Investment Bank Limited (NIBL).

1.1.1 Introduction of Nepal Investment Bank Limited (NIBL)

Nepal Investment Bank Ltd. (NIBL), previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French partners. The French partner (holding 50% of the capital of NIBL) was Credit Agricole Indosuez, a subsidiary of one the largest banking group in the world. With the decision of Credit Agricole Indosuez to divest, a group of companies comprising of bankers, professionals, industrialists and businessmen, has acquired on April 2002 the 50% shareholding of Credit Agricole Indosuez in Nepal Indosuez Bank Ltd. The name of the bank has been changed to Nepal Investment Bank Ltd. upon approval of bank's Annual General Meeting, Nepal Rastra Bank and Company Registrar's office with the following shareholding structure.

At the present scenario, NIBL has proved one of the best banks among the banking sector in Nepal. Competing in deposit collection, attraction of clients, management of investment portfolio, and earnings from various sources of income are due to its efficiency and effective results and better performance level in present context. NIBL has been awarded the prestigious "Bank of the Year 2005" by the London-based Financial Times Group's The Banker - making it the first Nepali Bank to win the award two times in three years. NIBL had also won the "Bank of the Year 2003" award. Nepal Investment Bank was selected for this honor amongst the Nepali banks by meeting the stringent benchmark criteria set by The Banker. The Award is based on the growth and performance in terms of capital, assets, return on equity and management quality.

The net assets of the Bank has increased from NPR 5 billion to NPR 13 billion since the Nepali-management took over the Bank in July 2002. In the fiscal year (2003-04), Nepal Investment Bank boosted its net profit about 32% and achieved the return on equity of 21%.

The Bank's non-performing asset (NPA) is about 1.64 % i.e., one of the lowest (when the national average is over 25%) in the banking industry in Nepal and well within the internationally acceptable standards.

Nepal Investment Bank is the first Bank to introduce Visa Electron Debit Card in Nepal and the first non-government bank to launch "Loan against Gold and Silver." The Bank has issued over 25,000 cards making it the leader in the industry within a span of over one and half years. The Bank has deployed the highest number, 600, of Point of Sales (POS) machines in the market. Nepal Investment Bank recently launched the "Premier Banking Cell" that caters to its high net worth clients and renders consultancy services in taxation, legal, insurance and travel and tours. The Bank plans to strengthen its position in products such as remittance and plastic money.

Customer satisfaction is the paramount driver at Nepal Investment Bank. The Bank constantly interacts with existing and potential customers to get feedback and suggestions that in turn help to design products and services to suit the requirements and expectations of customers. The Bank has started a concept of "15 Minute Banking" for the convenience of all its valued customers. Customers entering any of its thirteen branches can carry their entire banking transaction within 15 minutes. A survey shows 8 to 10 minutes as the average transaction time per customer to carry their transaction and leave the bank.

The Bank is committed to continue striving to improve on all fronts to ensure it can respond to today's challenges in meeting the demands of its customers. NIBL understands that to be successful, they need to know their customers. It is this commitment to understanding their customer's particular needs and applying their expertise accordingly that's led them to being recognized as Nepal's Bank of the Year 2005.

Capital Structure of NIBL

The capital structure comprises of various components. They are:

- A group of companies holding 50% of the capital
- Rastriya Banijya Bank holding 15% of the Capital.

- Rastriya Beema Sansthan holding the 15% percentage.

The remaining 20% being held by the General Public (which means that NIBL is a Company listed on the Nepal Stock Exchange). NIBL is managed by a team of experienced bankers and professionals having proven track record which can offer its customer what they are looking for.

Service Offered

Different type of service offered by NIBL are: Trade Finance, Remittances, Export Credit, Bills Purchase, Loans and Advances, Tele Banking Service, ATM with any branch banking, Vehicle loans, Mobile Bills Payment, ATM Locations, E-Banking service, deposits, Funds Transfer, Bank Guarantees, Clearing/Collection, Locker facilities. Any Branch Banking System (ABBS), EZEE saving Schemes, 365 Days banking, debit Card etc.

Goals and Objectives of NIBL

- To facilitate the reliable, prompt and high standard of banking service adopting the latest version banking technologies in compliance with the need and demand of the market.
- To develop life long relationship with clients and achieve profitability through customer oriented service and customer satisfaction.
- To widespread its branch-network in different part of the country covering at least one branch in all development regions facilitating large number of clients as far as possible.
- To support possible cooperation for the upliftment in the economic development of the country.
- To perform banking transaction in and outside Nepal, receive deposits, give loan and advances, discounting bills, promissory note, etc. foreign exchange, buy and sale of bills of lading, delivery order and other business papers, buy and sale of current and fixed assets, issuing letter of guarantee, letter of credit, manage merchant banking business etc.
- To act all the functions noted in memorandum of association and article of association and also to abide by laws and regulation.

The goal of this bank is to aim and achieve the highest standard of professionalism and service to create a lifelong relationship with their client by providing customized financial products and services through proactive management.

1.2 Statement of the Problem

The new Ordinance BAFIO has presented NIBL with ample of opportunities to conduct new ranges of functions among which the L/C operation has been the most sought after due to its lucrative nature. However, the complexity in operation of L/C and the intense competition to be faced in L/C market cannot be denied in any case. So it becomes challenging for NIBL to conduct L/C operations in a profitable way thus ensuring sustainable market share. Due to the same fact, the proper strategic planning is required to ensure the desired results and this study aims to provide NIBL with well formulated strategic plan for L/C operations.

The letter of credit should have an expiration date that gives sufficient time to the seller to get all the tasks specified and the documents required in the LC. If the letter of credit expires, the seller is left with no protection. Most LC is failed because Sellers/Exporters/Beneficiaries were unable to perform within the specified time frame in the LC. Three dates are of importance in an LC: a) the date by when shipment should have occurred. The date on the Bill of Lading, b) the date by when documents have to be presented to the Bank c) the expiry date of the LC itself.

A good source to give is an idea of the timelines would be your freight forwarding agent. As a seller check with freight forwarding agent to see if it would be in a position to comply.

Letters of credit could also have discrepancies. Even a discrepancy as small as a missing period or comma can render the document invalid. Thus, the earlier in the process the letter of credit is examined, the more time is available to identify and fix the problem. This is another common reason why LCs fail.

Letters of credit are about documents and not facts; the inability to produce a given document at the right time will nullify the letter of credit. As a Seller/Exporter/Beneficiary

it should try and run the compliance issues with the various department or individuals involved within the organization to see if compliance would be a problem. And if so, have the LC amended before shipping the goods.

The existing market of L/C is completely ruled by commercial banks. 26 commercial banks are the only players in the L/C market. The clientele base of commercial banks and the relationship between the clients and the bank is another dominant issue. The law prohibited other banks and financial institutions from carrying out L/C operations before the new Ordinance was forwarded. So, to penetrate the monopoly market, proper planning is quite necessary. The need for strategic planning arises with the need to carry out the operation in a profitable way.

The study focuses on developing the strategic plan for NIBL with regard to L/C operations in the bank. The study also identifies the dominant financial, regulatory, market issues etc. that affect the L/C market. However, the market studied for the purpose of this study is limited within the Kathmandu Valley, so the strategic market plan is based on the views and preferences of the customers within the Valley only.

What strategic planning and preparation is required to incorporate L/C operations in NIBL so that sustainable market share is ensured? The decision problem can be sub categorized into following sub-problem statement

- What are the environmental issues and risks that must be addressed?
- What are the strategic financial issues that must be addressed?
- What are the strategic market (existing and potential) issues that must be addressed?
- What are the strategic Operational, Human Resource and Infrastructural issues that must be addressed and planned?

The research questions for the preparation of strategic plan can be stated as follows:

- What are the political and legal issues that affect L/C operations?
- What is the economic condition of the country?
- What are the dominating social factors?

- What are the technological issues that affect L/C?
- What is the external and internal default risks associated with L/C?
- What is the appropriate interest rate, charges, exchange rates and commissions?
- What will be the interest, commissions and exchange returns from L/C?
- What is the direct cost involved in the processing of L/C?
- What is the total annual market size for L/C?
- What are the major sectors where L/C transactions take place? And how are the customers approached?
- Who are the major existing players and who are the potential players in L/C market? And where are they standing in terms of L/C?
- What is the satisfaction level of customers in case of L/C transactions?
- What are the expectations of customer with regard to L/C transactions?
- What type of logistics is required for operating L/C?
- What is the documentation requirement?
- What is the HR requirement?
- What is the infrastructural requirement?

1.3 Objectives of the Study

The main objective of the study is comparative study of Letter of Credit of Nepal Investment Bank. The specific objectives of the study are as follows:-

- To prepare strategic plan for NIBL for starting and capturing sustainable market share in L/C operations by analyzing in terms of market, operation, human resource, finance, risks and regulatory environment.
- To understand the market condition of L/C operation.
- To understand the customers' choice, competitors' standing, and existing regulatory environment in terms of L/C operation.
- To access the competence, strengths and weaknesses of NIBL.
- To develop strategies on how to conduct L/C operations and capture sustainable market share in the competitive market scenario.

- To evaluate the documents used in opening the L/C.
- To examine the procedure of opening the L/C.
- To examine the transactions of L/C.

1.4 Importance of the Study

The study aims at preparing the strategic plan for L/C operation in NIBL. The study tries to identify the major issues that must be addressed to formulate strategies for the L/C operation that is completely new study to researcher. But there exists a high level of competition among commercial banks in the present L/C market due to its profitable nature. So, formulating strategies for the commercial banks by studying the existing L/C market occupied by commercial banks has been the most prominent factor during the study. Besides, the differences in between commercial banks and development banks in terms of nature, functions, capital structure, coverage etc were the major points to be considered upon. The major issues governing the study could be summarized as follows –

- The study of existing L/C market scenario where the only players are the commercial banks
- Strategy formulation in context of commercial bank which is going to enter the L/C market after the new Ordinance is enacted.
- market share of the existing players.
- The perception of the L/C customer and their volume of business
- The dominance of Import L/C over Export L/C due to huge trade deficit faced by the country
- The exchange rate for foreign currency as L/C involves payment in foreign currencies, especially US dollars.
- Documentation and processing requirements for carrying out L/C operations.

Strict regulatory issues as well as ethical issues involved in L/C operations

- To gain the first hand and actual knowledge about the working style of the organization or in the other words, we can say that to gain the practical knowledge about the organization.
- To train the students for administrative and managerial functions.
- To gain the practical knowledge about the banking processes.
- To identify and analyze the organizational or management trend.
- To enable the students for accessing the source of information required by them.
- To gain ability to analyze the present and future market environment and also to improve the company's profitability.
- To make student capable of tackling problems faced by them during the entire course of making project.
- To find out the process and problem of L/C opening.

The opportunities provided to commercial banks by the new Ordinance serves as the major basis for conducting this study. The objective of NIBL to exploit every possible opportunity to result in profitable operation for the bank leading to capturing sustainable market share can be achieved only when a sound strategic plan exists to back up the operation.

The study has covered the strategic issues in terms of marketability, financial return, operation, human resource and infrastructural requirement, and regulations and risks areas. To sum up, the analysis highly focuses on identifying the best possible strategies for carrying out the L/C operations in a profitable way.

Thus, the study shall be useful for NIBL to conduct L/C operations in a planned and profitable way. The report shall also be a medium of guiding the readers regarding how such types of strategic planning can be conducted in a systematic method for any type of operation.

1.5 Limitations of the Study

The study is not free from hindrances and problems. In the course of the thesis preparation following major limitations are faced:

- Difficulty in theoretical and practical understanding of L/C due to the technicalities involved etc. in NIBL where the internship program was conducted.
- Time and budgetary constraints that prohibited in conducting in-depth survey at different geographical areas.
- Unavailability of quantified data for determining the annual L/C volume of commercial banks and also to know the market size and market share for the same
- Difficulty in arranging appointments with L/C managers and officers of selected banks, L/C department being one of the busiest departments in the banks.
- Staying under the scope of the study, it was difficult to a survey on the respondent outside Kathmandu valley
- Difficulty in analyzing the information obtained from respondent due to the qualitative nature of information.
- As the study will be primarily base on the secondary data source such as annual reports of concern banks, and other related journals, magazines, books, world wide web, etc. The up-to date and complete data will be very difficult to obtain due to inability of providing the required data by concerned authorities. Variations in data itself will also be found while comparing them with different sources. So the reliability of conclusion of the study depends upon the accuracy of secondary data.
- Though the study will be carry out for broadening the horizon of ones own knowledge the basis concern is to fulfill course requirement of MBS program rather than a full research work done for Doctorial thesis.

1.6 Organization of the Study

This study has been divided into five chapters. They are as follows:

Chapter I is devoted to the general background of the study, statement of the problem, importance of the study, and limitations of the study and so on.

Chapter II includes the review of literature. Books, journals, articles and the previous related research reports have been reviewed.

Chapter III contains the research methodology employed to attain the objective of the research. It contains research design, population and sample, sources of data, data collection techniques and data analysis tools.

Chapter IV deals with the presentation, analysis and interpretation of gathered data. That is analyzed by testing the hypothesis and major findings on the basis of this study have been derived.

Chapter V is the last and concluding chapter which includes the summary, conclusion, and recommendation of the study. At the end, appendix and bibliography have been presented.

CHAPRER-II

REVIEW OF LITERATURE

Different books, literatures, articles were reviewed and studied to have the in depth theoretical understanding of L/C and its related aspects. The loan provided on the basis of L/C, the interest rates involved, the documentation required etc were also assessed. This helped in construction of unstructured questionnaire for visiting different banks and interviewing L/C officers for the practical understanding of the subject.

2.1 Theoretical Review

The industrialization gave birth to present foreign trade where goods and services are bought and sold from and to foreign countries. When goods are sold and bought abroad then such transactions could become very complicated for a number of reasons: time, hazard of journey, customs formalities, import/export and exchange control regulations, and the fact that buyer and seller are most likely widely separated by borders. The other reasons could be both the parties may not have seen each other's business standing and integrity. For any kind of trade to occur; whether it can be a local or an international, there are basically two parties, namely buyer and the seller. The trade here refers to the exchange of goods and services from the side of seller to the buyer and the flow of money from buyer to the seller. Both the parties enter into a commercial contract as per the terms described. Once the terms of the commercial contract have been finalized between the parties, the importer will be required to establish the agreed method of payment. It is important because in the international trading the parties reside in two different part of the globe, and the issue of confidence or the credit worthiness of these parties always arises. The beneficiary should be proactive and be prepared for the worst case scenario that is the other party may default and may renege in its obligation. Hence, it becomes indispensable for the existence of form of proceeding that will protect the interest of both the parties while practicing such transactions. The buyer should know what he is getting for the amount that he has paid. On the other hand, the seller would definitely be interested in receiving prompt payments. Hence, in order to satisfy both parties, "letter of credit" was developed. In present business transaction also it is widely used, which is handled within the international banking

network. It is submitted or presented to the exporter as a guarantee via a bank after the exporter shows the documents evidencing shipment or dispatch of required merchandise for which, the documents are in order, he will be paid. Through Letter Of credit is widely in use, its requirement or usage as a guarantee has to be agreed upon the contract of sale (Parker, 1973:45-49).

In other words a letter of credit is a payment term generally used for international sales transactions. It is basically a mechanism, which allows importers/ buyers to offer secure terms of payment to exporters/sellers in which a bank (or more than one bank) gets involved. The technical term for Letter of Credit is 'Documentary Credit'. At the very outset one must understand is that letters of credit deal in documents, not goods. The idea in an international advises the L/C to the seller is called the 'Advising Bank", which is generally in the country of the seller (Erich, 1992:17).

The specified bank makes the payment upon the successful presentation of the required documents by the seller within the specified time frame. Note that the Bank scrutinizes the 'documents' and not the 'goods' for making payment. Thus the process works both in favor of the buyer and the seller. The seller gets assured that if documents are presented on time and in the way that they have been requested on the L/C the payment will be made and Buyer on the other hand is assured that the bank will thoroughly examine these presented documents and ensure that meet the terms and conditions stipulated in the L/C.

For the issuing bank, the L/C is an import L/C while for the advising bank it is an export L/C. Payment by means of letter of credit involves action between two banks; one in the importer's country and other in the exporter's country. Thus, a bank in the importer's country issues a letter in favor of the exporter with an undertaking that bills of exchange drawn by him upon his importer up to the amount specified therein will be honored by its presentation (Erich, 1992:21).

According to uniform customs and practice for Documentary Credit, 1993 Revision ICC-Publication No. 500 the expressing "documentary Credit" means any arrangement, however

named or described whereby a bank (the issuing bank) acting at the request and the instruction of customer (the applicant) or on its own behalf (Sayers, 1967:28).

- Is to make payment or to the order of third party (the beneficiary) or is to accept and pay bill of exchange (drafts) drawn by the Beneficiary.
- Authorizes another bank to effect such payment or to accept and pay such bills of exchange (drafts).
- Authorizes another bank to negotiate against stipulated documents, provided that the terms and conditions of the credit are complied with. For these purpose branches of a bank in different countries are considered another bank.

In letter of credit normally:

- The supplier is known as beneficiary.
- The bank that opens a letter of credit is the opening of issuing bank.
- The buyer who asks the bank to issue the credit is the applicant.
- The bank in the supplier's country that advises the credit to the beneficiary and checks its authenticity is the advising bank.
- When the advising bank adds confirmation on the L/C to be advised to the beneficiary it is then known as Confirming Bank too.
- When certain terms and conditions of the credit are changed such change is known as an amendment.
- The generally adopted set rules for credits are known as the uniform customs and practice for letter of credit (UCP), issued by the international chamber of commerce (ICC) in their publication dated 1993, numbered 500.
- When an exporter takes the required documents into the bank, he is presenting them, which is known as presentation of documents.
- If the documents are in order, the credit become drawn,
- In a letter of credit where payment is to be made a deferred period, correct (or credit confirmed) documents are taken up.
- Documents that are not in order are referred to as discrepant.

- Letters of credit are issued in variety of ways. They come by post from the issuing bank (rarely), by telex and by SWIFT (Erich, 1992:27).

2.1.1 Functions of Letter of Credit

- It virtually eliminates credit risk, if the bank has a good standing.
- It reduces uncertainty, as the seller knows the condition that should be fulfilled to receive the payment.
- It offers safety to the buyer who wants to ensure that payment is made only in conformity with the conditions of the letter of credit.

2.1.2 Types of Letter of Credit

I. Revocable Letter of Credit:

A Revocable credit is one that may be amended or cancelled by the issuing bank at any moment and without prior notice and consent of the beneficiary and other involved party. A revocable letter of credit is risky from the point of view of the beneficiary (Sayers, 1967:31).

II. Irrevocable Letter of credit:

An irrevocable credit constitutes a definite undertaking of the issuing bank, provided that the stipulated documents are presented and that the terms and conditions of the credit are complied with:

- If the credit provides for the sight payment – to pay or that payment will be made.
- If the credit provides the deferred payment – to pay or that payment will be made, on the date determinable in accordance with the stipulated of the credit.
- If the credit provide for the acceptance.
- If the credit provide for the negotiation.

Irrevocable credits can neither be amended nor cancelled without the agreement or consent of the issuing bank, the confirming bank and the beneficiary. An irrevocable letter of credit is safe from the point of view of the beneficiary.

III. Confirmed Letter of Credit:

If a letter of credit contains, in addition to the undertaking of the issuing bank, and undertaking of the negotiating bank is the beneficiary's country to honor the bill drawn by the exporter, it is called a confirmed letter of credit at the request of the issuing bank. A confirmed letter of credit assures absolute safety to the beneficiary, as the exporter can proceed against both the negotiating bank and the issuing bank in the event of the dishonor of the bill drawn by him.

