

CHAPTER 1

INTRODUCTION

1.1 General background

The word 'bank' came from the different words of different languages. Some of the words are Italian word 'banco' and 'banca', Latin word 'bancus' and French word 'banque' meaning 'bench' on which the bankers would keep money and all records. Banks are the business house established to safeguard people's money. Banks use the money deposited out to give as loans and for other investment. There are several authors defining the terms banks in their own way. Some of the definitions are:

According to Kent:- "A bank is defined as an organization whose Principle operations are concern with accumulation of the temporarily Idle money of the general public for the purpose of advancing to other for expenditure".

According to oxford dictionary:- "A bank is an establishment or Custody of money received from or on behalf of its customers, it's Essential duty is to pay their draft on it; its profit arises from its use of the money left unemployed by them".

Commercial banks are an integral part of the national financial system that functions on a continuous basis in the open social system .The basic mission or objective of every commercial bank is to move scarce loanable funds from those who save to those who borrow to buy goods and services and to make investment in new equipments and facilities so that the national economy can grow and increases living standard of citizens. This purpose, commercial banks collect deposits from savers group by promising a certain percentage of interest.

Out of the all collected funds they provide loan to **investors**, consumers and borrowers at a certain percentage of interest. Interest is the cost of fund. Difference between the interest on lending and borrowing of fund is the profit of bank. It is the major source of income of all commercial banks.

Commercial banks furnish credit to finance consumption and investment spending. Credit consists of a loan of funds in return for a promise of future payment. Basically, the principal business of commercial banks is to make loans to qualified borrowers or at least to assist them to find credit from some other sources. Loans are highest yielding assets that a bank can add to its portfolio and they often provide the largest portion of traditional banker's operating revenue.

Commercial banks make loans of reserves to other banks through the funds deposited at the central bank. For more important, in rupee volume, however, are the direct loans to business and individuals. These loans arise from the negotiation between the bank and its customers result a written agreement designed to meet the specific credit needs of the customer and requirements of the bank for adequate security and income for the specific period at a specific interest cost

Banks are provide many services such as accepting various types of deposits, `safeguarding deposits, giving out loans, providing means of payment, electronic banking and other services such as money orders, draft, promissory notes, bills of exchanges, traveler's cheque, telex , telex transfer and SWIFT services etc. it is provide to service that don't involve real money like **letter of credit** and guarantees In the past ,people used to buy or sell any goods and commodities in the shops or market in the physical presence of both the buyer and seller payment may be done at the same time or may be after certain time period as per understanding of both parties. When goods are bought and sold abroad then such transaction could become very complicated for a number of reasons like; time,

hazard of journey, custom formalities, export/import and exchange control regulations etc. and the fact that buyer and seller are most likely in opposite sides of this world and two parties may not have even seen each other and their business standing and integrity. Hence, it becomes indispensable for the existence of some means that will protect the interest of both parties while practicing such transaction. The buyer should know what he is getting for the money that he is paying. And on the other hand, the seller would definitely be interested in receiving prompt payment. Hence in order to satisfy both the parties, **LETTER OF CREDIT (L/C)** was developed. L/C is a written instrument issued by the bank on the behalf of the buyer in the favor of the seller expressing its definite undertaking to effect payment for the specific amount provided the seller complies the terms and condition stipulated in the letter. L/C often called 'Documentary credit' is one of the most widely used and universally accepted means of conducting commercial transaction. L/C mechanism provides security to both the buyer and seller. The seller can demand the payment from the issuing bank after presenting the required documents of goods.

For the issuing bank, the Letter of credit is an important part of banks. It is an export L/C payment by means of letter of credit involves actions between two banks, one in importer's country and other in exporter's country. Thus, a bank in the importer's country issues a letter in favor of exporter with an undertaking that bill of exchange drawn by him upon his importer up to the amount specified there in will be honored by its presentation.

“According to uniform customs and practice for documentary credit (UCPDC), 2007 revised ICC publication No.600 the expression ‘documentary credit’ means any agreement, however named or described where by a bank (the issuing bank) acting at the request and on the instruction of a customer(the

applicant) or on its own behalf”.(Guide to documentary of L/C and UPC 600 article)

In wide sense, a commercial letter of credit (here after sometimes referred to as a “credit’ or ‘commercial credit’) is simply a letter of instructions issued to an exporter by a bank at the request of its customer. In its narrowest sense, it is a specialized and technical instrument used to finance a shipment of goods from one part to another, whether a credit is highly specialized simple is determined usually not by its construction but rather by how well versed its users are in the language and practices of international trade.

What is letter of credit?

Letter of credit is written undertaking by a bank given to the seller (the beneficiary) at the request and in accordance with the instructions of the buyer (the applicant) to effect payment (that is by making payment or by accepting or negotiating bill exchange) up to start sum within prescribed time limits, against stipulated documents and provided that terms and condition of the L/C are complied with.

In Nepalese context the commercial banks are only provide the ‘**letter of credit**’ (L/C) transaction. The central bank (NRB) supervises all the banking industry and to guide the basic monetary policy of nation. The NRB were to regulate the issue of paper money, secure countrywide circulation of Nepalese currency, achieve stability in its exchange rate, mobilize capital for economic development and for trade and industry growth develop the banking system in the country thus ensuring the existence of banking facilities and maintaining the economic interests of the public. NRB was also to oversee foreign exchange rates and foreign exchanges reserve.