IV. Unconfirmed letter of credit:

If the letter of credit does not contain the undertaking of the negotiating bank in the exporter's country to honor the bill; it is called an unconfirmed letter of credit. In other words, if the letter of credit contains the undertaking of only the issuing bank, it is called unconfirmed letter of credit. An unconfirmed letter of credit is not very safe to the exporter, as he can proceed only against the issuing bank and not against the negotiating bank, in case the bill drawn by him is not honored.

V. Documentary letter of credit:

In the operation of a documentary credit all parties' concerned deal in documents and not in goods, services and other performances to which the document may relate. Documents required under a L/C will vary depending on the market, established regulations in the country of the importer and the prior arrangements between the importer and the beneficiary. The documents usually called for are:

- Transport documents
- Insurance documents
- Commercial invoice

- Other- e.g. certificate of origin, certificate of quality issued by specified bodies/agencies etc.

VI. Clean letter of credit:

If a letter of credit is issued by the issuing banker without insisting that the bill drawn under the letter of credit should be accompanied by the relevant shipping documents, the letter of credit is called a clean letter of credit. In a clean letter of credit, the necessary shipping documents are sent by the exporter directly to the importer. Generally, a clean letter of credit is issued at the request of a party of high financial standing only.

VII. Transport Documents:

In calling for transport documents the issuing bank must ensure that the bank has effective ownership of the goods till the opener accepts the bill or pays for the goods in terms of the L/C. In the case of NIBL, branches will use following types of clauses depending on the mode of transport.

Transport by sea:

"Full set of clean on board marine bills of lading made out to the order of NIBL and marked freight paid/collect and notify applicant.

Transport by air:

Airway bill issued and signed by the carrier or their agent bearing reference to the credit number, evidencing dispatch of goods consigned to the account of Nepal Investment Bank, marked freight prepaid freight payable at destination and notify applicant.

Transport by land:

Other modes of transport:

The primary requirement that the bank retain effective ownership on the goods should not be lost sight of ICC 400 provides for combined transport documents to reflect the changes

taking place in the method of transporting goods particularly the use of "containers". In the case of Nepal Investment Bank, branches shall take note of these provisions and depending on circumstances act accordingly but with due prudence and caution.

VIII. Insurance Documents:

If the insurance is being covered by the importer then the issuing bank must ensure that the insurance provides cover in the currency in which the L/C is opened. This is necessary to avoid exchange risk. The insurance should be for at least 110% of the CFI value of the goods.

IX. Commercial Invoice:

The description of the goods in the commercial invoice must correspond with the description in the L/C. It is therefore necessary to advise the customer to describe the goods briefly but adequately on the L/C application/ agreement from and to reproduce the description therein, on the L/C issued.

X. Other Documents:

Certificate of origin, certificate of Inspection/quality, etc. fall into the category of other documents i.e. documents other than transport documents, insurance documents and commercial invoices.

XI. Special type of L/C:

The following special types of L/C are defined in section 12 to 16. The section also indicates the factors to be taken into account by the bank either as the issuing bank or advising bank, which is in addition to those applicable to all issuing bank or advising bank, which is in addition to those applicable to all types of L/C.

- Transferable Credit
- Back to back Credit
- Revolving Credit

- Red Clause Credit
- Standby Credit

Transferable Credit:

A transferable credit is a credit under which the beneficiary has the right to request the bank called upon to effect payment or acceptance or any bank entitled to effect negotiation to make the credit available in whole or in part to one or more other parties. A credit can be transferable only if it is expressly designated as "transferable" by the issuing bank.

Back to Back Credit:

It is usually requested by a customer who offers as sole collateral another credit opened in his favor since he doesn't wish to, or is not in a position to supply the goods. Therefore, it involves two separate documentary credits. As applicant for the second credit, the customer is responsible for reimbursing the second issuing bank for payments made under the second credit, regardless of whether or not he himself is paid under the first credit.

Revolving Credit:

A revolving Credit is one where, under the terms and conditions, the amount is renewed or reinstated without amendment to credit being needed. It can revolve in relation to time or value.

Red clause Credit:

A 'Red Clause credit' generally authorizes the designated advising bank/negotiating bank or branch, to make clean advances to the beneficiary, to finance the purchase and preparation for shipment of the relative merchandise.

Standby Credit:

L/C issued in such a way as to enable the beneficiary to draw under the L/C only in the event of a default by the applicant in the performance of his contract is known as standby

credit. e.g. of standby credit are those issued by American Banks in lieu of guarantee. Typically the documents requested in a letter of Credit are the following:

- Commercial Invoice.
- Transport document such as a Bill of lading or Airway bill,
- Insurance document,
- Inspection Certificate,
- Certificate of Origin
- Other

In short the letter of credit (L/C) deals in documents, not goods. The L/C could be 'irrevocable' or 'revocable'. An irrevocable L/C cannot be changed unless both the buyer and seller agree. Whereas, in a revocable L/C changes to the L/C can be made without the consent of the beneficiary. A 'sight' L/C means that payment is made immediately to the beneficiary/seller/exporter upon presentation of the correct documents in the required time frame. A 'time' or 'date' L/C will specify when payment will be made at a future date and upon presentation of the required documents.

2.1.3 Three Reasons Why L/C Fail:

A. Time Lines:

The letter of credit should have an expiration date that gives sufficient time to the seller to get all the tasks specified and the documents required in the L/C. If the letter of credit expires, the seller is left with no protection. Most L/Cs fails because seller/exporters beneficiaries were unable to perform within the specified time frame in the L/C. Three dates are of important in an L/C (Sayers, 1967:34.36):

- The date by when shipment should have occurred. The date on the bill of the Lading.
- The date by when documents have to be presented to the bank.
- The expiry date of the L/C itself.

A good source to give you an idea of the timelines would be your freight forwarding agent. As a seller check with your freight forwarding agent to see if you would be in a position to comply.

B. Discrepancy within the letter of Credit:

Letter of credit could also have discrepancies. Even a discrepancy as small as a missing period or comma can render the document invalid. Thus, the earlier in the process the letter of credit is examined, the more time is available to identify and fix the problem. This is another common reason why L/Cs fails.

C. Compliance with the Documents and Conditions within the letter of Credit:

Letters of credit are about documents and not facts; the inability to produce a given document at the right time will nullify the letter of credit. As a seller/ exporter/beneficiary you should try and run the compliance issues with the various department or individuals involved within your organization to see if compliance would be a problem. And if so, have the L/C amended before shipping the goods.

2.1.4 Documents Required For Opening L/C:

While opening letter of credit, applicants have to submit various important documents. Nepal Rastra Bank (NRB) has directed that applicant have to submit various document related to the import trade. Those documents are given as follows (Upadhyya, 2004):

1. Income Tax renewed Certificate.
2. Firm registration Certificate (Duly renewed)
3. In case of Private Limited, minute must be presented, among those Article of Association(AOA) and Memorandum of Association(MOA) are the must
4. Performa invoice/indent/sales contract issued by beneficiary/indenter:

There must be following indicated details.

- Description of the goods(Name, Brand, and Model no. of goods)

- Harmonic Code.
- Country of Origin.
- Unit Price & Quantity.
- Total Price.
- Accountee/Beneficiary.

5. L/C application duly filled up, signed and stamped by Opener/ Accountee/ Applicant.

6. B.B.N.3 (Not required for L/C opened in IRS & NRS).

7. Garment Association Recommendation's letter (To import fabric for India only).

8. Wool Development Committees (To import wool only).

9. R.B.I's Documents/Export/Import documents issued by Directives of Foreign Trade of India.

10. Insurance Policy in case of L/C's opened of FOB, CFR Basis.

2.1.5 Procedure of Opening L/C:

- i. Applicant must fill up the "Applicant form and B.B.N. F. no.3". But in case of Nepalese and Indian Currency B.B.N.F. no 3 is not required.
- ii. L/C can be opened for those products only, which are mentioned in the "Customs Tariff Code" book and goods under OGL. But L/C can't be opened for those products, which are prohibited by the Government and NRB though they have Harmonic Code.
- iii. Letter of credit can be opened in convertible currency even for importing certain goods from India. But clause is that L/C must be opened by manufacturing industry and the product must be directly purchased from the Indian manufacturing industry and the product must be directly purchased from the Indian manufacturer as specified by NRB circular no. 200.

- iv. All import L/Cs issued, amendments advised and confirmation added to export L/Cs will be signed by the appropriate authorities of the bank, depending upon the amount and types of the transaction. The name of the signatories and their numbers, as appearing in the Bank's booklet of Authorized signatories, must be typed or stamped underneath the respective signatures.
- v. L/Cs can be opened only on behalf of those customers of the branch for whom such facilities have been approved. L/Cs opened on a one –off basis will need the specific approval of the lending authority concerned. For this, the credit department will also issue a CFR on specific deal basis on case to case basis.
- vi. In case of NIBL, a customer liability report will be maintained in respect of each customer for whom L/Cs are opened. This record will be used to monitor the customer's outstanding liability.
- vii. Before an application for issuing an L/C or an amendment is taken up for processing it must be validated by the officer in –charge of the L/C department on the basis of approved lines laid down in the CFR.
- viii. Selection of bank to advise/confirm an L/C will be made from the list of approved correspondents for handling L/Cs and will depend on the currency in which the credit is issued and the address of the beneficiary. In case of NIBL, if L/C is not approved, correspondents are available; arrangements will be made in consultation with or through head office, Treasury.
- ix. L/Cs should be opened by the bank only in favor of those beneficiaries whom it is known to bank and that the party is not been black listed. However, depending upon the standing of the client it may be done after specific approval of the concerned authorities obtained.
- x. The issue of an L/C is authorized subject to the holding of a stipulated margin, the margin amount should be collected prior to the issue of the "L/C and held in margin account" and a customer wise record to maintained of such margins held. In case of NIBL, the minimum margin in L/C as specified in the CFR should always be taken in cash i.e. debiting the client account; receive MDR, IDT, etc.

- xi. When a credit is opened by full text operative telex, they must carry the clause-
"This credit is subject to the Uniform Customs and Practice for Documentary Credits (1993) International Chamber of Commerce Publication No. 500"
- xii. In case of NIBL, Branches must not send mail confirmations of operative credits opened by telex.
- xiii. In order to minimize exchange rate risk and interest on loans which can occur on large value negotiations/payment bank should be instructed to tele-advice the treasury department of the bank about the details of negotiations or above USD 100,000.00.
- xiv. The original (beneficiary's copy) and the advising bank's copy must be dispatched to the advising/Confirming bank or the bank nominated in the L/C. Dispatch of amendments to an L/C must be handled in the same way.
- xv. In case of NIBL, all requests for amendments to an L/C issued by the branch must be supported by an application giving the full details of the amendments sought and duly signed and stamped by the customer concerned.

There are certain other rules to comply while opening Letter of credit, which are mentioned in the following book:

- ICC uniform Customs and Practice for Documentary Credit 1993, Publication No. 500.
- ICC Uniform Document for Banking Reimbursement under Documentary Credit Publication No.500.

But the whole operation of Letter of Credit is confirmed within the authority of the Nepal Rastra bank and the Related Government Bank.

2.1.6 Prohibition Regarding the Opening of L/C:

Opening of Letter of credit is prohibited for certain things by NRB, Government and the head office of related bank. Opening L/Cs for thinks like tetracycline, Boron, Readymade Garments, Clove, Video cassette, Plastic Scraps, Titanium dioxide, Shoes, Doxycycline, and raw material for Medicine, Flasks, are prohibited. Apart from this if the applicant

request the bank to open the L/C for other things that don't have harmonic code, bank should open only after taking the permission of the loan Investment department. But if the above mentioned products are going to be used as raw materials then the L/C can be opened in favor of those products to be imported in the country. Ministry of commerce has prohibited opening up the L/C relating the import of the Poppy Seed, which is basically used for making opium. L/C can't be opened for the import of the illegal products. Government has prohibited the opening of L/C for the export of Rice. Beside these, Nepal government prohibits certain things;

- Arms and Ammunitions
- Jewellery/ Precious Stones
- Narcotics
- Wild Life products like Elephant Tusk, Shin/Beef.
- Walki Talkie etc.

2.1.7 Problems While Opening L/C:

Opening procedure of L/C is long, legal and complicated process. So parties involved in this process face many problems. The main problem faced while opening L/C by banks and customers are:

- 1) Nepal Rastra bank (NRB) has instructed all the commercial banks to open L/C on the basis of the status of the client. Commercial banks find the term 'status' very vague. They say how to find out ones status. They say if someone comes to open L/C with import license and income tax clearance certificate, then why should they be sorry about status of the person. In the view, it should be the authority that gives import license to be responsible for giving license by looking at the person's status and not them.
- 2) Employees of commercial banks involved in L/C transaction have to be responsible if anything's goes wrong in the transaction. But employees of commerce department and Taxation department from where people get import

license and income tax clearance certificate respectively to open L/C, do not have to be responsible.

- 3) Government has made valuation for goods imported, which are undervalued NRB gives foreign currency according to their harmonic code, which is not sufficient to pay the bill. Therefore, importers are compelled to get foreign currency from black market.
- 4) Sometimes the client of the bank turns out to be fraud. In such cases bank has to face lot of problems. If all the documents are received as per L/C but the client does not come to take document, in that case, the bank has to pay money to the exporter although the goods will be under the bank control.
- 5) The new customer have to pay more than 100% margin of total amount of L/C. L/C process takes 15-30 days for settlement and in this period, the customer's whole amount will be blocked and he can't mobilize the amount.
- 6) If the party is new, exporter does not believe on them. So they ask for advance payment to deliver the goods. But, Nepal Rastra Bank does not give permission for advance payment. NRB has provision to give the advance payment only for sample. For this purpose, they may have to use other reputed importer's account and pay them commission.
- 7) Problem may arise during the shipment, which may be uncertain. Difficulty in accepting state transport document of which NRB approval is essential.
- 8) If a firm's age does not exceed more than one year, they have to pay tax in advance of L/C amount. Issuing bank charge 10% tax of L/C amount and send it to tax office early time. Businessmen do not have much idea about the profit margin but have to pay the tax in advance. Furthermore, within one year period they have to pay advance tax every time they open L/C. This amount is also blocked for whole the year.
- 9) The major problem of L/C is as per UPC up to 5% tolerance is allowed but as per NRB rules; no specific tolerance on the value and quantity is allowed.

2.1.8 Discrepant Document:

There are many reasons that may cause document to be incorrectly presented and subsequently dishonored by the paying bank. If the incorrectness is found in the document there are several possibilities for the paying bank and/or issuing bank to react:

- To contact the beneficiary to get the document correct, if possible
- The paying bank can contact the issuing bank in order to get their permission to take up documents despite the discrepancies stated.
- The paying bank can effect paying under reserve either internal or open reserve.
- The paying bank can send document to the issuing bank for payment authorization or, in case of major discrepancies for collection.

The largest portion of documents fall under discrepancy due to error in preparation and the majority of discrepancies are in the invoice (Sayers, 1967:37).

2.1.9 Expiry and Place for Presentation of Document

- The last date for shipment.

The time period available to the beneficiary from the date of issuance of the bill of Lading or other shipment documents, during which the beneficiary must present documents required under the credit. If this period is not stipulated it will take 21 days as per UCP.

- The expiry date of the credit.

In term of section 515:1 and 515:2 respectively the maximum validity period will be one year for revolving credits. However such validity could be more and can also be amended.

2.2 Conceptual Review

How does the credit work?

1. An importer A in Turkey, opens an irrevocable credit in favour of a merchant B in London, for 1000 tons of sugar value USD 500,000.

2. The merchant B is buying the sugar from supplier C in Dominica, for USD 480,000.
3. Supplier C asks the merchant B to provide an irrevocable credit in his favor.
4. But B does not have the necessary banking facilities to open such a credit on his own account or his facilities are fully used.
5. B therefore takes the Letter of Credit he has received from A and requests the advising bank (or his own bank) to issue a Back-to-Back credit in favor of C.
6. Thus the first credit from A becomes the security for the second credit; i.e. the two credits are 'Back-to-Back'.

Once both credits are in force, they operate in a manner similar to the transferable credits.

- a) Supplier C ships the sugar and presents his documents to the advising bank in Dominica.
- b) The advising bank pays those documents, if in order, and forwards them to the issuing bank in London.
- c) That bank reimburses the Dominican bank and then applies the same document (plus B's invoice which is substituted for C's invoice) against the prime credit opened by A.
- d) The London issuing bank sends the documents to the original issuing bank in Turkey and reimburses itself under the prime credit.
- e) The difference between the amount paid to C and the amount reimbursed under the prime credit is paid to B and represents his profit.

2.2.1 Roles and Responsibilities of the Parties

- Parties involved in the LC transaction should be well aware of the LC process and the consequences arising out of their actions and instructions
- They should therefore be clear and specific
- Every party involved in the LC transaction should thus ensure that the LC does not have any non documentary conditions

- It should be understood that an LC is separate from the contract/s on which the LC is based even if a reference to the said contract is made in the LC

2.2.2 Parties Involved in Letter of Credit

1. Applicant:

The applicant is the buyer/ importer of the goods who ask his bank, the issuing bank, to issue him a "Letter of Credit". The applicant is also called the opener. An applicant requests his bank to issue a letter of credit in favor of an exporter to cover the purchase of goods and agrees to pay as per the terms of the contract/LC. He should furnish the documents to the issuing bank as required to issue the LC and abide by the rules and regulations mentioned in the contract. The applicant should be well aware of the status of the beneficiary and understand the terms and conditions mentioned in the underlying contract.

In most of the cases the applicant maintains an account relation with the issuing bank. The bank may or may not require the buyer to secure the letter of credit by providing sufficient deposits to protect its own interests. It depends on the confidence, which the bank has over the buyer applying for the letter of credit.

2. Issuing Bank:

Issuing bank issues the letter of credit or guarantee and takes ultimate responsibility for the payment of the instrument. It provides the document on request of the applicant. The issuing Bank is the importer's bank that functions as the agent/trustee of the applicant, which agrees to establish the letter of credit. The bank is the one whose promise to pay is the main strength of the instrument. The issuing bank should ensure that the regulatory conditions are fulfilled and the instructions are precise and specific. The bank should check the shipping documents upon receipt and intimates the discrepancies (if any) to the presenter within reasonable time period provided by UCP. He has the right to decide the acceptance and refusal of the documents and ask for the disposal instruction of the presenter, finally it reimburses the presenter as per the instruction and as per the LC payment terms.

3. Advising Bank:

An advising bank is the correspondent bank or branch of the issuing bank in the exporter's country which informs the exporter that a letter of credit has been issued in his favor. The bank, normally in the exporter's country through which a letter of credit is transmitted and authenticated to the exporter. The bank should establish the authenticity of the LC before advising where as if it could not establish the authenticity or elects not to advise the LC then it should immediately inform the issuing bank. The bank should be aware of the conditions mentioned in LC and check if any of the conditions mentioned are against the local regulations. Finally if the bank opts to advise the LC then it should inform the beneficiary without any delay. There is no liability on the part of the advising bank to honor the letter of credit. The main function of the advising bank is to prove the beneficiary that the letter of credit is genuine, since the advising bank has to satisfy itself that the letter of credit is properly authenticated by the issuing bank.

4. Confirming Bank:

A bank which is requested by the issuing bank or by the beneficiary to add its confirmation is the confirming bank. This may be the advising bank or it may be another bank nominated by the issuing bank and is usually but not always, situated in the exporters country. It takes on all the liabilities/responsibilities of the issuing bank; the confirmation is based on the credit worthiness of the issuing bank. If the bank elects not to confirm the LC then it should immediately advice the issuing bank. When a bank "confirms" the letter of credit of another bank, it takes on obligation of the issuing bank. Such bank is known as confirming bank. Bank will only confirm the irrevocable credit. The advantage of this confirmation from the point of the seller lies in the fact that assured of payment as soon as the documents are presented at his own center.