This report studies or analysis of all the aspect involving the process of **“Analysis of letter of credit business in the context of NIBL”** at present, The total numbers of commercial banks in Nepal are as :-

1. **Nepal bank Ltd.**
2. **Rastriya banijaya bank Ltd.**
3. **Nabil bank Ltd.**
4. **Nepal investment bank Ltd.**
5. **Standard charter bank Ltd.**
6. **Nepal Bangladesh bank Ltd.**
7. **Everest bank Ltd.**
8. **SBI bank Ltd.**
9. **Bank of Kathmandu Ltd.**
10. **Nepal credit and commerce bank Ltd.**
11. **Nepal industrial and commercial bank Ltd.**
12. **Lumbini bank Ltd**
13. **Machhapuchhre bank Ltd.**
14. **Kumari bank Ltd.**
15. **Laxmi bank Ltd.**
16. **Siddhartha bank Ltd.**
17. **Agriculture development bank Ltd.**
18. **Global bank Ltd.**
19. **Citizen bank Ltd.**
20. **Prime commercial bank Ltd.**
21. **Bank of Asia**
22. **NMB bank Ltd.**
23. **Kist bank Ltd.**

24. **Civil bank Ltd.**
25. **Century bank Ltd.**
26. **Janata bank Ltd.**
27. **Mega bank Ltd.**
28. **Commerz and trust bank Ltd.**
29. **Sanima bank Ltd.**
30. **Himalayan bank Ltd.**
31. **Grand bank Ltd.**
32. **Sunrise bank Ltd.**

(Source: Nepal Rastra bank)

1.2 Statement of problem

L/C is a widely used instrument in the field of international trade. The need for it generally arises whenever any two parties (i.e. exporter and importer) get into a context to buy and sell something. In any international trading activity, as the parties to reside in two different countries, the issue of confident and credit worthiness of the both parties arise. Party might be big or prestigious even then the other parties always have to think from the worst case scenario.

It is to tide over such things the instrument of L/C invoked. L/C is a reliable instrument in trade and in the 20th century where the market of trade is enhancing. The importance of L/C is in increasing trend but there are many confusion regarding L/C transaction theory and practices in our country. The main focus will be towards studying the obstacles of L/C business, procedure of L/C transaction role played by NRB for L/C, document necessary for the letter of credit and other rules regulation and obstacles in the L/C business.

This problem is specifically related to the subject that is briefly presented as under:-

-) Is Nepal investment bank ltd. (NIBL) performing up to the expectation as it has targeted in terms of its **'letter of credit'** business?
-) Is the existence of the **'letter of credit'** benefiting the organization that are involved in international trade?
-) Is the **'letter of credit'** truly a financial instrument while making payment without receiving the goods from abroad?
-) Is the central bank monitoring the **'letter of credit'** operations of the commercial banks in order to control money laundering?
-) What are the pre requisites for opening **'letter of credit'** **Nepal investment bank?**
-) What are the problems existed during the **'letter of credit'** **transaction in Nepal investment bank ltd. ?**

1.3 Objective of the study

The objectives of the study are to study the aspects of **'letter of credit'** transaction and to examine how it facilitates the international trade in today's world, basic objectives are as follows:

-) To examine the pre requisites of **'letter of credit'** business.
-) To assess the process and operation in respect of **'letter of credit'**.
-) To find out the trend of **'letter of credit'** operation.
-) To evaluate the benefits of **'letter of credit'**.
-) To identify the problem in **'letter of credit'** operation.
-) To make suggestion and recommendations based on the study.

1.4 Significance of study

In today's world, due to high competition in the business sector import and export plays a vital role in every country. But it is very risky to send money directly from a buyer of one country to a seller in another. So the '**letter of credit**' is a guaranteed mean of a payment for both buyer and seller. Being a developing country, Nepal must do import and export transaction through a safe mean and '**letter of credit**' is a very important tool for the same. It is due to this reason this report is prepared and also to aware general public moreover to the people or entrepreneurs who are trying to start or already engaged in the import/export business. Generally, we have is the theoretical knowledge, which is not sufficient for successful career. So giving opportunities to student to know about organization and their operation is very good work.

The main importance of fieldwork is as follows:-

- J To gain about the working style of the organization or in other words we can say that give the student the practical knowledge about L/C.
- J To gain capacity to analyze the present and future market environment and also to improve the company's profitability.
- J To train the students for administrative and managerial function.
- J To find out the process and problem of L/C.
- J To make students capable of sorting out the problem.
- J To develop the business skill of the student, this may be helpful in their career path.

1.5 Limitation of the study

The law relating to L/C was very scarce and the material relating to theory and practice of L/C was very difficult to find in the market. It was difficult to get various rules and regulation regarding the L/C transaction since L/C is complicated subject matter and there seems lot of fraud in L/C so debt knowledge regarding L/C should be provided to the man dealing in L/C but due to incompetent manpower in L/C department of various banks its seems difficult to get proper interpretation to L/C theory and practice in Nepal.

This report is prepared simply in partial fulfillment of the requirement for degree of master of business studies (MBS). The limitations are as follows:-

Duration of study

This thesis writing is the part of academic requirement of MBS. The report is to be completed in the stipulated time. Hence the duration of the study is not sufficient to make the study more realistic and wide'

Data availability

This study is based on the secondary data source such as annual report 'letter of credit'. It also the up to date and completed data were very difficult to obtain from bank due to inability of concern authorities to provide the required the data.

Period concerned

The present study is undertaken for period of five years from fiscal year 2006/07 to 2010/11. The secondary data are collected from annual general meeting's (AGM)'s report and this is the basis to express the strength and weakness

concerned to international trade, especially L/C business of NIBL. Hence the conclusion had drawn, confines only to the extent of above period. Data for the current fiscal year is not available yet.

1.6 Organization of study

2.1 Chapter 1; Introduction

The first chapter includes background, statement of problem, objectives of the study, limitation of the study and organization of study.

2.2 Chapter 2; Review of literature

The second chapter includes a discussion on conceptual framework of the topic '**letter of credit**' and the profile of the bank and reviews the issues related to the study.

2.3 Chapter 3; Research methodology

The third chapter is concerned with the research methodology consisting to research design, method of data collection and tools of data analysis etc.

2.4 Chapter 4; presentation and analysis of data

The fourth chapter present the presentation and analysis of the performance of **Nepal investment bank** ltd. in terms of **import and export of 'letter of credit'** and income from commission on '**letter of credit**' transaction. It also includes major finding of the study.

2.5 Summary of finding, conclusion and recommendation

The fifth chapter or final chapter consists of summary of finding, conclusion and various suggestions for the improvement of future performance of **Nepal investment bank Ltd.**

CHAPTER 2

REVIEW OF LITERATURE

This chapter deals with review of books, review of reports, review of research paper, review of articles, of unpublished publication etc. Research review comprises of previous research study articles concerned with this study and other studies with a view to supplement the present research. The purpose of review is thus to find out what research studies have been conducted in one's chosen field of study and what remain to be done. Here the review of literature is divided into two parts.

a) Conceptual framework.

b) Review of related studies.

2.1 conceptual frameworks

Under this, meaning and concept of L/C parties involved in L/C and their rights and responsibilities, types of L/C, example of L/C, standard forms of the documentation, pre-requisition for opening L/C in Nepal, amendment and cancellation of L/C, payment settlement, etc. L/C is widely used instrument in the field of international trade. It is basically a mechanism, which allows importers/buyers to offer secure term of payment to exporters/sellers in which a bank (or more than one bank) gets involved. The need of L/C generally arises whenever any two parties (i.e. exporter and importer) get into contract to buy and sell something. As the buyer and seller are far away from each other and may not know each other. Therefore, the issue of confidence or credit worthiness arises. A party will always think from negative view i.e. the other party might default. Such problems between both the parties have been resolved after introduction of “**letter of credit**” in the trade.

The operations of L/C are governed by UCPDC (universal custom and practice in documentary credit) on force published by ICC (international chamber of commerce). The popularity and reliability of the L/C is such that in the present day scenario, one cannot visualize of foreign trade as well as of domestic trade without the presence of L/C.

The ICC banking commission has designed some common code of practice having wide application and uniform interpretation. The ICC established in 1920 at Paris and the UCPDC is the joint effort of the bankers, transporters, insurance companies, buyers, sellers etc. The UCPDC shall apply to all documentary credits. They are binding on all parties thereto, unless otherwise stipulated in the credit.

2.1.1 Meaning and concept of letter of credit

The earliest trade known to be done was through barter. Barter is exchange of one goods with another i.e. salt with oil, wool with leather, etc. Goods and property were then traded on spot and the deal was closed.

Human needs and desire soon become unlimited and produce of a given locality or vicinity could not meet the demands. Movement of people from one place to another reduced due to increase in size of family and development of the culture of setting families in allocation. This forced people to involve in buying and selling i.e. trading of goods and produces from one place to another. By then money has already been introduced as measuring rod for goods and services. The human desire could not be met by the goods and services produced in one locality to another and people now wanted to use produce from one country to another and from one end of the globe to another end of the globe. In such a scenario it was impossible for people to move around and buy the product

of their choice or demand due to the geographical distance as well as risk in carrying money and then complication faced in carrying back the produce to their habitat. The L/C is also popularly known as non fund loan of bank. “Non-fund based business helps to facilitate trade/non trade transaction between parties who are unknown to each other. The banks act as a facilitator or a middlemen and charges commission for this business. The good will and reputation of the bank helps alleviate doubts and apprehension of parties”. (Rakesh/Nikhil, ‘how to achieve success in banking career’)

Moreover, in much of these cases the buyer and seller would not have met or seen one another possibility of not knowing each other’s standing and integrity also loomed large. So the trades felt the need of L/C for both buyers and sellers, the need of bankers who are widely accepted for its credibility and standings to be involved in financial transactions. The buyer needs to know that he has paid for the getting the right goods and the seller interest is to get promptly paid for his goods. As a result the banks started arranging and extending wide use for credit instrument, which satisfied the needs of parties called the documentary credit handled by international banking network calling for the exporter to present a bank documents evidencing shipment or dispatch of the required merchandise for which of the documents are in order he will be paid. The requirement for such documentary must be agreed upon in the contract of a sale.

Letter of credit is written instrument issued by the bank (issuing bank) on the behalf of the buyer (the applicant) in favor of the seller (beneficiary) undertaking to effect payment for the specific amount, provided the seller (beneficiary) complies with the terms and conditions stipulated in the letter.

L/C often called ‘documentary credit’ is one of the most widely used and universally accepted means of conducting commercial transaction L/C mechanism provides security of both the buyer and seller. At the very outset one

must understand is that Letter of credit deal in documents, not goods. The idea in international trade transaction is to shift the risk from the actual buyer to a bank. The seller can demand the payment from the issuing bank after the presenting required documents. Seller also has option to avoid shipment of goods, when he feels that any terms and conditions in the L/C, if the document does not fulfill his terms and conditions, he has the option to reject the document.

Thus a L/C (as it is commonly referred to) is a payment undertaking given by a bank to the seller and is issued on behalf of applicant i.e. the buyer. The buyer is the Applicant and seller is the Beneficiary. The bank that issue L/C is referred to as the Issuing Bank which is generally in the country of Buyer. The Bank that Advises the L/C to the seller the Advising Bank which is generally in the country of seller.

The specified bank makes the payment upon the successful presentation of the required documents by the seller within the specified time frame. Note that bank scrutinize the 'documents' and not the 'goods' for making payment. Thus the process works both in favor of both buyer and seller. The seller gets assured that if document 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 other hand is assured that the bank will thoroughly examine these presented documents and ensure that they meet the term and conditions stipulated in the L/C.