5. Beneficiary:

Beneficiary is the exporter in whose favor the letter of credit is issued. Upon receipt of the LC the beneficiary should check if the terms and conditions mentioned are feasible and may ask for amendment. The beneficiary delivers the goods/services as per the LC and satisfies

the conditions mentioned. He presents the documents as required in LC to the negotiating or collecting bank. The bank issuing the letter of credit assures the seller that the letter of credit will be provided, the relevant documents are produced and the term and conditions set out in the credit document are strictly complied with.

6. Negotiating/Collecting Bank:

Negotiating bank acts as an agent/trustee of the beneficiary. It checks the document as per the LC conditions and advises the presenter (beneficiary) of the discrepancies (if any). The bank also forwards the same to the issuing bank as per the beneficiary's instruction. The bank collects the fund from the issuing bank or the reimbursing bank if any nominated in the LC and then it reimburses to the beneficiary either upon negotiation or upon receipt of funds from the issuing bank. The negotiating bank negotiates the bill or drafts under the letter of credit. Generally, the same bank will act as the notifying bank (advising) and the negotiating bank. The negotiating bank has to see that the documents negotiated conform strictly to the terms and conditions of the credit.

7. Reimbursing Bank:

The reimbursing bank is the NOSTRO Bank of the issuing bank. It pays the payment to the beneficiary's bank as per instruction of the issuing bank. It is the bank which pays the beneficiary upon the presentation of documents in compliance with the terms and conditions of the credit. This bank may be the issuing bank itself or it may be a bank authorized by the issuing bank as its agent to pay the credit (advising bank). It is not concerned about the terms and conditions of the LC.

2.2.3. Pre Requisites for Opening an LC

Before opening Letter of Credit following pre-requisites are to be fulfilled by the opener.

1. The company / Firm should be registered in concerning Ministry / Department / Authority (to obtain operational permission from concerning authority or submitted yearly renewal certificate, if required)

2. Income Tax Certificate, PAN Certificate, VAT Certificate (any one)
3. The customer should be current account holder.
4. The photocopies of the Citizenship of the Proprietor/Partners/Directors.
5. The Proprietor/Partners/Directors name should not be registered in black list or defaulter list.
6. Limit approval or review period bank should collect the copy of Customer/Firm's financial document, CIB report or Board Minute (if Co is P. Ltd).
7. Customer should be better creditworthiness in the market
8. For the import of following merchandise prior approval is require before opening of the L/C.
 - a. For import & export of Liquors VAT approval must be taken.
 - b. Ministry of Commerce has determined / restricted not to import certain quantity like Post Dana (Poppy seed) so if some importer wants to import Poppy seed more than determined quantity he must submit the approval from Ministry.
 - c. Trading firms do not import old clothes, Scrap and machinery but if somebody wants to import those goods he must get the permission from Ministry of Population & Environment.
 - d. To get the permission from Ministry of Population & Environment for import of merchandise which destroys the Ozone layer
9. Approval/recommendation letter is required from concerning authority for import like wool, cotton & medicine etc.
10. Permission letter is required from NRB in case of importer is an individual or non-registered firm.
11. Either approved limit or cash margin (cash or equivalent cash) required before L/C opening.
12. Import Restricted Items:
 - a. Arms and Explosive Products
 - b. Radio Frequency transmission products
 - c. Narcotic Products – Cigarette, Tobacco, Heroin
 - d. Gold, Silver and Precious Metals

- e. Liquors, Wines – *Inland Revenue Department's approval is required*
- f. Products made of Recycled Plastics granules
- g. Ozone Deflecting products – *must be CFC free.*
- h. Beef

2.2.4. Things that NIBL Check for LC

1. Go through the LC application
 - a. Are there any controversial clauses present in the LC?
 - b. Can the LC be established for such item?
 - c. In case of New Clients, NIBL checks the A/C Opening Forms, Board Resolution and Minutes.
 - d. Is the firm registration and income tax certificate updated and verified with the original semi-annually?
 - e. The bank has to ensure that the total LC exposures of firm are within 20 times of their registered capital.
 - f. Are all required legal documents as per banks policy and NRB Directives been properly obtained?
 - g. Is the PROFORMA INVOICE attached with the LC form?
 - h. Does the INCOTERM match the sales contract?
 - i. Are the shipment date and presentation period mentioned correctly?
 - j. Does the LC contain reimbursement instructions?

2. Process for approval
 - k. If the case is within limit and without any overdue, manager international banking can approve it directly. In case of overdue or non limit holders, it has to be forwarded for approval to concerned authorities.
 - l. Has it been duly approved by the concerned authorities?

3. After approval has been obtained

- m. NIBL's margin for LC is 10 % or above depending on clients however this can be lowered for selected clients by special approval.
- n. Has the margin been taken as per approval before establishing LC?
- o. Is it necessary to take NRB statutory margin?
- p. Has the commission and telex charge been taken?
- q. Has Bi. Bi. Ni. Fa No 3 been separated and sent one copy to NRB, second copy to the custom office and third copy properly filed by the bank?

4. Amendment

- r. Is there a proper request for amendment?
- s. Is the amendment signed by an authorized person?
- t. Is Bi. Bi. Ni. Fa No 3 filled and signed properly?
- u. Does the amendment violate any NRB directives?
- v. In case of amendment increasing the amount
 - i. Has the revised/additional PROFORMA INVOICE been submitted
 - ii. Has proper approval been obtained
 - iii. If the increased value is more than 10 % of obtained LC value, has approval been obtained from the central office
 - iv. Does the amendment hold valid reasons is it justified

5. After arrival of documents

- w. Enter the documents in the register maintained
- x. Staffs go through the LC terms and conditions and check the documents thoroughly.
- y. Check the date of LC and/or date of amendment in amount of LC with the date of shipment (transport documents). If the date of transport document is prior to the date of opening of LC or Date of Amendment of amount then such documents under the LC should not be accepted.

- z. Check the date of transport document with the date of receipt of document at the counter, only those documents received within 45 days from the date of transport documents can be accepted.

The documents related to LC can be as follows:

- i. Commercial Invoice
- ii. Packaging List
- iii. Proforma Invoice
- iv. Certificate of Origin
- v. Certificate of Insurance
- vi. Transport Document

6. Retiring the documents

- bb. NIBL reminds/informs the party at least seven days before the due date.
- cc. On due date NIBL debit the party's A/C with the bill amount plus other charges and up-to-date LC commission.

2.2.5. Procedure Involved in Import LC of NIBL

1. The buyer and seller conclude a sales contract providing for payment by a Documentary Credit.
2. The buyer instructs NIBL- the issuing bank- to issue a Documentary Credit in favour of the seller (Beneficiary).
3. NIBL will have to check whether the buyer is a new client or not, the limit has to be determined to the buyer since the bank always try to be in the safer side it will have to know about the customer in detail. So the information is collected. The process involved in determining the limit is as follows
 - a. The staff involved in determining the limit gathers the information of the customer about the shareholding pattern, total capital, sanctioned facilities to the client and its group and the maximum and minimum utilization made by the group and the client.

- b. Details of the borrower like the financial performance, current market position, the degree of competition, the credit policy of the borrower, is also collected, and the charges is determined.
 - c. The most important factor that is to be considered for providing the limit for an LC is the risk analysis of the business. The risk associated with the business and the mitigation involved with it should be properly revised by the bank.
 - d. The information collected are presented in the Credit Committee Meeting as a credit memorandum report and along with its preparation the bank has to know whether the person is black listed or not, this information can be collected through sending a request to the Credit Information Bureau (CIB) of NRB.
 - e. The bank may have to go for a site visit and know about the stock position of the client.
 - f. If the committee feels that the project is feasible to the bank then the limit is finalized and the limit is given with a fixed commission charge, minimum of 10 % cash margin is held by the bank and for the remaining balance the security of the client is kept as a mortgage.
 - g. If the client is ready for the limit then before opening an LC a certain amount of security is held by the bank.
 - h. After completion of the legal matters the bank will open an LC for the client.
4. The client provides the PROFORMA INVOICE to the bank and fills the application form and all necessary details are filled. Bi. Bi. Ni. Fa No. 3 (Ka) is filled or if the custom office is Tatopani then Bi. Bi. Ni. Fa No. 3 (Kha) should be filled, one copy of the form should be filed by the bank, the second copy is given to the NRB and the third copy to the custom office.
 5. NIBL issues the Documentary Credit and ask another bank (advising bank), usually in the country of the seller to advise or confirm the Documentary Credit.
 6. The Advising bank informs the seller about the issuance of Documentary Credit in favour of the beneficiary.
 7. As soon as the seller receives the Documentary Credit and is satisfied that it meets the terms and condition of the sales contract and that he can meet the documentary credit terms and conditions, he is in the position to affect shipment.

8. Seller then sends the required documents to the bank where the Documentary Credit is made available (the nominated bank).

The documents sent by the seller are as follows:

- a. Proforma Invoice:

It is the document which gives detail information about the exporter and the consignee and the invoice contains of the harmonic code of the goods that is going to be purchased. The country of origin of the good is also specified in it. The invoice consists of the terms of payment and the detail information about port of discharge, port of loading and the final destination of the goods.

- b. Commercial Invoice and Packaging List:

The commercial invoice is a document that is send to the bank by the beneficiary's bank after the goods has been shipped. The INCOTERMS i.e., a universally recognized set of definitions of international trade terms, such as FOB, CIF, C&F etc is also presented in the document. The number of packages, description of goods, quantity, rate and amount is specified along with the 8 digit harmonic code. The proforma invoice details and the commercial invoice details should match each other.

- c. Certificate of Origin:

The origin of the goods is generally precisely stated in a credit and in many cases (e.g., commodities) the origin can considerably influence the price of the goods; hence it must be exact. The Certificate of Origin should be certified by the Chamber of Commerce of the origin country, or it can be valid if the buyer accepts to purchase the goods that is certified by the beneficiary himself.

- d. Transport Document:

The transport document describes about the means through which the buyer is receiving the goods. If the credit calls for marine or ocean B/L a bank accepts the document which

indicates the name of the carrier and is signed or authenticated by the carrier or his agent, or the master or his agent. B/L indicates that the goods have been loaded on board or shipped on named vessel. The B/L should indicate the port of loading and port of discharge and should be as per the credit. The B/L must indicate "Freight Prepaid" or "Freight Payable". The terms like "Freight to be prepaid" or "Freight prepayable" will not be accepted. If the credit is silent, bank accept transport document stating "Freight yet to be paid". In some cases there may be a lot of goods to be shipped so for this purpose whole ship is chartered with goods so (Sayers, 1967:47).

If the credit calls for a transport document covering at least two different modes of transport, bank accept the document which indicates the name of the carrier or multimodal transport operator and is signed or authenticated by the carrier, multimodal transport operator or the master; or their named agent. Similarly the credit may call for an air transport document, i.e., the goods are sent through air way. The date of issuance of the air transport document will be deemed to be the date of shipment. The credit consists of the airport of departure and the airport of destination. The transshipment in air way 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. If the credit calls for a road, rail, or inland waterway transport document; banks accept a document which contains the name of the carrier; has been signed by the carrier or the agent and bears the indication of the receipt; indicates that goods have been received for shipment; mentions the place of shipment and destination as per credit; and meets all other requirements of credit (Sayers, 1967:51).

e. Insurance Documents:

Insurance Document is one of the important documents required for LC transaction. UCP 500 devotes article 34 - 36 to this document as it is of very complex nature. All the originals of insurance document issued and signed by insurance companies, underwriters or their agents are required to be presented. The cover notes issued by the broker are not acceptable. Date of issuance must be on or before the date of shipment or it must be

evidenced by the specific notation that the cover is effective from the date of shipment. The insurance cover must be in the currency of credit and at least for 110% of CIF value.

9. The bank examines the documents against the Documentary Credit. If they meet the requirements of the documentary credit the bank will pay, accept, or negotiate accordingly to the terms and conditions of the Documentary Credit.
10. The bank which takes up the documents sends the documents to the issuing bank.
11. The issuing bank examines the document and if the documents meet the Documentary Credit requirements reimbursement is made in the pre agreed manner to the conforming bank or any other nominated bank that has paid, accepted, or negotiated to pay under the Documentary Credit.
12. When the documents have been examined by the issuing bank and are found to meet the Documentary Credit requirements they are released to the buyer. The client when fills the application form should mention the number of documents that he requires e.g., original signed commercial invoice and 3 copies, original certificate of origin and 3 copies issued by the Chamber of Commerce, original packing and weight list and 3 copies, insurance certificate and other required documents. NIBL then separates one copy of all the documents to the custom office of Nepal, it should have an original B/L which should be presented in Kolkata port, second copy to NRB, the third copy is documented by the bank for the future reference. The bank has to fill Bi. Bi. Ni. Fa No. 4 which are of 4 colours; Blue and Brown copy is for the custom office, Green for NRB, Orange for the company itself. While dispatching the documents the "Certified copy of Original LC" should be mentioned in the photocopy of LC and authorized person should sign it. The Brown copy of Bi. Bi. Ni. Fa No. 4 should be returned back to NIBL after the goods pass through the custom office and this document should be returned back to the bank within 120 days. If the LC is Usance LC Bi. Bi. Ni. Fa No. 4 (Gha) should be filled. If the dollar payment has to be made then 10% of cheque amount should be kept as mortgage to the custom office, whereas in the Tatopani custom office 15% of the cheque amount should be kept and then only the Bi. Bi. Ni. Fa No. 4 should be released. The cheque should contain LC no. Applicant name, invoice no. foreign currency amount, beneficiary's name and the serial no. Bi. Bi. Ni. Fa No. 4.

13. In case of a sight payment the documents are released only if the buyer reimburses the LC amount or the client can ask the bank to convert the LC amount to T/R loan.
14. In case of the usance LC if the client has time to pay the LC amount within 180 days the bank will have to take a risk and hold the certain amount of cash margin and then the goods are released. The client can convert the LC amount to T/R loan but the maturity period is not more than 180 days. At the end of the LC period the client has to reimburse to the bank if the client renege from its obligation then the bank can go legally to get the amount back as before opening an LC there are various securities held by the bank to be at the safe side.

2.2.6. Amendment of LC

If the client finds a need of change in the LC then the Amendment is required. For this the client has to request for amendment and the letter should be signed by the authorized person. The bank has to clearly check whether the amendment do not violate any NRB directives and hold a valid reason with it. Bi. Bi. Ni. Fa No 3 should be filled and signed properly. In an LC there may be a discrepancy in the Proforma invoice and the commercial invoice and it cannot be considered then the amendment is required. The revised/additional Proforma Invoice has to be submitted. The amendment form is also called F.56 form and it contains the Reference No. of LC, the detail information about the beneficiary. This form is basically filled if there is a need of change in the extension in latest shipment date, negotiation date, the increment or the decrement in the LC by certain amount remaining other terms and conditions unchanged (Sayers, 1967:53).

After the form is filled by the client and do not violate the terms and conditions prescribed by NRB, then the new Proforma invoice should be properly assessed. The LC opened for more than USD 50000 should be approved by the Central Office.

2.2.7. Cancellation of LC

Since the LC opened in NIBL is Irrevocable in nature the LC cannot be cancelled through just one party, for the cancellation of LC the consent of both parties is required. The buyer can cancel the LC before the goods have been shipped by the seller, but if the seller has shipped the goods then he would not agree to cancel the LC. There can be various personal as well as business problem which lead him to cancel and LC.

2.3. Regulatory Environment Analysis for L/C

Letter of Credit is considered as one of the widest accepted and safest mode of payment. However there are other modes of payments which are also equally used for domestic and international payment. But, in Nepalese context L/C is relatively important because it is mandatory as per the Central Bank.

Another major dominant issue of L/C business is its profitability for the banks. The banks take L/C as one of the most happening business for them. The banks further benefit from commissions in foreign currency exchange involved in L/C business. The scope for L/C business is ever increasing as it is based on the international trade of the country. Due, to all these factors the L/C service is an attractive business for the banks. Besides, L/C transactions takes place in between the buyers and suppliers of two different countries and in the due course banks as the mediator and guarantor on behalf of each of these parties.

Thus, L/C business involves a huge amount of money and profits, and also links banks all over the world. So the banks, buyers and suppliers are heavily regulated in this context. Different national and international rules govern the L/C business. The regulatory environment for L/C is analyzed below.

2.3.1 National Regulatory Environment

NRB is the regulating authority for commercial banks, so NRB is responsible for formulating rules and regulations concerning L/C as well. The major rules and regulations as prescribed by directives and Circulars of NRB are as follows:

What is in the Local Rule?

The local rule does not allow Advance Payment ¹ and all import has to be done through L/C. However, recently central bank has allowed import through advance payment up to US \$ 3000 with certain conditions. Like the shipment has to be received from Air only, payment date must be prior to the date of airway bill date etc. Besides that NRB has also allowed the importer to import goods through Advance Payment if the shipment has to be made from Tibet through Tatopani Customs. Besides, these all other imports from any other country exceeding the volume of US \$3000 require establishing L/C.

The old rule authorizes only the commercial banks for opening L/C. However, the new Ordinance BAFIO has also allowed development banks for establishing L/C.

Who are eligible for opening L/C?

- Registered industries
- Registered Trading firm/ companies whose objective is import
- Government offices, companies, corporations etc.
- Diplomatic offices
- Any other registered entities

What documents are required?

- Renewed income tax or PAN certificate
- Renewed firm registration certificate
- Proforma invoice/ indent/ contract duly accepted by the buyer having beneficiary's detail, eight digit harmonic code and country of origin
- L/C application form duly filled up and signed by the authorized signatory(s).
- Bi.Bi. Ni. Fa. No. 3² in 3 copies duly signed by the authorized signatory(s).
- Personal Guarantee (if the facility exceeds the approved limit³)

¹ Paying in advance before the shipping of goods

² Form prescribed by NRB

³ Limit sanctioned by the bank

- Corporate Guarantee if the client is using the limit of sister concern

What are other requirements to consider upon?

- Check if the goods imported are under the jurisdiction of Law.
- To check if the license, quota, approval is required.
- To check if the goods being imported are marketable.
- To classify the goods as trading item, industrial raw materials or capital items.
- To assess the individual exposure of the client, group exposure of the client, falling due maturity, funded verses non funded exposure etc.
- To classify the L/C on the basis of its types.
- Confirmation
- Discounting
- Credit lines etc.

What are the areas where prior approval is required for opening L/C?

- Export/ Import of Alcohol
- Quantity Restriction on Poppy Seed
- Import of Old/Used Cloth, Metal and Plastic Scraps and Second hand Equipments
- Ozone Depleting Substances

Thus, these are the major areas of regulation for L/C clients and service providers in context of Nepal.

Note: The unofficial translation of Circulars issued by NRB in context to L/C is included in the annexure.

2.3.2 International Regulatory Environment

The international rules and regulations that govern the L/C operations are ISBP and UCPDC 500. The ISBP stands for International Standard Banking Practice. It aims in bringing consistency in international banking services through out the world. It is used for

the examination of documents under Documentary credit. It includes provisions regarding application and issuance of documentary credits, certifications and declarations, corrections and alterations etc. The UCPDC stands for Uniform Customs and Practices Documentary Credits. This is applied to all L/C transactions and the parties involved in the transactions. It includes definitions for related terms and words used in course of L/C transactions. It further includes provisions on liability and responsibilities of the issuing, advising, confirming banks etc. It also includes provisions for confirmation, declaration, certifications etc.