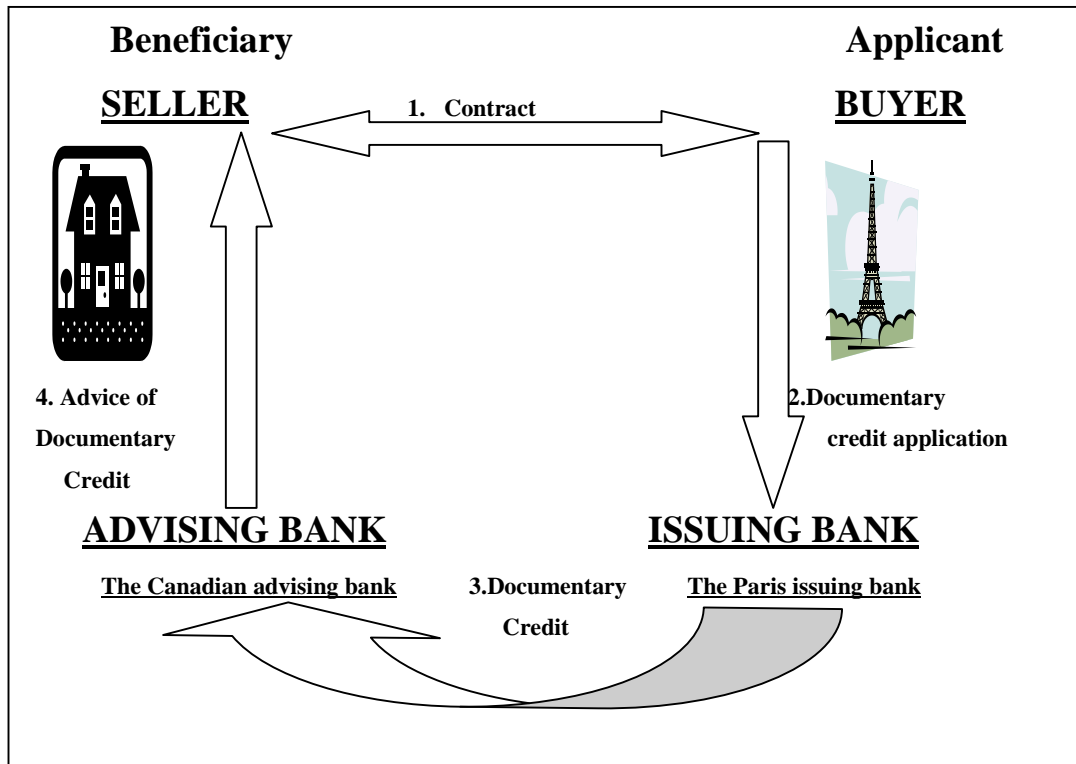
Letter of credit in the effect is the guarantee to the exporter from the bank that he will receive the payment if the terms and conditions of the L/C are complied with and simultaneously assures the importers that he will receive the goods for which has been assured.

2.1.2 Parties involved in letter of credit

The documentary credit cycle

“Letter of credit”

Figure.1



1. **Applicant:** An applicant is the one who request 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 of L/C. He should furnish the documents to the issuing bank as required to issue the L/C 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 in the underlying contract.

2. **Issuing banks:** The issuing bank is the bank, which issues L/C on behalf of the applicant. It is the customer’s bank. The buyer mentions the terms and condition of the credit to issuing bank. The issuing bank should ensure that the regulatory conditions are fulfilled and the instructions are precise and specific.

The issuing bank will select a bank in the exporter's country to act as its agent, and will notify that the credit has been opened.

3. **Advising bank:** The bank, normally in the exporter's country through which a letter of credit is transmitted and authenticated to the exporter. There is no liability on the part of the advising bank to honor the letter of credit. The main function of the advertising 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. The bank that issues a letter of credit or grantee and ultimate responsibility for payment of the instrument ,it provides the documents on request of the applicant.

4. **Settlement bank:** The settlement bank is the bank, which negotiation the bill of exchange or draft under the L/C. It is the bank where sellers present document for settlement. Generally, the same bank acts as the notifying bank/negotiating bank. This bank must see carefully that the documents are strictly according to the terms and conditions of the credit.

5. **Confirming bank:** when bank 'confirms' the letter of credit of another bank, it takes on obligation of the issuing bank. Sometimes the sellers insist that a bank in this own country must confirm credit. Bank giving confirmation is known as conforming bank. Here, one of the merits from seller point of view is that he can receive the payment as soon as documents are presented at his own center.

6. **Beneficiary:** The beneficiary or seller is the exporter of goods or merchandise. He issuing bank makes assumptions that the terms and condition mentioned in the credit should be strictly followed and relevant documents produced. The exporter ships the goods before the credit expires and sends the shipping documents to the agent bank, which checks the document against the

condition and pay him or they ask to draw a bill of exchange on them and will discount the bill for him so that he can get his money immediately.

In letter of credit normally

-) The supplier is known as the beneficiary.
-) The bank that opens a letter of credit is the opening or issuing bank.
-) The bank in the supplier 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 banks too.
-) When certain terms and conditions of the credit are changed such change is known as amendment.
-) The generally adopted set of rules for credit is known as the uniform customs and practice for the letter of credit issued by the ICC (international chamber of commerce) in their publication dated 2007 numbered 600.
-) Letters of credit are issued in a variety of ways. They came by post from the issuing bank. By telex and by SWIFT (society for worldwide interbank financial telecommunication) network. SWIFT is an industry owned cooperative supplying secure messaging services and interface software to over 7000 financial institutions in over 196 countries.

2.1.3 Types of letter of credit

The same letter of credit is either an import L/C or an export L/C. The L/C for the issuing party/bank/country becomes an import L/C whereas for the seller it becomes an export L/C.

Letter of credit may be any one of the following types:-

1. Revocable and irrevocable

The applicant (buyer), usually with the prior agreement of the beneficiary (seller), request its bank to issue of credit in either a revocable or irrevocable form. A revocable letter of credit may be amended or canceled by the issuing bank at any time with or without prior notice to, or agreement of, the beneficiary. In its function, the revocable letter of credit is not an assurance of payment, but rather provides the buyer and the seller with a means of settling payments. Because a revocable letter of credit may be canceled or amended without prior notice to the beneficiary, the beneficiary should not depend on a revocable letter of credit for financial protection. The beneficiary must have faith that the applicant will abide by the underline contract of sale or other agreement, and will not instruct the issuing bank to revoke its letter of credit. The convenience afforded the beneficiary under a revocable letter of credit is that payment to the beneficiary will be made by the bank nominated to pay in the letter of credit and on which the draft is drawn (paying bank), provided that the documents comply strictly with the letter of credit and that the letter of credit has not been revoked. Once the payment is made by the paying bank, the obligation of the issuing bank to reimburse the paying bank, if not previously revoked, becomes irrevocable. The paying bank is thus protected and will receive fund from the issuing bank in accordance with the letter of credit.

An irrevocable letter of credit is a definite undertaking by the issuing bank to pay, provided the beneficiary complies strictly with the letter of credit. The letter of credit cannot be amended or cancelled without the consent of the issuing bank, the confirming bank (if the letter of credit is confined) and the beneficiary. Citibank's obligation to pay is set forth at the bottom of the undertaking. The

beneficiary holds the undertaking of Citibank's (in addition to that of the applicant), but does not hold the undertaking of any other bank.

2. Confirmed and unconfirmed L/C

When the using a letter of credit, it is important to know which bank is giving its irrevocable undertaking. Some advising banks attach a letter to the issuing banks letter of credit stating whether the advising bank is merely advising or it's advising and also confirming the letter of credit. Other advising banks advise the irrevocable undertaking of an overseas issuing bank to the beneficiary by incorporating it into the text of the advising banks advice. If the advising bank is merely advising, the advise, whether it attaches or incorporates the overseas issuing banks undertaking, will likely bear a notation by such advising bank that it makes "no engagement" or words to that effect. An unconfirmed advice of a correspondent banks irrevocable letter of credit. Beneficiaries of such advices are dependent on the commercial stability of the issuing bank and political and foreign exchange stability of the country in which the issuing bank located. Beneficiaries are not always willing to rely on the stability of an issuing bank particularly when that bank is in another country or is unknown to the beneficiary. Consequently, a beneficiary may request that the applicant instruct the issuing bank to have its irrevocable letter of credit confirmed by a bank in the beneficiary's country. A confirmed bank is the which, at the request or with the consent of the issuing bank, adds its own irrevocable undertaking to that of the issuing bank. An example of advice and confirmation of correspondent is, if an overseas bank (buyer's bank) issues its irrevocable letter of credit and request that Citibank, new York, add its confirmation and advise the beneficiary, then Citibank, as advising and confirming Bank, could use its own form of advice and confirmation. Confirmed letter of credit includes the confirmation from the advising bank. The advising bank also takes responsibilities for honoring

drawing. In the case of Unconfirmed L/C, advising bank does not add confirmation and neither takes responsibilities for honoring drawing.

3. **Back –to – back L/C**

Back to back letter of credit, one irrevocable letter of credit facilitates the seller to obtain another letter of credit. To obtain back to back letter of credit the permission of the buyer or the applicant of the first letter of credit is not required. Back to back L/C is generally used by the middleman or agencies to hide the identity of the real suppliers or manufactures. The seller can utilize this back to back L/C as a security for his back, to issue a back to back letter of credit in “favor of his suppliers” in order to get a very competitive rate for his purchases and increase his profit margin in the process. Thus this can very well be used by seller to rise. Quick funds and complete his orders in the scheduled time.

Transferable and non-transferable L/C

A transferable L/C is a type of a letter of credit under which a beneficiary (exporter or seller) has the right to give instruction to the paying or accepting bank to make the credit(funds) available to one or more third parties, sometimes referred as secondary beneficiaries. **A non transferable letter** of letter of credit is when the bank makes credit available to the beneficiary only and cannot be transferred to any other party. As to why the seller is increasing 2% for non transferable L/C is something that has to specifically ask the seller why there is that additional 2% one possible reason could be that the seller is passing fees that he is charged by his bank.

4. **Red clause and green clause L/C**

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. This is basically a facility extended to the seller to draw upto 100% of credit amount as a pre-shipment finance to the produce manufacture or arrange merchandise as desire by the buyer prior to shipment. This clause is called red clause because the term would be typed in red ink. These credits are rare these days. **A green letter of credit** under which part of the credit amount is provided as advance to the beneficiary for the purpose of collecting goods of the part of shipment and preparation of relative documents regarding the shipment, green clause L/C Allows advance payment before shipment of goods, especially green products.

5. **Sight and Usance/Time L/C**

In sight L/C, payment done to the beneficiary is as soon as document presented to the paying bank. In case of time L/C, terms of the credit made are for 30, 60, 90,120 and 180 days or even more. Sight letter of credit is a letter of credit where the exporter gets the payment from his bank by discounting it, by discounting we mean that the exporter's bank will pay him the total amount of L/C by deducting some money to exporter. In sight L/C exporter get the money within 5 to 10 days after presenting the documents while in usance letter of credit a time period is given before which exporter cannot claim payment from his buyer.

Revolving and assignable credit

Single letter of credit covers multiple shipments over a long period. Instead of arranging a new letter of credit for each separate shipment, the buyer establishes a L/C that revolves either in value (a fixed amount is available which is replenished when exhausted) or in time (an amount is available in fixed installment over a period such as week, month or year). L/Cs revolving in a time is of two types: in cumulative type, the sum of utilized in period is carried over to be utilized in the next period, whereas in the non-cumulative type, it is not

carried over. Assignable letter of credit whose beneficiary can assign its proceeds to a third party, normally the assignability of a L/C is not dependent on the advising or issuing banks approval, Power or property that can be transferred by one entity to another with its associated obligations and rights.

2.1.4 Reasons for using L/C

The letter of credit is not an agreement or an official contract. The letter of credit is made from the official sales contract or agreement that customer and sales person signed. The L/C is only a means to transfer funds for payment. L/C is basically a guarantee from a bank that a particular buyer. The bank guarantees that the seller will receive a specified amount of money within a specified time. In return for guaranteeing the payment, the bank will require that strict terms are met. It will want to receive certain documents.