Thus, these are the major components of regulatory environment of L/C. Nepalese commercial banks currently providing L/C services are also following these rules and regulations. NRB supervises the commercial banks in this regard and takes actions in case of failure to abide by these rules.

2.3.3 Market Size for L/C at Present

At present, all the trade finance activities are being carried out only by the commercial banks and other financial institutions are not permitted to carry out L/C activities at the present. This gives the commercial banks the monopoly over international trade finance which is considered quite profitable as it generates byproducts for the banks such as packing credit, trust receipt loan, operations of current account, overdraft and so on i.e a single activity can create a chain effect in the bank. The major players in foreign trade activities are Himalayan Bank Limited, Nepal Investment Bank, Standard Chartered Bank Limited, etc or the banks that are well established. The recently established commercial banks such as Laxmi Bank Limited, Kumari Bank Limited, and Siddhartha Bank Limited etc are the new players coming into the L/C market. These banks are looking forward towards making a strong hold in this sector.

The L/C sector, previously just assessable to the commercial banks will now also be opened for development banks after the new Ordinance is enacted. So, the commercial banks will now need to compete with the Development banks who are preparing themselves to venture out in this segment of the economy. This implies that although the market size will remain

more or less the same, the banks will face intense competition to keep the share of their market.

2.3.4 Market Growth

The growth of the banking industry has been quite remarkable in Nepal as new banks both commercial and development get established every year. The market has grown in the sense that there has been increase in deposit portfolio, increase in loan portfolio, the menu of financial services offered by the banks etc. As the trend for banking services is growing and is being demanded by the people the banks are coming up with new and innovative concepts, products and services to strengthen their hold in the market and are looking for opportunities for growth that contributes to the development of the economy of the country.

2.3.5 Market Growth for L/C

The growth for L/C depends upon the growth of international trade for the country. So, the market growth rate for L/C transactions has not been up to expectations over the years especially in the export sector of the country. The reason for which is the shutdown of many export oriented industries, political instability in the country and the rules and regulations governing the foreign trade. However, the import figures have been rising continuously. Although, trade figures are rising with certain fluctuations now and then, the true picture about the trade scenario can be observed through the constant rise in trade deficit of the country. The balances of foreign trade for the past 10 years can be observed from the table 2.1 below:

This is a provisional statement of foreign trade balance in Nepal indicating the huge gap between the import amount and export amounts which is growing each year indicating the dominance of import trade over export trade. This shows the increasing demand for L/C especially in the import segment of the economy.

Table 2.1 Export and Import Figure of the Country for the Past 10 Years**F. Y. 1994/95 to F. Y. 2003/04**

Value in '000 Rs.							
Fiscal Year	Exports	% in	Imports	% in	Total Trade	Total	Trade Deficit
		Total		Total		%	
1994/95	17,681,253	21.8	63,324,840	78.2	81,006,093	100.0	45,643,587
1995/96	19,758,388	20.7	75,896,306	79.3	95,654,694	100.0	56,137,918
1996/97	22,861,951	19.8	92,874,671	80.2	115,736,622	100.0	70,012,720
1997/98	27,402,244	23.6	88,894,771	76.4	116,297,015	100.0	61,492,527
1998/99	35,269,272	27.7	92,003,390	72.3	127,272,662	100.0	56,734,118
1999/00	49,561,028	30.4	113,687,149	69.6	163,248,177	100.0	64,126,121
2000/01	55,245,900	31.7	118,786,609	68.3	174,032,509	100.0	63,540,709
2001/02	47,386,788	30.4	108,634,801	69.6	156,021,589	100.0	61,248,013
2002/03	50,011,122	28.1	128,228,134	71.9	178,239,256	100.0	78,217,012
2003/04	54,416,614	28.2	138,752,735	71.8	193,169,349	100.0	84,336,121

2.3.6 Technological Advancements in Banking Sector

Technology and Banking, in the modern time goes side by side and can be considered as vital element of the bank for efficient operations, quality service delivery and to remain competitive. The use of telecommunications, networks and computers are increasing the economies of scale and economies of scope for the banks. The use of technology has created a platform for fast and efficient service deliveries and depersonalized banking. Considering the fact that banks deal with hundreds and thousands of data and transactions everyday, the proper management of data and workflow is a must. The banks also handle information that are sensitive and need to be protected. Thus, the use of information systems, application software packages and network became a necessity for efficient and

effective banking processes. The popular banking software packages used in the present days are Pumori, Pumori Plus, Finacle and Globus etc. to name few. The banks are also updating themselves with latest technologies and investing huge amount of money for the same. The use of Internet, VSAT, and Intranet etc. is also increasingly becoming popular in Nepal (Upadhyaya, 2004).

The banking sector is now offering plastic money in the form of credit cards, debit cards, ATM cards etc. that have resulted from technological revolution and product innovation. Technology has further enhanced the banking sector by making access to banking services easy through the use point-of-sales machine, Any Branch Banking Services (ABBS), Tele Banking etc. The technology can also contribute to L/C operations by assisting in Online processing, Online tracking of documents, providing information on the net etc.

In context to NIBL, technology has also played a big role and it is the first commercial bank to provide ATM and POS services to its customers with computerized infrastructure using the Pumori Plus software to support its business processes.

2.3.7 Product and Services

The various services and products offered by the banks are similar in nature, however, the banks tend to differentiate themselves and their products through service delivery techniques, brand image, non-financial services etc. The products and services that are offered by all the banks in general are accepting deposits from the general people and mobilizing the funds to for productive use through loans.

Service proliferation and product differentiation is the major trend in the banking industry as the banks thrive to make the similar services and product distinct from those of other banks. Service proliferation is the result of increased competition from other financial institutions that are forcing banks to rapidly expand their menu of financial services and differentiate their products in order to be competitive. The banks are becoming more innovative and creative in their services and products such as credit cards, debit cards, online banking, tele-banking and so on.

The banks are also looking for opportunities to differentiate **L/C operations** by adopting online L/C processing. This will enhance efficiency and reduce the lengthy processing time in processing and approval of L/C documents.

2.3.8 Capital Requirement

As per the directives of NRB the capital requirement for commercial and development banks as per the old directives and new Ordinance is as follows:

Table 2.2 Capital Requirement for Commercial and Development Banks

	Old Directives	BAFIO
Institution	Minimum Paid Up Capital	Minimum Paid Up Capital
Commercial Banks based on Kathmandu Valley	500 Million	1000 Million
Commercial Banks outside Kathmandu Valley	250 Million	500 Million
National Level Development Banks	160 Million	320 Million

Source: Bank and Financial Institution Ordinance, 2036

Existing commercial and development banks registered under old directives are required to raise their capital fund to minimum RS. 1000 million and Rs. 320 million respectively by Mid July 2009 through minimum 10% paid-up capital increment every year

Generally, minimum 30% shares should be sold to common public. This limit can be reduced to 20% only when foreign banks hold minimum 50% shares in a bank. Foreign banks can hold maximum 67% stake in a bank.

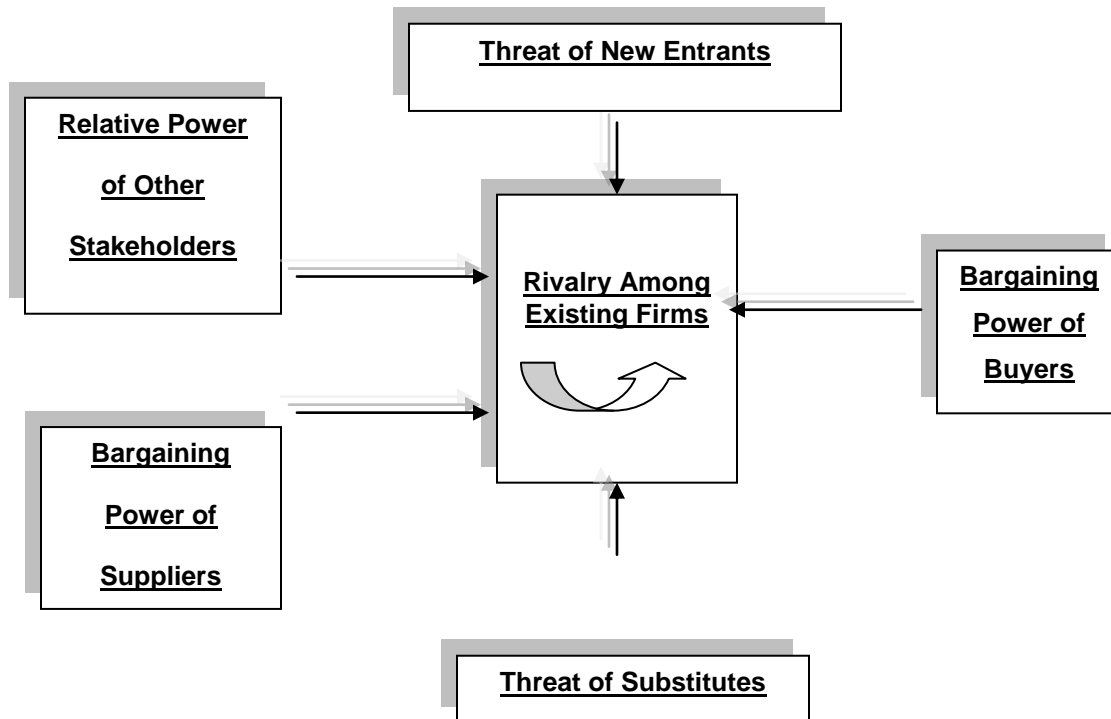
2.4 Porter's Industrial Analysis

2.4.1 Introduction to Porter's Industrial Analysis

An **industry** is a group of firms producing a similar product or service, such as financial services or soft drinks. **Michael Porter** contends that a company is most concerned with

the intensity of competition within its industry. The level of this intensity is determined by basic competitive forces. Porter says: "The collective strength of these forces," he contends determines the ultimate profit potential in the industry, where profit potential is measured in terms of long-run return on invested capital."

Figure 2.1 Porter's Approach to Industry Analysis



In carefully scanning its industry, the corporation must assess the importance to its success of each of the six forces (Sayers, 1967:67):

- Threat of new entrants
- Rivalry among existing firms
- Threat of substitute products
- Bargaining power of buyers
- Bargaining power of suppliers.
- Relative power of other stakeholders

The stronger each of these forces, the more limited companies are in their ability to raise prices and earn greater profits. A high force can be regarded as a threat, since it is likely to

reduce profits. A low force, in contrast, can be viewed as an opportunity, since it may allow the company to earn greater profits. In the short run, these forces act as constraints on a company's activities. In the long run, it may be possible for a company, through its choice of strategy, to change the strength of one or more of the forces to the company's advantage.

2.4.2 Conducting Porter's Industry Analysis

Threat of New Entrants

Banks are one of the world's heavily regulated business industries and in Nepal, NRB, the central bank of Nepal has been authorized to regulate, supervise, inspect and follow up on the financial institutions dealing with public money. This implies that NRB regulates and controls the area of establishment of banks and has set up requirements and mandatory that must be fulfilled. The major factor is the capital requirement to be fulfilled as a bank that makes the entry in to this industry very difficult. The Central Bank is also very cautious about giving approval/recommendation and license for establishment unless all necessary requirements are met as prescribed by it, so it is quite difficult for new banks to enter the financial arena as per the new Ordinance. The threat of new entrant in regard into L/C at present is quite substantial as the new act has provisions for commercial banks to carry out foreign trade and there are national level commercial banks are that preparing to grasp this opportunity.

Rivalry among Existing Firms

The banking industry is faced with rising competition for deposits, loans and services. The number of players in the industry has also increased significantly over the past 10 years. The banks face competition from not only other banks but also the rising number of finance companies, cooperatives etc. The trend of service proliferation has also driven banks to compete with innovation and creativity by providing attractive value added services to the customers. The customers are considered to have benefited from the intense competition in the market as they are receiving quality services at low cost. All these facts show that there exists high level of rivalry among the existing firms in the banking industry.

The competition in the L/C market is also quite heavy; all the 17 commercial banks are competing to attract the same set of customers. The competition in this sector of business is not explicit as the interest rates are not published are unique to each bank plus negotiable by the client. On the other hand, no marketing is conducted to attract customers in this sector as L/C business is quite a sensitive business and internal networking and relationship is used to identify good clients and efforts made to sustain existing good customers.

Bargaining Power of the Buyers

The buyers in the banking industry are the depositors and the customers using the various services such as loans and advances, credit card facility and so on. The bargaining power of the buyers does not impact the bank to a large extent as the rules and regulations to be followed by the banks remain unaffected by any cause. The regulatory environment for banks overshadows all other decisions for the bank so bargaining power of the buyers is not always the determining factor. The buyers of the bank services have a limited if at all any bargaining power. In context to L/C services, the buyer or the client has a bargaining power to certain extent as the interest rates in L/C are negotiable and fluctuate from time to time.

Bargaining Power of the Suppliers

The suppliers in the case of bank industry are difficult to define explicitly as in case of other industries such as manufacturing, trading etc. The suppliers for the bank could be the stationery suppliers, software and hardware suppliers, credit card suppliers etc. The bargaining power of suppliers in this case can be considered negligible. This is same with the case of L/C as well (Parker, 1973:45).

2.4.3 Relative Power of Other Stakeholders

The Central Bank of Nepal, NRB has a major influence on the banking industries as it is the main regulatory body that regulates and supervises the activities of financial institutions. The approval of NRB is compulsory for banks to be establishes, operated or even closed. The other major stakeholder in the industry is the Bankers' association of Nepal, BOD, employees and the shareholders of the bank. In this case the power of NRB in fixing rules

and regulations is quite high. Further, the growing HR concerns have added to the power of employees. Similarly, the banks are always accountable to its shareholders and a provision for public director identifies the power of shareholders. Thus, the power of stakeholder in the banking industry is quite high. L/C operations are also guided by the rules and regulations of NRB so the power of NRB cannot be undermined in any case. While the power of other stakeholders is quite low in case of L/C (Upadhya, 2004).

2.4.4 Threat of Substitute Product or Services

The threat of substitute product or services in banking industry is also becoming quite high as other institutions have also started to provide core banking services such as loans and deposits. The rising trend of finance companies, leasing companies, cooperatives etc. could pose loss of market share by the banks. However, threat of substitution of banking services and products is highly unlikely.

Porter’s Industry Analysis with Regard to L/C

Table 2.3 Summary of Porter’s Approach to Industry Analysis in case of L/C

	High	Medium	Low
Threat of new entrants			
Rivalry among existing firms			
Bargaining power of buyers			
Bargaining powers of suppliers			
Relative power of other stakeholders			
Threat of substitute product or services			

2.5 Review of Thesis

Shrestha (2008) conducted a study on “*SWOT Analysis of Nepal Bank Limited*” with the objective of:

- a) To Review strength & weakness of Nepal Bank Limited in it’s major areas of operation.

- b) To explore areas of opportunities and threats to Nepal Bank Limited prevailing in the changing context.
- To show a suggestive package based on the findings of the study for the improvement of the financial performance of Nepal Bank Limited.

On the basis of the various studies and analysis major findings of this study are presented below:

- i) Liquidity Position of sample bank seems quite near or an average. It is obvious that in the present situation of the country, investment potentiality is not favourable so the liquidity in the commercial banks is sufficient.
- ii) The sample commercial bank has high volume of non - performing assets with respect to the total assets i.e. 0.30.
- iii) There was a situation of continuously negative profit in Nepal Bank Limited till the FY 2059/60. Therefore, all the indicating factors to represent the profitability are in negative in Nepal Bank Limited. NBL was generating interest income from its credit on average of 7.0%. If we take the volume of net profit in NBL, It was 1323 million in the FY 2061/62.
- iv) Because of the negative profit up to 2059/60, NBL has negative earning per share. But from the FY 2060/61, it can earn profit and its earning per share is positive. But average EPS of NBL was Rs 307 in the study period.
- v) Credit and Investment to total deposit ratios of Nepal Bank Limited was 78% on an average for the study period. Similarly correlation between deposit and loan and advance was negative correlation in Nepal Bank Limited for the study period. This indicates that trend of deposit utilization in RBB was poor.

Sharma (2009) conducted a study on “*Comparative SWOT Analysis of Nepalese Commercial Joint Venture Banks (Standard Chartered Bank Nepal Ltd., Nepal Arab Bank Ltd. and Himalayan Bank Ltd.)*” with the objective of:

- To study and analyze the growth, objectives, functions, and role of the commercial Joint Venture Banks
- To evaluate the comparative financial strengths & weakness of three competitive JVBs.
- To provide package of suggestions and possible guidelines to improve the banking operation in order to maximize the values of their shareholders based on the findings of the study.

On the basis of the various studies and analysis conducted above, the following are findings of the study:

- a) Banks are primarily profit making organizations that provide a range of financial services to their customers. On the basis of the profitability, the selected JVBs are among the top five commercial Banks operating in the country, Standard Chartered Bank Nepal Ltd., being the top one. The profitability position of SCBNL & NABIL is better than that of HBL in terms of Return on total assets and total deposits.
- b) Interest incomes form the major portion of the total income in all these selected JVBs during this study period. Likewise, interest expenses cover the major portion of total expenses in these banks.
- c) HBL has been seen to adopt the aggressive lending policy during the period of this analysis. It has been mobilizing a large portion of its Total deposits on Loans & Advances. The Loans & Advances of HBL has always been greater as compared to SCBNL & NABIL during this whole period under analysis.
- d) In case of all three JVBs, debt financing has always almost exceeded 90 % of the Total Assets over the review period, which indicates the excessively geared capital structure of these banks, which signifies the excessive use of debt to finance Total Assets. The high 'Total Outsiders' Fund to Total Assets' ratio implies bank's success in exploiting debts to the more profitable assets. Since all the JVBs had been extensively using debt financing to the total assets, it can be concluded that these banks are highly levered.
- e) The analysis reveals that all the JVBs have limited their Net Fixed Assets to Net worth Ratio at adequate level. Banks being the non-manufacturing enterprises have the

minimal investment of owners' equity in the fixed assets in order to maximize the return on shareholders' fund.

- f) The investments of all these JVBs are found to be more or less volatile. In some years, they are in the increasing trend whereas in other years, they are in the decreasing trend. This might be due to the instability in the political & economic situation of the country, which created an environment of chaos in the overall economy including the banking industry.
- g) The comparative strength of SCBNL is better as compared to NABIL & HBL as per data and as per the analysis done in the various sections. One the primary objective of the commercial bank is to maximize the profit. The SCBNL has dominated in this regard during almost the whole period of study except for one or two cases where NABIL took off. However, the profit before tax of all three banks is in the increasing trend.

2.6 Research Gap

Very few specific researches have been undertaken on the subject related to the Letter of Credit (L/C). The researcher felt research gap and has conducted research on this topic since very few other research has been undertaken to assess the Letter of Credit (L/C). It is necessary to research about the Letter of Credit (L/C). The flow of investing pattern of commercial banks so far as banking product such as Letter of Credit (L/C) and deal in foreign currency are concerned. Hence, this research covers what factors affect the commercial banks to invest in Letter of Credit (L/C) and deals in foreign currency are preferred by the customer. And also assess Letter of Credit (L/C) regarding the investment decisions in selection banking product. So, this study will be fruitful to those interested person parties scholars, professor, students, businessman and government for academically as well as policy perspective.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Research Design

The most dominant part of this whole study is the design of research and its implementation to gather required data and figures. The availability of data was not easy as L/C is more of a relationship business. Besides, no individual are allowed to open L/C, only registered firms are entitled to open L/C so determining the sample size and choosing the sample organizations for customer survey was also difficult. The chosen ones were also reluctant in providing information about the interest rates on the export and import credit (given on basis of L/C) which was often negotiable between the banks and the client on the basis of their relationship.

3.2 Population and Sample of the Study

The study was conducted on two different areas. The first was the industry analysis and the second was the customer analysis. Thus, for these two different areas, different populations and different samples with varying sample sizes were considered for the study. Now we shall analyze these population and samples in detail:

Population Study for Industry and Competitor Analysis

The population for the industry analysis is all the commercial banks and the Kathmandu based development banks. The commercial banks are allowed to carry out L/C operations as per the existing law. 26 commercial banks currently providing L/C facility to the clients is the part of the population mentioned.

Sample Size Determination for Industry Analysis

The organizations that require opening L/C for conducting their business is the population for the study. The information about the L/C openers on the sector wise basis was identified through the in depth interview with personnel of commercial banks taken for the study.

Other related subjective aspect of the customers was also revealed during the interviews. However, the objective information about interest rates, etc were not easily available from the interview so approximate figure was used to analyze the population. The major identified sectors where L/C clients operate as based on information provided by existing players are as follows:

- Garment Industry
- Steel and Iron Industry
- Banaspati Ghee Industry
- Electronic Equipment Traders
- Medicine and Chemical Industry
- Confectionery products Traders

For all these organizations, the export and import volume should be more than US \$ 3000 for opening L/C. Thus all these organizations serve as the population base for L/C clients to be selected for the survey. However, the population size is reduced to Kathmandu Valley because of the following reasons:

- As per the information collected from the unstructured interview that maximum L/C clients have been experienced inside the Kathmandu valley
- Time and cost constraint to make a research outside Kathmandu valley
- Under the predetermined scope of study

Sample Size Determination for Customer Analysis

Since the population for the L/C clients is all the registered organizations that require opening L/C so it was difficult to determine the sample size. The unavailability of proper statistics on L/C clients further made the sampling process hard. However, the sample size has been drawn in such a manner that it gives most of the relevant information with maximum accuracy and in a convenient way. No calculation could be done to find the appropriate sample size, as the exact population could not be calculated. The sample size has been chosen in such a manner that it would be enough to provide all necessary

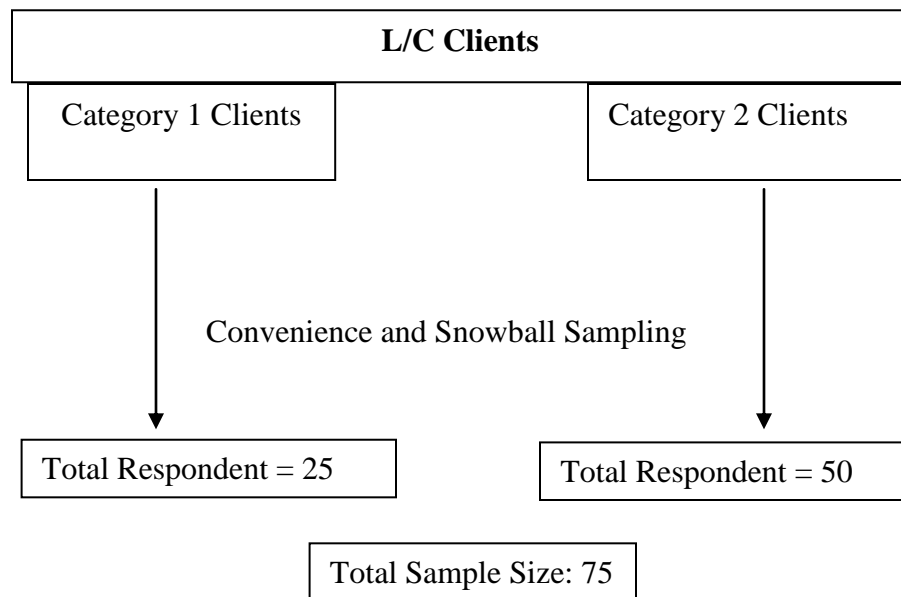
information. Under the guidance and recommendation of the internship supervisor at NIBL total sample size of 75 respondent organizations was taken to get the required information. However it was not possible to segregate the organization on the basis of their types (manufacturing and trading), and on the basis of L/C they open / receive (Export and Import L/C). During the sample calculation Stratified cum Convenience and Snowball sampling⁴ methods has been used under the geographical distribution.

Stratified cum Convenience Sampling and Snowball Sampling

The whole population has been divided into two major strata as follows:

- **Category 1:** L/C clients who have some sort of relationship with NIBL, like they have an account at NIBL, they are enjoying credit from NIBL etc.
- **Category 2:** L/C clients who are not at all associated with NIBL

25 respondents are taken from the first strata whereas 50 remaining respondents are taken from the second strata. However, while choosing the respondent under these categories, convenience and snowball sampling was used. Besides, the personal and family contacts of the respondents were also used.



⁴ In Snowball Sampling, one respondent is asked to refer to another respondent and thus the chain of respondents is formed

3.3 Sources of Data

Methodology basically deals with the sources of data i.e. from which sources the data has been collected. Data required for the preparation of this report will be collected from two sources;

Primary Source: primary data has been used for preparing this study. Primary data is more valid and up to date for making any analysis and interpret the result but at the same time needs processing and evaluation for making any kind of decision. Primary has been collected from the field directly.

Secondary Source: For preparation of this report secondary data also has been collected. This secondary source consists of two sources. One is internal source and another is external source. The sources of information collected were namely as follows:

Internal sources:

- Annual report of the Bank
 - Balance Sheet
 - Income statement
 - Interest rate chart

External Sources:

- Book Publications
- Banking statistics of NIBL
- Internet
- Directives from NRB

3.4 Nature of the Data

The research is conducted in the L/C market which is currently being occupied by the 26 commercial banks. The research was conducted through in-depth interviews with bank personnel of Trade Finance Department that carries out L/C operations, questionnaire

survey on the L/C clients and financial analysis of the commercial banks taken for the study. Secondary information was also collected from different reports and publications of the respective banks as well as NRB.

3.5 Study Approach

The major phase for the study along with the type of research carried out in each phase is as

Phase 1: Observation and Adaptation

In the initial phase of the study, the working environment of NIBL was observed. The working practices, the culture followed in the bank was further observed. The rules and regulations that bind all the employees of NIBL were also experienced. This helped to adapt in the bank along with carrying out the assigned works in the various departments.

Phase 2: Exploratory Research

The exploratory research was conducted to identify the possible opportunities that the Class A Institutions i.e. commercial bank. Like any other commercial bank, NIBL had opportunities to have current account, deal in foreign currency and its remittance, provide L/C services etc. Thus as a part of exploratory research, an unstructured interview was conducted with the employee of NIBL, to identify the opportunities and the ways to take advantage of these opportunities.

Phase 3: Descriptive Research

In this phase, descriptive research was carried out to prepare a strategic plan for L/C operation in NIBL. The need for planning and preparation was materialized in this phase by preparing a strategic plan to ensure profitable L/C operations. Since L/C is the old venture for commercial banks, adequate preparation was required and this research facilitated the preparation by gathering information on different aspects of L/C operations and the L/C market. The bank has to enter the already crowded L/C market so it is important for the bank to have the good strategic posture. The descriptive research comprises mainly of two types of research. They are:

- Qualitative Research
- Quantitative Research

In the course of qualitative research, in depth interviews were carried out with personnel of L/C department of different banks. Further, questionnaire survey was done for the L/C clients. The rules and regulations were also studied. Whereas, in course of quantitative research quantified data were used to find the size of L/C market, demand for export and import credit, applicable interest rates, etc.

Qualitative Research

The qualitative research comprises of following different types of research:

The in-depth interview was held using unstructured open-ended questionnaires so that more qualitative and wider information could be collected from the bank personnel regarding the L/C operations in those banks. This further contributed in understanding the practical facet of L/C. The complexities and the technicalities involved were also evaluated in this phase. The subjective analysis of customers' expectation, their requirement, etc was also done being based on the clients served by the particular bank. This served as the basis for designing questionnaire for the customer survey as well.

3.6 Questionnaire Survey on the L/C Clients

The questionnaire was circulated and administered by making personal visits to the organization that requires opening L/C for carrying out their business. The questionnaires were filled by the existing NIBL clients who take L/C facility from other commercial banks and the L/C clients who had no relationship at all with NIBL. This helped in assessing the internal strengths and weaknesses of the bank. The understanding of strengths and weaknesses contribute in proper strategy formulation for the bank. The competence and the potentials along with the capacity of the bank were evaluated in this phase. Further, the future plans of the bank were also considered.

3.7 Data Analysis Tools and Techniques

The data were analyzed using SPSS software and Microsoft Excel. SPSS is data analysis software, which helps, is easy data entry and easy analysis. However, for the purpose of graphs (Bar Chart, Pie Chart, Histograms, Frequency charts), Microsoft Excel has been used. The data analysis techniques used during the study were as follows

- **Frequency Distribution**

It summarizes the number of times different values of a variable occur. It further includes calculation of mean, median, mode etc.

- **Chi square test**

It tests the hypothesis that the row and column variables are independent, without indicating strength or direction of the relationship

- **Cross tabulation**

The Cross-tabs procedure forms two-way and multiway tables and provides a variety of tests and measures of association for two-way tables. The structure of the table and whether categories are ordered determine what test or measure to use. Most of the analyses have been done on percentage so that it gives much clearer picture of the results.

CHAPTER IV

DATA PRESENTATION AND ANALYSIS

4.1 Nepal Investment Bank Limited as a Major Player in the L/C Market

The investment bank is one of the major players in the L/C market. The bank is facing rapid growth in all of its service aspects including L/C. So, its market share in terms of L/C is increasing thus upgrading its rank among the banks. The clientele base of L/C clients for this bank is also quite high than other banks. The analysis of other aspects of L/C is done below under different headings.

4.1.1 Nature and Size of Clients Served

The major L/C clients for NIBL are the industrialist. These clients are marketed by the bank on the basis of personal and service relationship with the clients. The high satisfaction level for the clients with regard to other services of the bank contributes to the increment in L/C clients for the bank. On average the bank serves 40 - 50 clients at a time. However the overall clientele base of the bank is approximately 150 business houses. NIBL clients are from various sectors. The majority of import L/C clients are Oil and Ghee manufacturers, Steel and Iron manufacturers, Plastic product manufactures that import plastic granules etc. However, the export L/C is dominated by exporter for garments and handicrafts.

4.1.2 Economic Variables

The bank provides credit facility on the basis of L/C transactions. This credit facility is further based on collateral or the cash margin. The interest rate structure for the T/R loan ranges from 6.75% to 14%. However for Packing Credit it is 4% on dollar account and it ranges in case of IC account. The commission rates applicable are approximately 0.125% per quarter on dollar and Euro account and 0.24% per quarter on IC account. However, the commission rates are higher for the trading clients. But, these rates are negotiable on the basis of volume of transaction and relationship.

4.1.3 Competitors

The major competitors for NIBL in the L/C market are HBL, NABIL, and SCBNL etc.

4.1.4 Customers' Preference for NIBL

The customers prefer NIBL due to the following strengths of the bank:

- Good Network
- Less Problem in Confirmation
- Cost factor (negotiable)
- Credibility of the bank due to no default cases at all

Problems faced by NIBL

The problems faced by NIBL are as follows:

- Complex NRB rules and regulations
- Frequent amendments in rules and regulations
- Increasing competition

L/C Department Set up

The L/C department in NIBL consists of one departmental head followed by 14 assistants. The department is further divided into Import, Export and Guarantee so the assistants are divided according as per the volume of work in each sub division. The major infrastructure for the department includes computers, furniture and filing system. The computers are provided on 1:1 basis. NIBL also focus on proper documentation and its retrieval. This helps the bank in avoiding default cases and also enhancing processing efficiency.

Thus, these are the major issues that are considered by NIBL so as to result itself as the major player in the L/C market.

4.2 VRIO Analysis

The VRIO Analysis of NIBL answers four questions in order to evaluate the Bank's key resources:

- **Value:** Does it provide competitive advantage?
- **Rareness:** Do other competitors possess it?
- **Imitability:** Is it costly for others to imitate?
- **Organization:** Is the firm organized to exploit the resources?

4.2.1 Value

NIBL has various aspects that provide it with a competitive edge over other competitors. NIBL, at present, is one of the national level commercial banks to provide the shareholders with dividends. NIBL is also one of the ISO 9001:2000 certified banks in the industry that provides quality banking services with a faster response towards customers compared to competitors. The composition of the Top Management and the BOD of the bank, who are all well-reputed in their own fields, also provides an advantage to the bank in the form of goodwill and trust towards the bank. The friendly and conducive internal environment in the bank and the good working relationship among the employees and management has greatly increased the productivity of the bank, leading to happy customers and shareholders. Although the bank has been in the industry only for the past four years, it has been able to make a good impression in the market by exhibiting professionalism, transparency, and hard work.

4.2.2 Rareness

The competencies possessed by NIBL can also be found in most of the commercial banks, but there are hardly any commercial banks that have been able to match up to NIBL in terms of services provided by the bank. For instance, NIBL is the only ISO 9001:2000 certified bank and works under the principle of 'Quality Management'. NIBL is also considered to be the commercial bank that has been successfully competing with the commercial banks. NIBL has also been awarded as the best financial institution in the category of commercial

banks by NRB and Financial Times London on the occasion of its golden jubilee. NIBL is also the second joint venture bank to provide ATM and POS service after the deal with Smart Choice Technologies (SCT).

4.2.3 Imitability

In the banking industry it is not very easy to imitate others as this requires a lot of cost, time and effort. Imitating the technology, strategies, Top Management and other resources of a bank is not always feasible. Thus, copying the bank's goodwill, public image and competencies both core and distinctive is not as easy as it seems. Considering these facts, it is not very easy for others to copy NIBL. The competitors would need to work hard to gain the brand image of NIBL, achieving the quality certification in itself would require a lot of hard work and patience as well as costs to organize the bank as per requirements of the certification agency and it is also hard to imitate the qualified workforce and Top Management of NIBL.

4.2.4 Organization

NIBL is well organized to exploit all the resources they possess and to compete with other financial institutions in the industry especially the commercial banks. The highly experienced Top Management, motivated employees, well defined strategies and policies all support for the maximum utilization of the resources of the bank.

4.3 Major Competitors

The unavailability of financial data of all commercial banks made it quite difficult to analyze the competitors in a quantified way. However, being based on the goodwill and share value of the commercial banks, NIBL was found to be in the topmost position. The banks that follow NIBL and compete with it in the commercial banking sector are Nabil Bank, Himalayan bank, Laxmi bank etc. The credibility and quality of NIBL are its major assets. In this regard, the bank is better than few commercial banks as well, so bank benchmarks and compete with newly established banks like Prime bank, Citizen International bank, Kumari Bank, Sun Rise bank etc.

4.4 Market Share of the Bank

The market share for any bank is normally analyzed on the basis of quantified data. However, due to lack of financial figures in the commercial banking sector it was impossible to determine the market share for the bank in the commercial banking sector. But analyzing the service portfolio, credibility, share value etc. NIBL can be termed as the major player in the commercial banking sector. Thus, being based on this fact NIBL can be inferred as the commercial bank with highest market share.

The financial figures of NIBL could have been compared with that of the commercial banks and the overall figure of the financial system, but these results in very negligible market share for NIBL so such a comparative analysis is not done. The huge difference in capital base of the joint venture banks with that of commercial bank makes the analysis insignificant for use. Further, the restrictions faced by development banks and the limited opportunities enjoyed by commercial banks make the basis for comparison inappropriate. So, NIBL is not compared with other development banks for determining its market share. Although both commercial and development banks operate in the same industry the market for them is differentiated in significant areas so market share analysis could not be presented.

4.5 SWOT Analysis

The SWOT Analysis for the banks is as follows:

Strengths:

- BOD, Promoters and Top Management
 - Highly reputed and influential directors/promoters
 - Qualified and experienced staff in the Top Management
- Awards received by the Bank for its performance
- Award for being the best performing financial institution by NRB
- Awarded “ Best Financial Institution” by The BOSS business magazine

- Quality Service Policy
 - The only ISO 9000 : 2001 certified Bank in the industry
 - The queuing time is less than 5 minutes for the customers
 - Fast decision making process
 - Customer satisfaction is first priority
 - Computerized system
 - Timely audit and AGM

- Pioneer in Commercial Banking Sector
 - First commercial bank to introduce ATM cards through SCT
 - Savings for corporate houses and various business organizations
 - The one of the commercial banks dealing with Forex (buying and selling)
 - The one of commercial bank providing dividend for last two years

- Staff of NIBL
 - Experienced, qualified and highly motivated workforce
 - Minimum staff but high productivity
 - Staff turnover is almost zero
 - Self governance and corporate governance is practiced

- Financial Institution with the lowest cost of fund (5.3%-5.4%)
- Customer base created through personal relationship, public relations and marketing.
- Diversified loan portfolio and deposit mix

Weaknesses:

- High one man dependency i.e. the CEO
- Medium number of branches
- The bank does not have its own property or premises regarding many branches

- The bank has reached a saturation point whereby in order to expand it has to increase its capital structure, so at present the bank is maintaining a medium profile
- The bank is less aggressive in off-balance sheet activities

Opportunities:

- The New Ordinance i.e. BAFIO has opened doors to many activities that the bank can take benefit from such as :
 - Letter of Credit
 - Foreign Exchange
 - Travelers Cheques sales and issuance
 - Issuance of Bank Over Draft
 - Safely Lockers
 - Domestic Remittance
 - Housing, Land Development and Construction
 - Leasing
- Scope for promotion of the bank from Class A to International Class under the provisions of WTO
- Scope for merging
- Branching out
- Political stability can give rise to new investment opportunities

Threats

- Intense competition in the market
- Entry of international banks due to WTO
- Implementation of BASLE II 2006 that requires to meet strict conditions regarding capital adequacy
- Instability in the country causing NPA to grow and narrowing the investment opportunities

All these strategic factors are summarized below in the table 4.1:

Table 4.1 SWOT Analysis of NIBL

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> • Highly qualified and experienced BOD, Promoters and Top Management • Awards received by the Bank for its performance • Quality Service Policy • Pioneer in Commercial Banking Sector • Staff of NIBL • Financial Institution with the lowest cost of fund (5.3%-5.4%) • Customer base created through personal relationship, public relations and marketing. • Diversified loan portfolio and deposit mix 	<ul style="list-style-type: none"> • High one man dependency i.e. the CEO • The bank does not have its own property or premises at many branches • The bank has reached a saturation point whereby in order to expand it has to increase its capital structure, so at present the bank is maintaining a medium profile • The bank is less aggressive in off-balance sheet activities
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • The Umbrella Act i.e. BAFIO has opened doors to many activities that the bank can take advantage of • Scope for promotion of the bank from Class A to International Class institution • Scope for merging • Branching out • Political stability can give rise to new investment opportunities 	<ul style="list-style-type: none"> • Intense competition in the market • Entry of international banks due to WTO • Implementation of BASLE II 2006 • Instability in the country causing NPA to grow and narrowing the investment opportunities

The SWOT analysis specific to L/C operations in NIBL are as follows:

Table 4.2 SWOT Analysis Specific to L/C Operations in NIBL

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> • Experienced personnel in the L/C field • Quality service • Information Systems that support L/C transactions • Goodwill in the market • Proper strategic planning and preparation • Proper study of regulatory environment for L/C operations 	<ul style="list-style-type: none"> • Multi Banking Organization i.e. many branches • Higher cost of fund than international commercial banks • Lower Capital base than the international commercial banks • Inadequacy of present infrastructure to start L/C operations
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • Growth of the bank • Increase in market share of the bank • Increase in international trade of the country • Scope for International exposure • Scope for larger clientele base • 	<ul style="list-style-type: none"> • Social acceptance risk to be addressed as previously few commercial banks were the players in the L/C market • Difficulty in establishing international network for the bank • Competition with commercial banks as well as development banks • Difficulty in training staff and understanding the technicalities involved in operation of L/C

Thus, these are the major strategic factors determining L/C operations in NIBL.