L/C of credit is most commonly used when a buyer in one country purchases goods from a seller in another country. The seller may ask the buyer to provide a letter of credit to guarantee payment for goods.

Advantage of buyer: when a buyer uses a letter of credit they get a guarantee that the seller will honour their side of deal and provide documentary proof of this.

Advantage of seller: By asking for an appropriate L/C a seller is reassured that they will receive their money in full and on time. A letter of credit is one of the most secure methods of payment for exporters as long as they meet all the terms and conditions. The risk of non-payment is transferred from the seller to the bank.

Other things to consider: it's important to be aware of the additional costs involved in using a letter of credit. Banks make charges for providing them, so it's sensible to weight up the costs against the security benefits.

Although the letter of credit can be useful, it's often best to avoid using one transaction. They can sometimes result in expensive delays, bureaucracy and unexpected costs. As a general rule should probably only consider opening a letter of credit as an importer.

2.1.5 Examples of simple letter of credit

To:	Asian international Bank, Tokyo, Japan (The advising Bank)
From:	Nepal Investment Bank, Kathmandu, Nepal (The Issuing Bank)
Date:	2010/09/12
Applicants:	Nepal Importers 12345, Kathmandu Nepal
Beneficiary:	Asian export 56789 inner harbor Yokohama, Japan
Amount:	USD 1000000(US Dollar ten lakh only)
Validity:	31 september2010for shipment 21 October2010for presentations at our counters in Kathmandu for sight payment against presentation of the following documents:
(a)	Signed commercial invoices of the beneficiary
(b)	Certificate of origin
(c)	full set clean on board ocean bills of landing evidencing shipment of the goods from Yokohama to Antwerp CFR made out to order and indorsed to
Special condition:	Insurance covered by the buyers, all bank charges Nepal for account of the beneficiary.
Reimbursement:	we hereby undertake to pay five bank working days from received a credit confirmed document at our counters in Nepal.

2.1.6 Benefits of L/C

The main objectives of L/C in Nepal are as follows:-

1. Facilitates financing

Letter of credit

-) Provides a specific transaction with an independent credit backing and a clear cut promise of payment
-) Satisfy the financing needs of the seller and the buyer by placing the bank's credit standing, distinguished from the bank's funds, at the disposal of both parties.
-) May allow the buyer to obtain a lower purchase price for the goods as well as longer payment terms are possible
-) Reduce or eliminates the commercial credit risk as payment certainty is made by the bank, which issues an irrevocable L/C. the seller no longer needs to rely on the willingness and capacity of the buyer to make payment.
-) Reduces certain exchange risk and political risk while not eliminating term.
-) Expanding sources of supply for the buyer since certain sellers are willing to sell only against cash in advance or a L/C.

2 provides legal protection

L/C supported by a wide variety of laws and regulations are such:

-) Legislative and semi-legislative law.
-) Codified law-in most countries the law for L/C has been codified, e.g. in
Civil law code countries, and in
Common law code countries.

) Decision law-statutory law governing L/C found in various jurisdictions. There are also extensive legal cases that have interpreted these statutory provisions and well known in judicial circles.

) L/C are usually governed by the ICC(international chamber of commerce's uniform custom and practices (UCP600 in practice) for L/C. these rules are periodically revised and have been in effect and are the set of universally recognized rules that are helping L/C to operation grow.

) The UCP (uniform custom and practice) are adopted by the banks through collective notification to the international chamber of commerce, by the respective national committees of the ICC, by the national banking association of the country, by a banks individual adherence and notification to the ICC, or by incorporation of the UCP in the L/C itself.

3. Assures expert examination of document

) The buyer is assured that the documents required by the L/C (if issued subject to the UCP) must be presented in compliance with the terms and conditions of L/C and the UCP rules.

) The buyer is assured upon documents presented will be examined by banking personnel knowledgeable in L/C operations, and

) The buyer is confident that payment will only be made to the seller after the terms and conditions of the L/C and the UCP rules complied with.

2.2 Brief profile of Nepal investment bank Ltd.(NIBL)

Nepal investment bank was established in 1986A.D, in the name of Nepal Indosuez bank Ltd., 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, professional, industrialists and businesspersons, has acquired on April 2002 the 50% shareholding of credit Agricola Indosuez in Nepal Indosuez bank Ltd.

) The name of the bank changed to Nepal investment bank Ltd.(NIBL) with the following shareholders structure:

Shareholders	percentage
1 Group of companies	50
2 Rastriya banijaya bank	15
3 Rastriya bema sanstha	15
4 General public	20

The holding of shares by public also implies that NIBIL is one of the listed company act 2021 B.S and commercial bank act 2031, in year 2042 B.S, magh 6th (1986/02/27). Under commercial bank Act 2031, the bank started operation as a commercial bank with the permission of NRB, on 2042 B.S, magh 22nd.

Goals and objectives

) To provide 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 build profit through customer oriented service and customer satisfaction.

) To widespread its branch network in different parts of the country covering all different development regions facilitating large number of clients as far as possible.

) To provide possible co-operation and support for the improvement of the economy condition of the country.

) To perform banking transaction with in Nepal and out sides Nepal, received deposits, give out loans and advances, discounting bills, promissory notes, foreign exchanges, by and sell of bills of lading, delivery order and other business papers, opening letter of credits as well as issuing bank guarantee.

) To perform all the functions noted in the memorandum of association, article of association and per the rules and regulations.

2.3 Review of works

During any research work, the previous studies cannot be ignored because they provide foundation to the present study. In another words, there has to be continuity in the research. This continuity in research ensured, by sinking the present study with the past research. Literature review is basically a ‘sock taking’ of available literature in field of research. The main purpose of literature review is to find out what study has been done in the field of the study and what remains to be done. It provides the foundation for developing a comprehensive theoretical framework and minimizes the risk of pursuing the dead in the research. Thus sum books, unpublished materials and previous research study in the topic of “**letter of credit**” have been review. Though sufficient literature does not exist related to this subject, it has been tried to include all possible information in this report.