4.6 Customer Analysis

Customer Analysis is one of the major analyses done for preparing the strategic plan for L/C operations in NIBL. The Structured Questionnaire was designed for conducting this

analysis. As mentioned in earlier sections the population for the customer survey was the overall L/C clients or the organizations that require opening L/C. However, the sample chosen was as follows:

- **Category 1:** L/C clients who have some sort of relationship with NIBL, like they have an account at NIBL, they are enjoying credit from NIBL etc.
- **Category 2:** L/C clients who are not at all associated with NIBL

The sample size for the Category 1 is 25 whereas the sample size for Category 2 is 50, i.e. the total sample size is 75. The data collected from the survey was analyzed using different tools and techniques. The tools used were Microsoft Excel and SPSS. The techniques applied are as follows:

- Frequency Distribution
- Chi square test
- Cross tabulation

The major issues addressed by the customer survey are as follows:

- Nature and Size of L/C market
- Economic Variables in the L/C Market
- Competitors' Stand in the Market
- Customers' Preferences, Expectations and Satisfaction Level
- Potentiality for commercial Banks in the L/C Market.

The major findings from the survey are analyzed in the following way:

4.6.1 Nature and Size of L/C Market

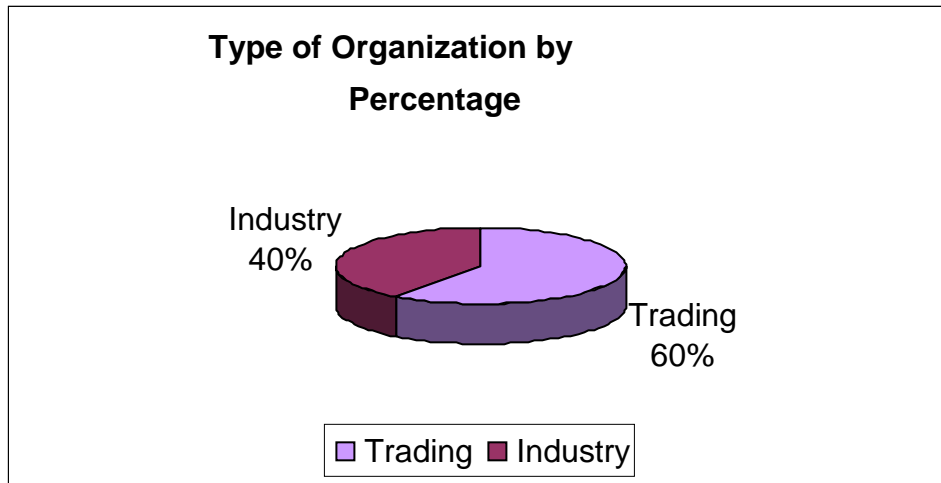
This section of the analysis includes the analysis for knowing the nature and size of L/C market at present. It consists analyses on type of organization requiring L/C, the type of L/C, the sectors in which L/C is established and received, the average size of each L/C, the average annual volume etc.

Table 4.3 Type of Organizations Opening of L/C

Type of organization	Number	Percentage
Manufacturing/ Industrial	30	40
Trading	45	60
Total	75	100

Source: Field Survey, 2066

Figure 4.1 Type of Organization Opening L/C



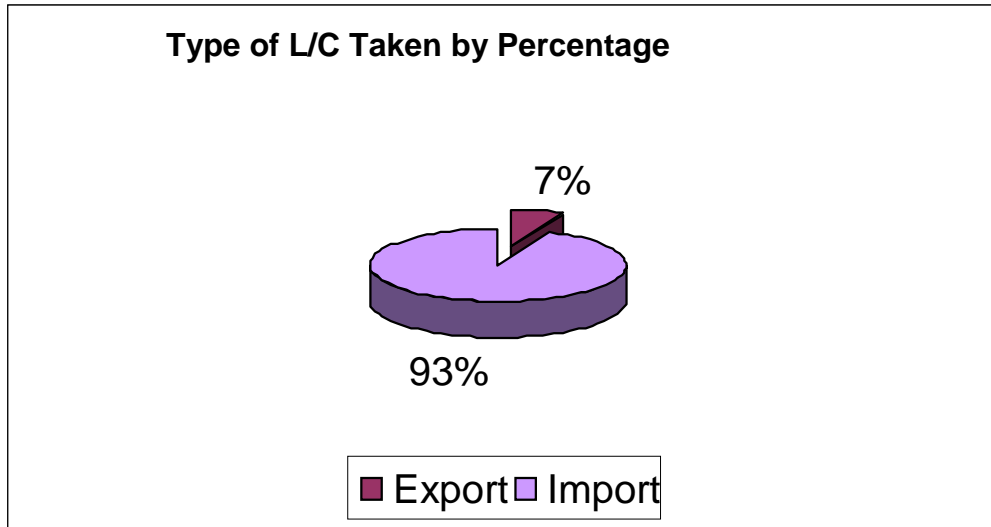
Out of the total organizations surveyed 40% was the Trading Houses and the remaining 60% was the Manufacturing/ Industrial Organizations. This figure helped in identifying the dominance of manufacturing clients in case of opening L/C. Generally, the manufacturing industries open L/C in case of importing the raw materials. In some cases it is for exporting the finished products.

Table 4.4 Type of L/C Taken by Customer

Type of L/C	Number	Percentage
Import	70	93
Export	5	7
Total	75	100

Source: Field Survey, 2066

Figure 4.2 Type of L/C Taken by Organization



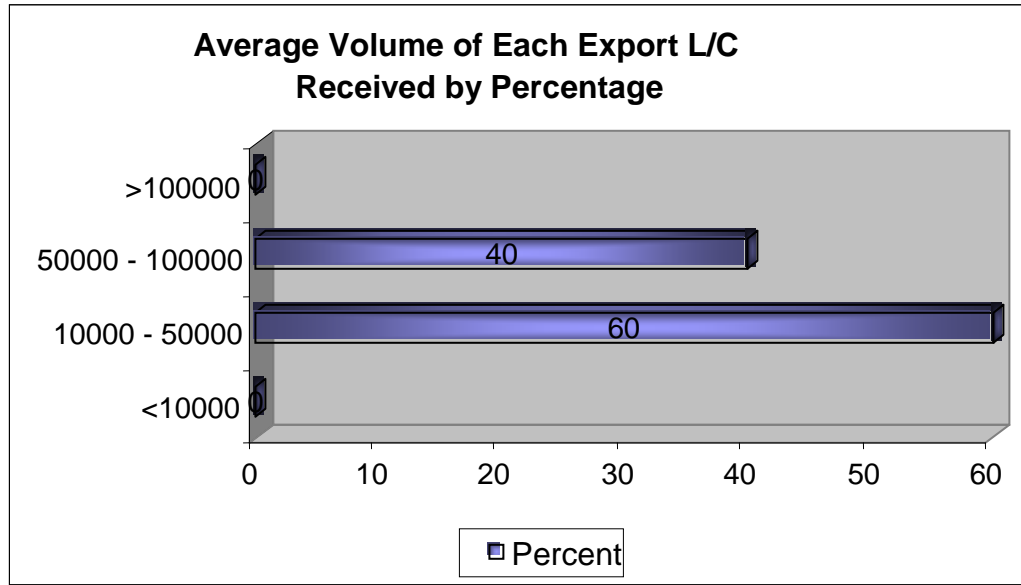
The dominance of Import L/C over Export L/C is recognized by this figure. The graph shows 93% of Import L/C being established and 7% of Export L/C received. The trade deficit faced by the country itself has contributed to this figure. This further, helps in formulating marketing strategies for L/C operations by the banks.

Table 4.5 Average Volume of Each Export L/C Established by Bank

Volume of L/C	Number	Percentage
\$ 10000-\$50000	45	60
\$ 50000-\$100000	30	40
Total	75	100

Source: Field Survey, 2066

Figure 4.3 Average Volume of Each Export L/C Received by Organization



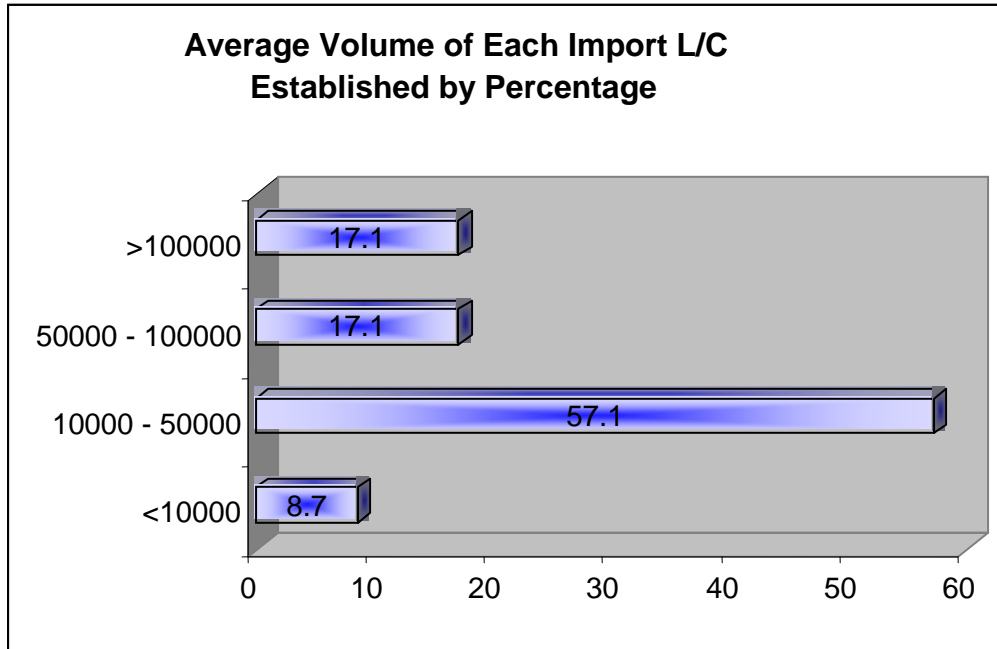
The 4.3 figure shows the ranges for the Export L/C received by the organizations. The average volume for 60% of the L/C is received is \$10,000 to \$50,000. The remaining 40% enjoys the average volume of \$50,000 to \$100,000. This helps the bank to estimate its returns with regard to volume of each L/C. It further helps in determining the average number of times the bank must facilitate the customer in a year.

Table 4.6 Average Volume of Each Import L/C Established by Bank

Volume of L/C	Number	Percentage
Less than \$ 10000	6	8.7
\$ 10000-\$50000	43	57.1
\$ 50000-\$100000	13	17.1
More than \$100000	13	17.1
Total	75	100

Source: Field Survey, 2066

Figure 4.4 Average Volume of Each Import L/C Established by Organization



The average volume for each L/C established in each range of values is given by the figure 4.4. The maximum percentage, i.e. 57.1% is for the medium sized L/C, in between \$10000 to \$50,000. This signifies that only few clients establish high volume L/C beyond \$50000 at a time. The volume of each L/C helps in segmenting the clients and facilitating them accordingly. Cross Tabulation for Type of Organization and Type of L/C is given in table 4.7.

Table 4.7 Type of Organization and Type of L/C Cross Tabulation

		Type of L/C		Total
		Export	Import	
Type of Organization	Trading	1	44	45
	Industry	4	26	30
Total		5	70	75

Source; Field Survey, 2066

The table 4.7 shows that most of the trading houses in Nepal require establishing Import L/C. The Export L/C is received mainly by manufacturing industries. This helps the bank in understanding the client. Cross Tabulation for Type of Organization and Average Volume of Each L/C is given in table 4.8.

Table 4.8 Type of Organization and Average Volume of Each L/C Cross Tabulation

Type of Organization	Average Volume of Each L/C				Total
	<\$10,000	\$10,000 - \$50,000	\$50,000 - \$1,00,000	>\$1,00,000	
Trading	5	32	5	3	45
Industry	1	11	9	9	30
Total	6	43	14	12	75

Source: Field Survey

This figure shows the size of L/C as per the type of organization. Most of the manufacturing industries enjoy high volume L/C. However, the maximum concentration for both trading houses and industries is the medium sized L/C. Average Annual L/C Turnover is given in table 4.9.

Table 4.9 Average Annual L/C Turnover

Type of L/C	Average (Mean) Volume	Mode Volume
Overall L/C Market	\$ 2545214.29	\$ 300000.00
Export	\$ 1637500.00	\$ 250000.00
Import	\$ 2600227.27	\$ 300000.00

Source: Field Survey, 2066

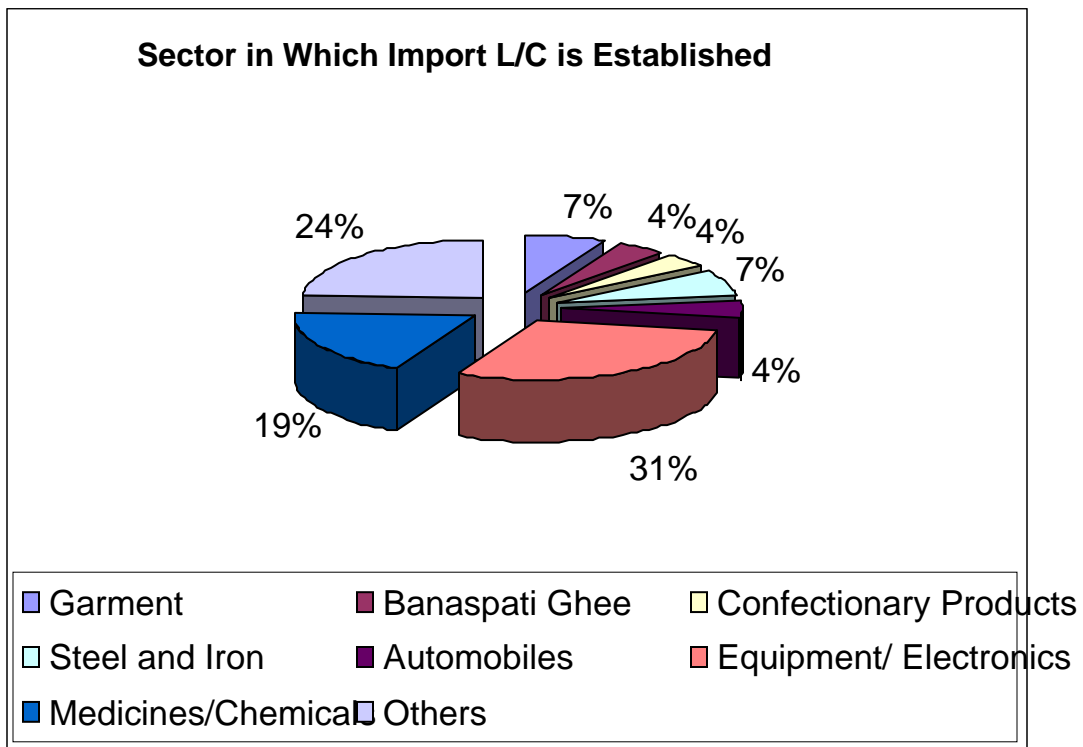
As per the annual average L/C turnover provided by the respondent, the above mentioned figures were derived. However, the reluctance of respondent was the most for this question; the approximate figures were obtained on the basis of which average was calculated. The huge average figure shows that the L/C market is quite a happening market.

Table 4.10 Sector wise Classification for Import L/C

Sector	Number	Percentage
Garment	18	24
Banaspati Ghee	3	4
Steel and Iron	5	7
Automobiles	3	4
Equipment/Electronics	24	31
Medicines/Chemical	14	19
Confectionary products	3	4
Others	5	7
Total	75	100

Source: Field Survey, 2066

Figure 4.5 Sector wise Classification for Import L/C



The above graph 4.5 identifies the sectors that dominate the transactions in Import L/C. The Import L/C is established mostly for importing of equipments and electronics; this is

followed by garment industry, medicines and chemicals and so on. This information helps the bank to market the clients of the most happening sector.

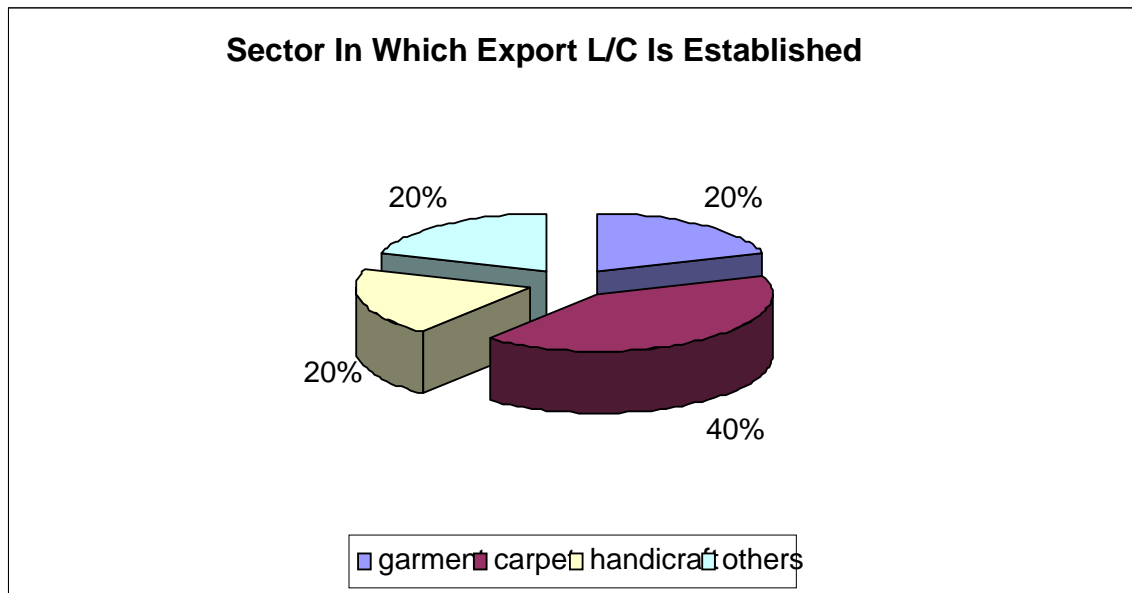
The list of imported products included in the category of “Others” is as follows: Some of the other products for which Import L/C is established are bags, suitcases, liquors, telephones, stationery products, paper products, lubricants etc.

Table 4.11 Sector wise Classification for Export L/C

Sector	Number	Percentage
Garment	15	20
Carpet	30	40
Handicraft	15	20
Others	15	20
Total	75	100

Source: Field Survey, 2066

Figure 4.6 Sector wise Classification for Export L/C



The above graph 4.6 identifies the sectors that receive Export L/C. The Export L/C is received mostly by carpet, garment, and handicraft industry. Some of the items included in “Others” category is tea, herbs etc. This information also helps the bank to identify the clients of the most happening sector.

4.6.2 Economic Variables in the Market

The economic variables in the L/C market mainly relate to commissions on L/C transaction itself, and the interest rates on L/C based loans. Import credit, popularly known as Trust Receipt Loan (T/R Loan) and Export credit, known also as packing credit are the major loans associated with L/C. These loans are provided as a percentage of total L/C volume. These loans are usually short term ranging from 90 days to 180 days. And, the interest rates on these loans largely depend on the negotiation between the clients and the bank. However, at the current market situation it ranges from 6% to 14%. In this section as well, it was difficult to get the exact loan amount, loan tenure and mostly the interest rate so the analyses are based on approximate figures. With regard to the information related to commissions and exchange rates, it was simply impossible to get the required data as these are the most confidential information for the clients as well as the banks. The table 4.12 included below provide the detailed analysis for this section.

Table 4.12 Loan Amount Enjoyed Out of Export L/C Volume

Loan Percent	Number	Percentage
<70%	19	25
70%-80%	37	50
81%-90%	19	25
Total	75	100

Source: Field Survey, 2066

Usually the banks provide 70 to 80% loan in form of packing credit being based on L/C volume. None of the banks provide more than 90% of L/C as credit. This information contributes the bank in formulating financial strategy. In case of Import L/C as well the loan amount is usually 70% to 80% of the L/C volume. Only 7% of the clients enjoy loan greater than 90%. This figure is also instrumental to bank in formulating financial strategy.

Table 4.13 Loan Amount Enjoyed Out of Import L/C Volume

Loan percent	Number	Percentage
<70%	11	15
70%-80%	48	63
81%-90%	11	15
>90%	5	7
Total	75	100

Source: Field Survey, 2066

In case of Export L/C, it is observed that the most commonly accepted loan tenure is 120 days. It is followed by 90 days. These figures characterize the L/C based loans and help the bank in understanding the L/C market.

Table 4.14 Loan Tenure for Export L/C Based Loan

Loan tenure	Number	Percentage
<90 Days	7	10
90 Days	19	25
120 Days	38	50
150 Days	7	10
180 Days	4	5
Total	75	100

Source: Field Survey, 2066

The tenure for Import L/C based loans are commonly 90 days, followed by 120 days, 150 days and so on. These types of data assist the bank for understanding the economic variables that characterize the L/C market.

Table 4.15 Loan Tenure for Import L/C Based Loan

Loan tenure	Number	Percentage
<90 Days	7	10
90 Days	30	40
120 Days	23	30
150 Days	11	15
180 Days	4	5
Total	75	100

Source: Field Survey, 2066

The interest rates applicable for Export L/C based loans ranges from 6.25% to 8%. However, the average (mean) interest rate is 7.0625% and the mode rate is 7%. By, knowing the industry average for the interest rates, bank can use it as the benchmark for fixing interest rates.

Table 4.16 Interest Rate for Import L/C Based Loan

Interest rate	Number	Percentage
6 percent	4	5
6.75 percent	7	10
8 percent	30	40
9 percent	23	30
10 percent	4	5
11.5 percent	7	10
Total	75	100

Source: Field Survey, 2066

The above table 4.16 depicts the interest rates enjoyed by the respondents in case of Import L/C based loans. The average (mean) rate is 8.0806% whereas the mode rate is 8%. This information also helps the bank in pricing loans for itself.

Hypothesis Testing

In this section of the customer analysis, the independent study of economic variables affecting L/C transaction is not adequate. So, two hypotheses are formulated and tested for determining the association between the variables taken for the study. For this, Chi-Square Test has been used.

Hypothesis 1

Ho: There is no association between the loan amount and the interest rate

H1: There is association between the loan amount and the interest rate

Chi-Square Tests

Table 4.17 Chi Square Test for Determining Association between Loan Amount and Interest Rate

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	22.810	18	0.198
No of Valid Cases	66		

From the Chi Square Test it can be observed that the significance value is 0.198 which is greater than 0.05 so the null hypothesis is accepted. It signifies that interest rate and loan amount are two individual variables, not associated with each other at any way. The interest rate does not depend on the loan amount and vice versa.

Hypothesis 2

Ho: There is no association between the loan tenure and the interest rate

H1: There is association between the loan tenure and the interest rate

Chi-Square Tests

Table 4.18 Chi Square Test for Determining Association between Loan Tenure and Interest Rate

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	36.394	24	0.050
N of Valid Cases	66		

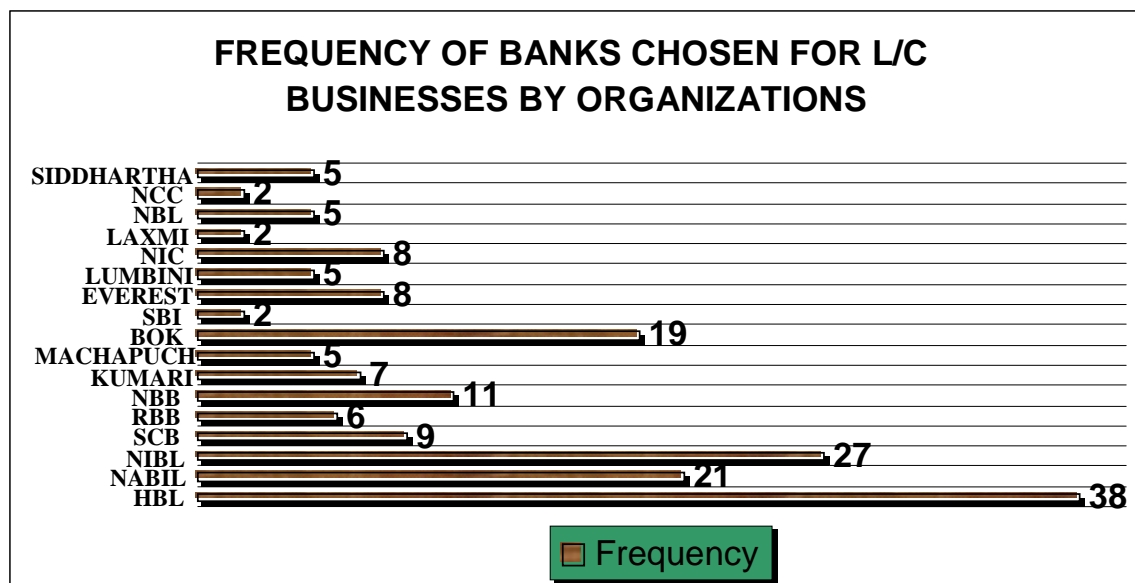
The above Chi Square Test shows the significance value as 0.050 which is equal to 0.050 so null hypotheses is rejected. The alternative hypothesis is accepted. There exist association between the loan tenure and interest rate. However, the significance level is exactly 0.050 so the association is not that strong. The interest rate is affected minimal by the loan tenure and ice versa.

This type of Chi Square Test and analysis examines the degree of dependency between any two variables. Here, the association was tested for loan amount, loan tenure and the interest rate. The findings are instrumental for banks to make decision concerning these variables; and also analyzing its impact on other variables.

4.6.3 Competitors' Stand in the Market

This section of analysis is aimed at depicting the competitors stand in the L/C market. It accounts for respondent's selection of banks till date for L/C transactions. On the basis of frequency of selection; the market share for the bank in terms of L/C is determined. However, the organization can take L/C services from two or more banks simultaneously so the graph presented below is mutually inclusive.

Figure 4.7 Frequency of Banks Chosen for L/C Businesses by Organizations



From the figure, it can be observed that HBL stands first in the L/C market by enjoying the largest number of L/C clients. It is followed by NIBL, NABIL, and BOK in order of their market share. The banks with the least market share are NCC, Laxmi and SBI. This information on market share of competitors is very helpful to the bank for planning its marketing strategies as well as to estimate its future market share.

4.6.4 Customers' Preferences, Expectations and Satisfaction Level

The objective of this section of analysis is to have information about the customers. It further includes information about their preferences and the factors influencing the same.

The satisfaction level of customers along with their expectations is also identified. The detailed analysis is presented with the help of graphs as follows:

Table 4.19 Satisfaction Level With Regard to Loan Amount and Interest on Loan

Satisfied with loan	Number	Percentage
Yes	69	92
No	6	8
Total	75	
Satisfied with Interest on Loan		
Yes	67	89
No	8	11
Total	75	100

Source: Field Survey, 2066

From the study it shows that the satisfaction level of customers with regard to loan period and loan amount is high as compared to satisfaction on interest rates. In case of interest rates 40% of the respondents are not satisfied. The customer satisfaction is prime objective of any bank so banks are to focus upon the expectations of the customers. The findings on expectation of the customers' on above mentioned aspects are as follows:

Table 4.20 Expectations With Regard to Loan Amount, Interest on Loan and Loan Period

Loan amount	Number	Percentage
Need to increased	6	8
Satisfied	69	92
Total	75	
Loan period		
Extension	8	11
Satisfied	67	89
Total	75	100
Interest on Loan		
Reduced	20	27
More competitive	10	13
Satisfied	45	60
Total	75	

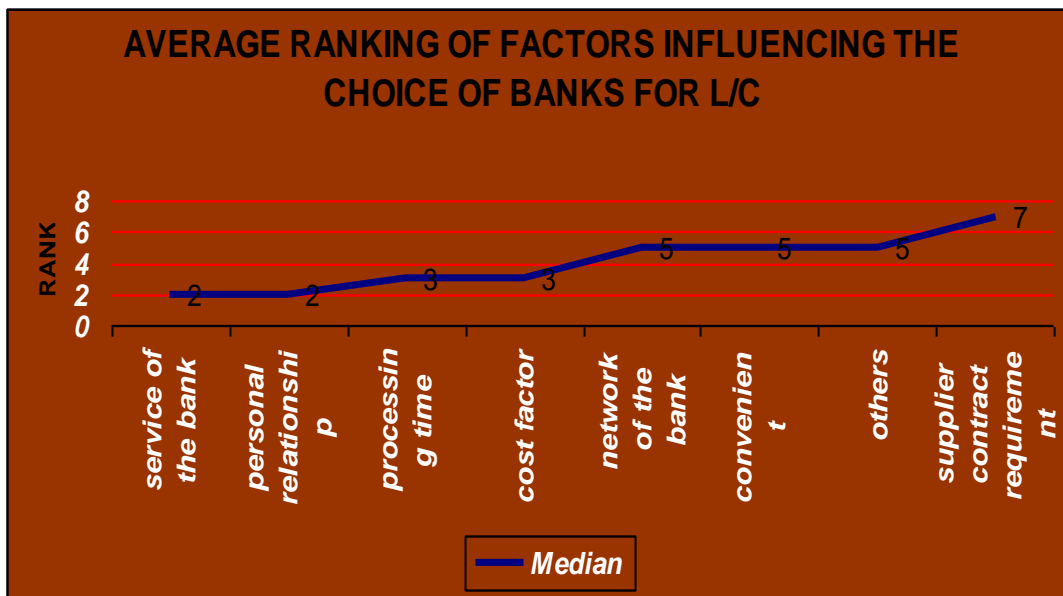
Source: Field Survey, 2066

The expectation of customers' regarding loan amount is the increment of the amount.

The customers' expect the loan period to extend further. The extension of the loan period is likely to benefit them for easy processing and trading of the items imported. 27 % of the respondents' want the interest rates to be reduced irrespective of the on –going industry rates whereas 13% of them want it to be more competitive as per the industry competition. However, the need for timely revision of rates cannot be undermined in case, but in case of L/C rates are mostly based on negotiation and relationship so these aspects must be addressed first.

All these information on satisfaction level and expectations assist the bank in knowing the preferences of the customers and also help in understanding them. The analysis of factors influencing the choice of banks and their ranking are done below:

Figure 4.8 Average Ranking of Factors Influencing the Choice of Banks for L/C



Several factors such as service of the bank, network of the bank, convenience etc influence the choice of banks for conducting L/C transactions. From, the graph above, it can be observed that service of the bank and the personal relationship of the client with the bank are ranked ahead of all factors. These are followed by ranking of processing time, cost factor, network, convenience, others and the supplier contract requirement. So, if the banks

want to excel in L/C business it has to pay attention to these factors. The table below depicts further factors mentioned during the ranking in the “Others” category.

Table 4.21 Other Factors Influencing the Choice of Banks for L/C

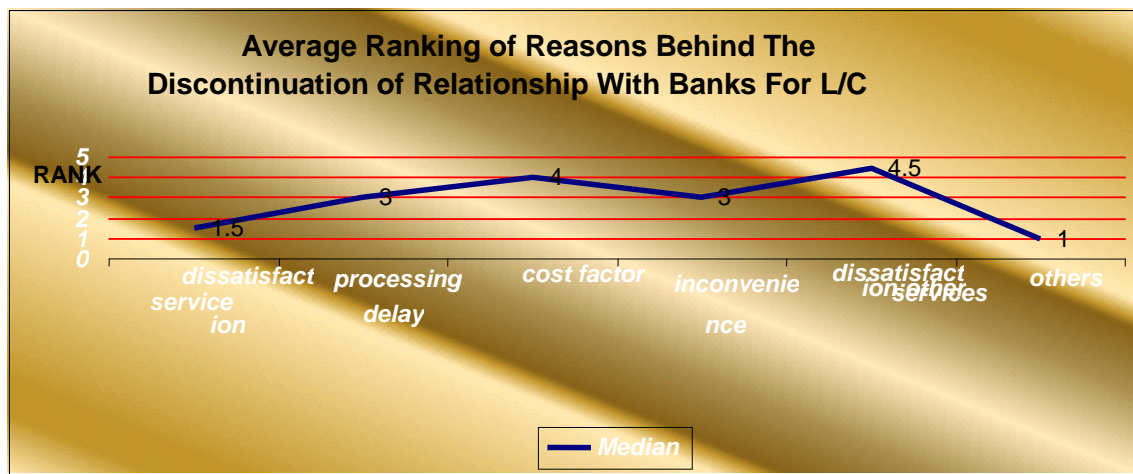
Factors	Number	Percentage
Response and behaviour of staff	4	8
Single obligor limit	7	68
Umbrella service provided by bank	30	8
Use of Internet in L/C	23	8
Value addition	4	8
Total	75	100

Source: Field Survey, 2066

With growing dissatisfaction the client can discontinue the relationship with the bank with regard to L/C. The reasons behind discontinuation of relationship along with the figure for discontinuation are presented below:

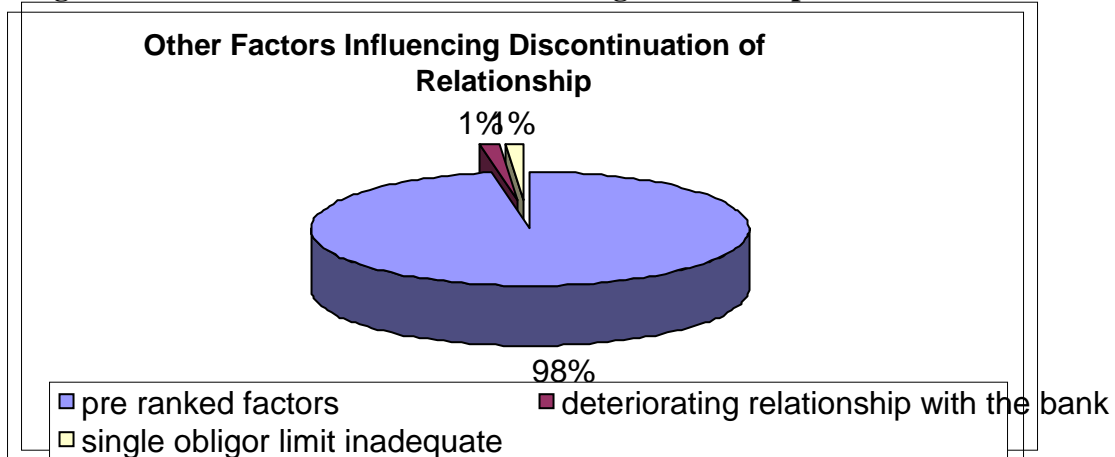
Only 13% of the clients have discontinued the business relationship with the banks they were taking L/C services from. The dissatisfaction level is quite low. The reasons for discontinuation of relationship are as follows:

Figure 4.9 Average Ranking of Reasons for Discontinuing Relationship with Banks for L/C



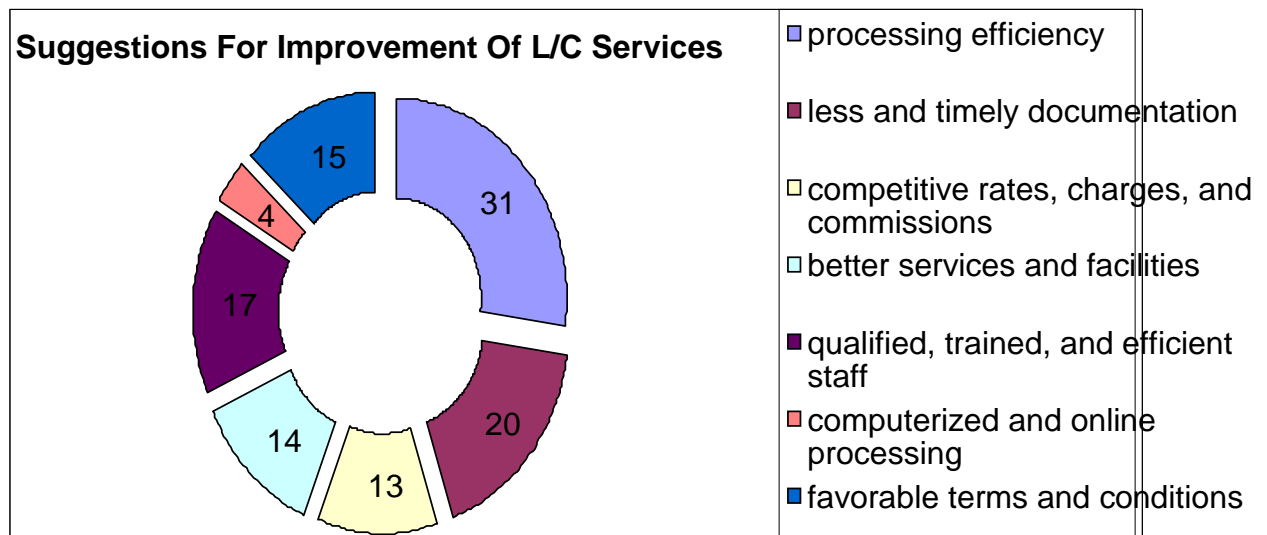
The major reason behind discontinuation of relationship with the bank is service dissatisfaction. Further, processing delay is another major factor. It is followed by inconvenience, cost factor, dissatisfaction regarding other services. The factors mentioned in the “Others” are also significantly ranked as follows:

Figure 4.10 Other Factors for Discontinuing Relationship with Banks for L/C



The other factors for that attribute for discontinuation of relationship with banks with regard to L/C are inadequate single obligor limit, deteriorating relationship with the banks etc. All these information are useful to the bank for enhancing customer satisfaction and thus retaining the customers.