2.3.1 Review of related work in NIBL

From the library of Nepal investment bank ltd, I found that **Mr. kunjan K.C (2008)** has conducted a study titled “**letter of credit process of Nepal investment bank Ltd.**” the main objective was to find out the process of letter

of credit especially in context of Nepal investment Bank Ltd. and to provide recommendation for the improvement of the company in the subject matter. **Mr. K.C's** conclusion in his own words was that 'NIBL' has played a great role in the development of the international trade finance. From the transaction of letter of credit of 'NIBL', we can say that this bank really has helped in the international trade, which has also helped to uplift the national economy. The terms and procedures used in the letter of credit may vary from country and also from bank to bank. It is advised the bank in Nepal should follow the directives of NRB as well as ICC (international chamber of commerce) guidelines before opening of L/C. Due to the efficient and effective management in the technology so that there is drastically rise in the L/C transaction.

Mr. Sajjan kansakar(2007A.D) conducted a study on letter of credit information system of Nepal investment bank Ltd. This study was conducted basically to explore the letter of credit process of the bank and to learn about the use of information trade in the field of international trade in the field of L/C transactions.

His conclusion was that letter of credit is becoming a popular way of payment and is particularly suited to cross-boarder trade. A customer arranging for a letter of credit to be opened can specify precisely what goods he/she is ordering and the documentation that evidences they have been dispatched according to his/her wishes. The customer does not make any inspection himself so the bank is required to scrutinize documents. The text of the letter of credit will specify whether the documents will be negotiated and accepted by the issuing bank which may be in the suppliers country or by the advising or conforming bank.

2.3.2 Review of Related Research in NIBL

i) The article in UCP(Uniform custom and practice) 600

It is now over one year since UCP 600 was implemented and is an opportune time to take a brief look at where we are with the implementation, issue, and usage of letter of credit from an ICC perspective, 2008 has seen three requests for decisions relating to credits issued subject to UCP600. The first was in respect of a credit that was issued on 24 July 2007. The Underlying issue related to the action of a bank when refusing documents where that bank was not the issuing bank, but the bank to which the issuing bank had outsourced their processing. The issues this case would equally have arisen if credit had been subject to UCP 500.

The second also related to whether or party had refused the documents in a timely manner. In this case, the issuer of the credit was a non bank who took longer than the maximum of five banking days to provide their refuses. In fact, their refusal was sent on the 11th banking (business) day. Again, the issues in this case would equally have arisen UCP 500

The third related to a case where the issuing bank required presentation of an “arrival advising report” in relation to vessel. The beneficiary presented a document so titled but the issuing bank refused on the basis that it should have been issued after the vessels arrival although this was stated in the credit.

ii) The article in uniform custom and practice for Documentary credit (UCPDC)

The transaction of L/C deals with documents only, it does not deal with goods. As the UCP started that in credit operation all party deal with Documentary many related. As the international character of L/C sometime domestic and local law are not effective to solve the problem and interpret the proper terms on it. So need of one international law related to letter of credit enacted by international

chamber of commerce the first attempt in this field was made early 1993 and revised many times.

iii) The article in international trade and L/C (bineet dhungana, journal of ICAN 2009 page 34)

Letter of credit has become one of the most widely used documents in international trade. For a bank, letter of credit is linked with many revenue sources. But banks need to be cautious in L/C related transaction as L/Cs are susceptible to many risks. When there are some unpredictable turns in international trade, or major economic movements in world market, even the transaction related to L/C are exposed to disputes (in between various parties to L/C). Such unfavorable situation will generally result in to disputes related to technical as well practical aspects of trade executed via letter of credit.

iv) The article in collection of circulation issued by foreign exchange management department, Nepal Rastra bank.

Nepal Rastra bank the central bank of Nepal was established in 1995 under the rastra bank Act 1995 to discharge the central banking responsibilities including development of the embryonic domestic finance sector.

In, Nepalese context, L/C transaction related with foreign currency stately follows those circular. If L/C transaction made without following the rules or circulars laid down by NRB shall presented violation of NRB rules.

In this study, “collection of circulars issued by foreign exchange management department, NRB or central office is denoted as NRB forex policy or NRB forex guideline.

2.3.3 Review of thesis

In this study, “collection of circulars issued by foreign exchange management department, NRB, central office is denoted as NRB forex policy or NRB forex guidelines”.

There has been little number of theses done in L/C. therefore, my finding has been confirmed.

In this, review of related studies section some researcher finding related to this topic is presented below:-

i) Chhetry (2005): has submitted a thesis entitled on ‘A study on letter of credit operation of SBI bank limited. He had done analytical study of L/C on joint venture commercial bank, which is operating from Kathmandu valley. His main objective of the study is:

- To examine the NRB direction on L/C operates.
- To analyze the problem while opening L/C.

Finding of this study

-) Rules laid down by NRB regarding L/C transaction are inconsistent with the international practice. This has caused difficulty to business people for international trade(import and export) and decrease in the earnings of bank.
-) There should be sound coordination between NRB and SBI and other commercial bank so as to deliver credit and other supporting services smoothly. So that jointly effort can be earned out in making any decision like change in service charge, interest rate,lending criteria, credit term etc.
-) There have been a lot of fraud cases in bank by ineffective and inefficient management. Therefore to prevent future fraud cases in future, the manager must be careful and must follows the direction given by NRB, which is important for successful running of business.

ii) Pradhan L(2008) has submitted a thesis entitled on ‘A study on letter of credit operation of Nepal credit and commercial bank Ltd.’ she has done the study of L/C operation in Nepal credit and commerce bank ltd. her main objective of study are:

- To examine the pre- requisites for opening L/C.
- To evaluate the documents used in L/C.
- To analyze the procedure of opening L/C.
- To study the problem of L/C.
- To explore the transaction of L/C sample bank.