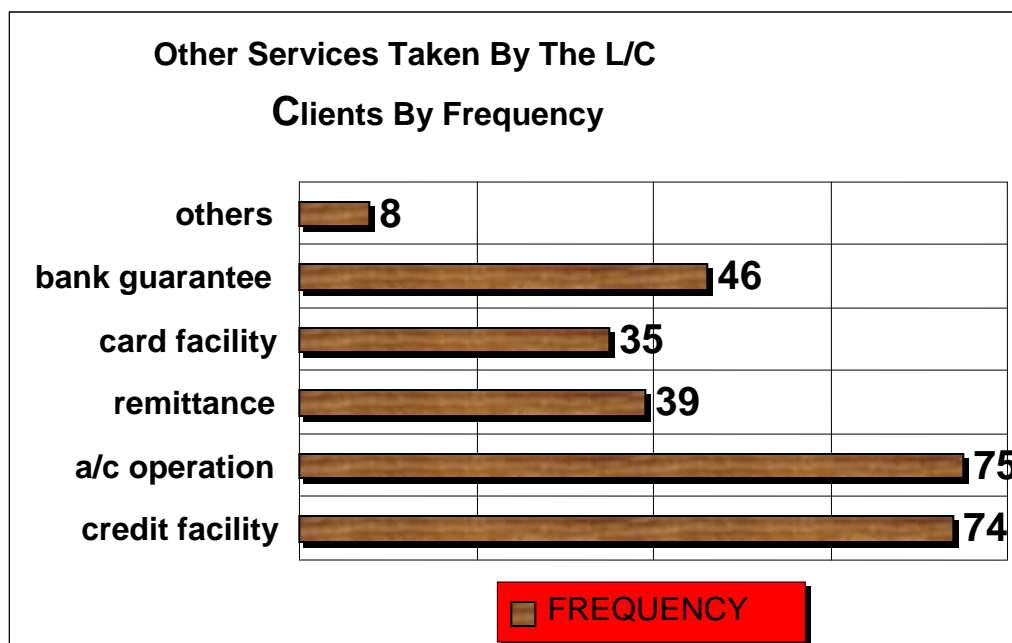
Figure 4.11 Suggestions for Improvement of L/C Services



The major suggestions provided by the respondents' for improvement of L/C services include improvement of processing efficiency, less and timely documentation, competitive costs and rates, qualified trained and efficient staff, favorable terms and conditions etc. The suggestion that is provided the most is improvement of processing efficiency followed by the need for qualified, trained, and efficient staff. This information identifies the areas where the bank must concentrate to satisfy the customers and thus get the desired outcomes.

The other services provided by the bank can be the channel for bringing L/C business for the bank and vice versa. So it is necessary to analyze other services that clients are currently taking from the banks with which they have taken L/C service as well.

Figure 4.12 Other Services Taken By L/C Clients



All the clients take additional services besides L/C from the bank. The major services enjoyed by L/C clients are account operation and credit facility. Further, other services taken are bank guarantee service, remittance, card facility etc. This data help the bank in formulating the strategies for other services in line with L/C so as to attract maximum business for L/C.

4.7. Data Presentation and Analysis of L/C in NIBL

The report basically is focused on the data of last 3 years i.e., from 2007-2009. NIBL is facing through a good trend of LC some of data are presented below:

Table 4.22 Total L/C Opened in NIBL

Year	Number of L/C opened	Percentage
2007	11	9.2
2008	48	40.0
2009	61	50.8
Total	120	100

Source: Field Survey, 2066

The table 4.22 shows the total number of LC opened in last three years. During 2007 the Total number of LC opened by NIBL was 11 which considerably increased to 48 and 61 at 2008 and 2009 respectively whereas the data of 2009 is only up to the month of August which has reached to 61 this shows the positive trend of LC. The major amount of LC was opened during June – August, and in the year 2008 the months like March and April was also good for the LC business. Whereas the survey also found out that the LC is opened less in the months like February, March, and April. Since Kalimati branch is newly opened branch, it has started its operation from last year's October hence the number of L/C opened is not that high as that of the other branches.

Table 4.232 Total L/C Opened in NIBL with Different Currency

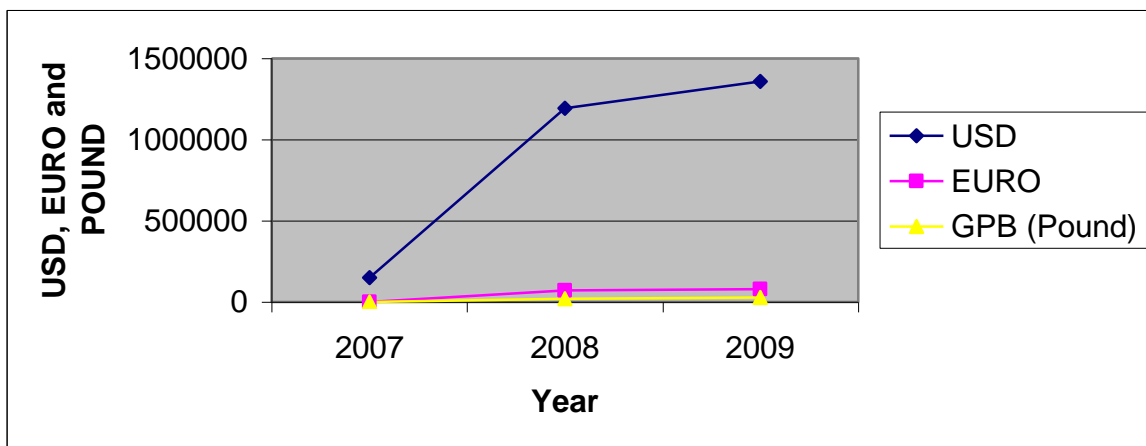
Year	USD	EURO	GPB (Pound)
2007	150200	0	0
2008	1194011.99	71721.29	17862.5
2009	1356721.55	78990.65	25988.6
Total	2700933.54	150711.94	43851.1

Source: Field Survey, 2066

US Dollar plays a dominant role in LC, in the year 2007; LC business was quite good maximum and the minimum amount of USD opened was \$150200 and \$360.18 respectively. The total of 11 LC was opened on 2007 as the branch was operated on October 2007 (local as well as the international LC). In the year 2008 the total amount of

LC opened was 48 maximum and the minimum amount of USD opened was \$1, 19,011.99 and \$530.06 respectively within first 8 months. In the year 2009 the total amount of LC opened was 61 maximum and the minimum amount of USD opened was \$1356721.55 and \$817.50 The trend of LC opened in USD, EURO and GBP is presented below. As the branch is new so the opening of L/C has just been started hence the trend is increasing in all the three cases. Here the USD means United State Dollar, EURO is the European Currency and the GBP means Great Britain Pound Sterling. The graphical representation of the entire trend is presented below:

Figure 4.13 Trend in US Dollar, EURO and Pound



4.8. Problems Associated With L/C in NIBL and Lesson Learnt

L/C itself is very complex in nature so there can be various kinds of problem associated with it, in Nepal there are various kinds of L/C in practice. There can be various problems some of the problem and its solution are given as follows:

- 1) The most common problem in L/C is the discrepancy in the documents i.e., the actual Pro-forma invoice and the Commercial invoice. For example, the problem arises when the LC is opened of USD 10,000 and the commercial invoice contains amount more or less than USD 10,000. For this condition NIBL writes a letter to NRB and after the approval of the NRB then only the custom can give the entry to

- the goods else the whole process of the LC should be done, the LC should be amended.
- 2) Another problem in LC is the late shipment of goods. The buyer actually opens an LC with the bank to grab the current opportunity present in the market whereas if the beneficiary has shipped the goods late then the buyer may discard the goods. So it is one of the major problems, since this problem cannot be solved by both the parties the parties can claim in court for arbitration which considers the rule of ICC.
 - 3) The International Chamber of Commerce (ICC) is a non-governmental organization serving the world business community since its inception
 - 4) UCPDC is its widely accepted publication which has facilitated smooth trade of goods and services by safeguarding the interest of both buyers and sellers living far apart.
 - 5) Rules of UCPDC-ICC brochure No. 500 are general and they will be in force unless otherwise stipulated in the “Credit”
 - 6) Application of UCP as per ICC publication No. 511
 - i. Because of its incorporation in the documentary credit, the UCP governs Documentary Credit primarily, but not solely. Courts and Arbitration tribunals often apply UCP because it is the most universally followed set of customary documentary credit rules and because it is perceived as being quite close to the level of perfection permitted by the “laws” of international compromise. However, it must be recognized that incorporation of UCP in the documentary credit does not prevent the court from applying its country’s national law. Over the years there have been disputes on the jurisdiction, especially in those cases when there seems to be a conflict between the UCP and the national law. Such legal issues can not be addressed in the rules and that the UCP cannot legislate the national laws. Such matters are best left for the courts to hear and to resolve.
 - 7) Issuing/Confirming/Nominated Bank must notify the presenter within reasonable time all discrepancies and must also state whether it is holding the documents at the disposal of the presenter or is returning to the presenter if it decides to refuse discrepant documents.

- 8) The applicant is responsible for any adverse consequences of foreign laws.
- 9) Other problems can be as the applicant being unable to pay the amount to NIBL. In Sight LC the buyer should make the payment first to get the goods out of the Kolkata Port, if the buyer does not have liquidity at that moment then he can take TR Loan for it. Similarly for the Usance LC NIBL takes the risk by holding only 10 % of the buyer and taking 90 % risk. At the time of payment NIBL is liable to pay to the corresponding bank so if the buyer does not reimburse NIBL then those securities which is held by NIBL during the approval of limit can be taken.
- 10) Other groups can make a claim in the guarantee and other securities.
- 11) The reduction in voyage times and the increase in short haul voyages has necessitated the forwarding of one original (signed) bill of lading with the ships bag in order to clear the goods and avoid demurrage (a charge levied when a vessel is delayed in port).
- 12) Actual evidence of loading on board and the date of such loading have often been difficult to determine.
- 13) It is a very rare case but sometimes the goods that is shipped can be wrong e.g., if the actual goods was 1000 tons wool and there can be a wrong shipment of goods like 1000 tons of cotton. This kind of problem also exist but the bank is liable to pay to the corresponding bank as in the credit operation all parties concerned deal with the documents and not with goods, services and/or other performances to which the documents may relate.
- 14) The LC stipulates goods to be dispatched latest by 14 April 2007. The Airway Bill presented bears the date 15 April 2007, as 14 April 2007 is a Nepali New Year and public holiday. The BL dated 15 April 2007 not acceptable. It is late shipment by 1 day. Only Expiry date and Presentation Period get extended by the public holidays. In case of Force majeure, (article 17) this extension is also not allowed.
- 15) The insurance policy should also be of proper date if the insurance is done late then the document cannot be accepted.
- 16) If no 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, documents must be presented not later than the expiry date of the credit.

17) Sometimes the client may want to change the custom office. So if he wants to do so then the letter must be written to the Nepal Banijya Bank by NIBL. Then the custom office can be changed.

4.9 Ethical Issues Involved in L/C Business

L/C is one of the most lucrative services for any bank so banks compete fiercely for the clients in the L/C market. But, in case of L/C operations bank acts only as an intermediary. It deals with documents only. So, the chances of defaulter L/C clients are very high. L/C operation is inbound by many ethical issues which has to be given high consideration by the bank. The issues to be given priority by the banks are as follows:

- Verification of documents and only accepting the authenticated real documents. But, it is often difficult to identify fake documents if the buyer and seller are in united to take advantage from the bank in an unethical way.
- There is a possibility of misutilization of fund and foreign currency in the name of L/C. The employees can also get involved in these types of fraudulent activities. Such fraudulent activities can hamper the profits and the goodwill of the bank.
- Sometimes, the defaulters arise despite of the strict regulatory environment and in such cases the bank has to pay the huge sum of money as a guarantor. This not only erodes the profit for the bank but also reduces its credibility in the market. So, bank must account for confirmation process as and when required.
- There is possibility that the customer may not pay the loan provided on the basis of L/C. the ethical issues can further arise in sanctioning of loans. So the bank must administer credit properly.
- Since L/C being a relationship based business, it rests on negotiation to a great extent. This can also pose an ethical threat for the bank. The illegal negotiations can really hinder the performance of the bank.
- Documents which are required to be presented under an LC are frequently prepared by other people, and this may not meet the strict compliance standards required by the banking community for payment. So, this is another ethical area to be considered by the bank.

- Due to all these issues involved in the L/C operations both the bank and the client should provide due consideration for the L/C operation. The rules must be understood properly, documents must be kept simple, and control mechanism should be ensured so as to avoid any problems. Clients and the bank should understand that in working with L/C's, it is most important to get good advice from the outset, to learn the rules of the game, and to proceed with great care. Once mistakes have been made, too often they are irreparable and costly.

4.10 Major Findings of the Study

The societal environment analysis included analysis on political-legal, economic, socio-cultural, and technology forces. The findings are as follows:

The country is neither expected to have political stability nor is the unstable legal environment to change soon. This state has hampered most of the business for the country. Even the existing ones are not able to decide upon the proper direction to head their business. This has also resulted in low investment in every sector especially the manufacturing sector.

The major implication of this in the L/C market is the requirement of confirmation in the L/C process. Further, the degrading situation of manufacturing industries can result in reduction of overall L/C transaction volume for the country.

The implication of this in L/C market and its management is quite crucial. The increase in trade figure has resulted in increase in market for L/C and this will continue to increase even if it is by minimal percentages. The low cost competitive strategy has also affected the L/C business as commissions and rates are very competitive thus leading to lesser profit for the bank.

Due to this, players in the L/C market have to shift their focus from economic variables to customer relationship management as well. L/C involves large amount of money so bank are in position to risk their profits at the cost of bad personal relationship with the client.

This also has a great managerial implication in case of L/C operations. The use of technology in L/C processing is instrumental in enhancing the efficiency. The growing concerns in the L/C market about online processing, use of internet in L/C is simply unaddressable without the use of technology. So, the banks must direct their efforts and investments towards technology that supports L/C business.

The difficulty in understanding the rules and technicalities involved in L/C operation is one of the major factors that commercial banks must address to succeed in the competitive market of L/C.

The scope of the banking industry is ever increasing with the increment in diversified service portfolio of the bank. The role of banks has been extended to many new areas that were previously unexploited and uncared. The innovation in product and services is another major force that drives the industry forward. The size of the market is increasing and also the market growth is continuous. The capital requirement have also increased so is the volume of transactions. The increasing financial trend of the banking industry is expected to continue in future as well.

The increasing scope, innovation, market size are the managerial issues that requires due consideration. The banks have to move with the demand and the market, in failure to do so it becomes difficult for the bank to have the strong position in the market. In case of L/C operations as well these issues matters a lot and managers are to formulate strategy for L/C in such a way that all these issues are addressed.

The L/C market is dominated by Import L/C. the industrial clients is less than the trading clients as overall industrial scenario of the country is degrading. But, the industrial clients deal in larger volume transactions than the trading clients. The major items for import through L/C are electronic equipments, iron and steel manufacturing raw materials, raw material for oil and ghee etc. In case of export it is carpet, garment and handicrafts. The above findings are also expected to remain for some time as no drastic change in the economy is anticipated. But, the industrial clients might decline due to down fall of these clients.

NIBL also has to operate in the above characterized market so knowing the traits and nature of the market is quite essential for it. Further, the scenario is not going to change immediately, so NIBL also has to prepare strategy accordingly. The NIBL is also expected to provide focus on trading clients and also on more of Import L/C as to be on safe side in the initial phase.

The competition in the L/C market is most of the time based on the economic variables in the market. The rates and commissions are highly competitive. Further, the negotiation for higher loan amount, increased tenure and lowered rates are common in the L/C market. However, the interest rate is not dependent on loan amount. In case of loan tenure it is very slightly dependent. The relationship and negotiation counts first in deciding these variables.

This type of trend in the market is expected to continue as banking business is switching towards relationship business. NIBL has maintained very good relationship with its clients and the satisfaction level of the clients is very high so it can be said that NIBL has mastered in the area of relationship building and maintaining. This aspect of NIBL is expected to help NIBL in course of conducting L/C operations as well. But, the bank managers must set limit in negotiating as the returns are the only factor that determine the sustainability of any operations.

The lucrative nature of L/C business and the high volume of foreign currency involved in it has resulted in different sorts of unethical practices. The misutilization of fund as well as the chances of defaults is quite high. Despite of strict regulatory environment the unethical practices could not be avoided at times. So, many established banks have also faced default cases. However, the default cases can be attributed to processing inefficiency and handling of more transactions than capacity.

NIBL being new bank can face processing problems but the NIBL also consists of L/C experts in the top management; so it would be unlikely to predict for default cases facing NIBL. However, proper attention is always compulsory.

CHAPTER- V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

The banking industry is characterized by intense and ever rising competition. Not only the commercial banks, development banks, finance companies and other cooperatives are in the line of competition. However, due to this competition, the consumers are getting to reap the maximum benefits. The competition is expected to rise even further with the New Ordinance as it allows entry for development banks and finance companies to areas that were previously allowed to commercial banks only.

The L/C market is also characterized with the same level of competition. The banks compete with each other to get the maximum market share. The potential threat of competition from development banks after the new Ordinance also exists. So, the managers of both commercial and development banks are in very crucial position as commercial bank managers have to account for increasing competition whereas the commercial bank managers have to prepare itself to enter the crowded and competitive L/C market.

The major players in the market like HBL, NIBL, NABIL, NBB etc are ahead in every service aspect. The market share enjoyed by these major players are quite high than other banks, besides the NBL and RBB which are not accounted for the analysis. Their infrastructure, HR and other operational aspects are strong as compared to other banks. However, the major players are not always the major profit earners in the banking industry.

The major problems faced by the competitors at their early stage are confirmation problem, difficulty in network building, competitive scenario of the market, inexperienced staff, difficulty in understanding the regulatory environment and complexities in processing, etc. NIBL is also likely to face these problems during its start-up stage. However, the degree of difficulty can be reduced by ensuring proper homework for L/C in advance. So, the managers are to prepared for serious brain storming session.

Customer analysis was carried out to understand the nature and size of L/C market, the economic variables in the market, competitor's stand, expectations, preferences and satisfaction level of customers, and finally the potentiality of commercial banks in the L/C market.

5.2 Conclusion

NIBL, established in 1986 as Nepal Indosuez Bank Ltd. being a joint venture between Nepalese and French partners holding 50 % of the capital, changed its name in 2002. The vision statement of the bank is "To be the most preferred bank in Nepal". The bank has been able to provide the customer oriented quality service and has been awarded as the bank of the year twice in 2003 and 2005 by London based Financial Times Group. This is the bank which introduced 365 days banking in Nepal, and the Visa Electron Debit Card. It also introduced loan against gold and silver.

It was a great experience being an intern in NIBL. I had a lot of opportunities to learn about different aspects of the banking sector. The banking industry is one of the most important industries in the economy as it enhances the economic activities of the country. During my internship program I was placed in various departments like operation department, credit department, clearing department, retail department, LC department, Cash department, remittance department, Internal Audit Department and customer service department.

My project is focused in LC operation of NIBL, during my internship program I was in the LC department for 3 weeks I found that the credit situation of NIBL is in an increasing state the total No. of LC opened in 2007 and 2008 has been increasing. In the year 2007 the total No. of LC opened was 11 as the branch was started from October 2007 and in 2009 it reached to 61 and it is up to the month of August 2008. The data also shows that the most of the client who opens an LC import the goods from third country. Most of the payments are done on the US currency, EURO, GPB. All of them are in the increasing trend. The maximum No. of the L/C is opened during June, July and August and the minimum is during February, March, and April.

In NIBL buyer is assured that the documents presented will be examined by banking personnel knowledgeable in L/C operations, and he is confident that payment will only be made to the seller after the terms and conditions of the L/C and the UCP rules are complied with. It can be concluded from the observation and analysis of above data that with the improvement in the country's current condition the L/C can foster a lot in Nepal and NIBL has a the capability to get more and more clients who opens an L/C.

5.3 Recommendation

The recommendation for implementation of the strategic plan is given below:

- Continuously monitor the current performance
- Whether the strategies are actually being implemented?
- Whether such implementations are bringing desired results
- Assess the performance progress and give feedbacks to all for improvement
- Assess the relevance of all strategies periodically. Any strategy is only relevant for a relatively short period of time and not after that.
- Make changes; change the implementation of strategies if the desired performance is not being gained
- Change the strategies if they are not working
- In dire circumstances, there might be a realization that the strategy is correct but the objective itself is wrong. It is always a better decision to change the objective after such a realization that sticking with it in the longer run.
- Strategic management is a continuous process and it should be implemented as one. Sporadic outbursts of energy and efforts towards strategic management will never work.

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