Finding the study:

- NCC bank has increasing trend of total loan and advances to total deposit ratio.
- The bank has decreasing trend of non performing assets to total loan and advances ratio.
- The bank has decreasing trend of interest income to total loan and advances to net profit ratio.
- The book has increasing trend of total number and total transaction value of export L/C opened in US dollar except the two following years of study period.

iii) Khadka Y (2010); has submitted a thesis entitled on ‘Analysis of letter of credit operation of Nepal credit and commerce bank Ltd.’ he has done analysis of L/C operation of NCC bank and findings of his study from primary data is concerned the following conclusion have drawn.

Finding of the study:

- Study and examine the pre-requisites and required documents for opening of L/C.
- Evaluate the coordination between L/C operation, NRB forex polices and international rules for L/C guidelines i.e. UCPDC 600.
- Analyze the sample banks L/C transaction with the overall national value of L/C business.
- Evaluate the L/C business and profitability of the sample bank.

- Provide recommendation to the concerned bank on the basis.
- NRB forex policy and UPDC 600 and concerned banks requirement (pre-requisite for opening of L/C in NCC bank) should be simple and easily understandable. Since NRB forex policy and UPDC 600 and banks requirements are the major before opening the L/C. the concerned bank must monitor whether the NRB forex policy and UCPDC 600 both are strictly followed or not.
- NCC bank should adopt the sound credit collection policy. It helps to decrease loan loss provision and non performing loan of the bank.
- The policy should ensure rapid identification of dealing with loans, immediate contact with borrower and continual follow up until a loan is recovered.

2.4 Research gap

This research previously conducted were on the whole performance of the banks whereas this research focuses particularly on the performing of L/C business and in the context of **Nepal investment bank Ltd.(NIBL)** there were no reports available specifically written on this subject. This report is related exclusively to **‘Analysis of letter of credit business of Nepal investment bank Ltd.’** The need for it generally arises whenever any two parties (i.e. exporter and importer) get into a context to buy and sell something. In any international trading activity, as the parties to reside in two different countries, the issue of confidence and credit worthiness of the both parties.

L/C is a reliable instrument in trade and in 20th century where the market of trade is enhancing. The importance of L/C is in increasing trend but there are many confusion regarding L/C transaction theory and practices on our country. The main focus will be towards studying the obstacles of L/C business, procedure of L/C transaction role played by NRB for L/C document necessary for the letter of credit and other rules regulation and obstacles in L/C business.

CHAPTER 3

RESEARCH METHODOLOGY

3.1 Concept

Research methodology is the way to solve systematically about the research problem. This study aims to examine, analyze in interpret the letter of credit business of NIBL. Research methodology may be express in other words as process of arriving to the solution of the problem thought plan and systematic dealing with collection of data and analysis of figure.

The basic objective of this thesis is to analyze theory and practice of L/C to enhance letter of credit theory and practice in Nepal for the improvement of business transaction. Thus in this chapter focus have been made on different law regarding letter of credit, documents require for letter of credit, role played by NRB for monitoring L/C as well as NRB act and commercial bank act 2031 has been examined meticulously. The internationally accepted UCP 600 for L/C transaction has been taken as reference along with various circular issued by NRB and directives of NRB for L/C transaction have been consider as key factor for letter of credit transaction.

3.2 Research Design

Research work is designed to obtain answers for the research questions. Research design is the plan, structure and strategy of investigation conceived so as to obtain answer to research question. This study is mainly concerned with the examination and evaluation of letter of credit business of NIBL. Therefore the study is closely related with the subject matter. In course of preparation of

this thesis regular discussion was made with the supervisors of trade finance department of NIBL and from the discussion and the provided materials the study has been conducted.

3.3 Nature and Source of Data

Information is the life blood of any research. So, the significance of research depends upon the nature, availability and accuracy of the information, together the true information, the data collection matters the most of fulfill the objective of this study. Data and information that have been use in this study were collected from the following sources:-

- Financial statement of NIBL
- Different and periodical reports of trade finance department of NIBL
- Published as well as unpublished matter
- Various reports and directives of NRB
- Books related to subject matter
- Related materials available in the library of NIBL
- Some sites on the internet

3.4 Research Variables

The research variable of this study mainly related with periodical reports that are prepared in the trade finance department of NIBL. And the available matters related to the subject in the NRB.

3.5 Tools Used

The data collected are managed and organized in the tables and formats interpretation and explanations are made wherever necessary. To analyze the collected data, tables, graphs and diagrams have been used as per the requirement. Both financial tools as well as statistical tools are used to analyze the collected data which are discussed below:-

3.5.1 Financial Tools

Analysis of financial statement is the process of determining financial strength and weakness of the company by establishing strategic relationship between the items of balance sheet. Among various tools, ratio analysis and trend analysis will be used for this study purpose. The data are collected from balance sheet of the company as well as different data which are calculated and submitted for the quarterly meetings are presented as records.

3.5.2 Statistical Tools

There are different statistical tools; here few statistical tools are used to analyze the study as per requirements.

i) Correlation Coefficient (r)

Correlation coefficient is the important tool to analyze the degree of relationship between two or more variables. It is used to describe the degree to which two or more variables in the linearly related to another variables. It refers the closeness of the relationship between two or more variables. In other words, it is an analysis of covariance between two or more variables. It is the statistical measure of the relationship, if any, between series of numbers representing data of any kind, from returns to test scores. If two series move in the same direction,

they are positively correlated, if the series move in opposite direction, they are negatively correlated.

The degree of correlation is measured by the correlation coefficient, which ranges from +1 for perfectly correlated series to -1 for perfectly negatively correlated series. Symbolically, correlation coefficient can be expressed as follows:

$$r = \frac{n \sum XY - \sum X \sum Y}{\sqrt{n \sum X^2 - (\sum X)^2} \sqrt{n \sum y^2 - (\sum y)^2}}$$

Probable error (P.E.)

The probable error of the coefficient of correlation helps in interpreting its value. With the help of probable error, it is possible to determine the reliability of the value of the coefficient in so far as it depends on the conditions of random sampling. The probable error of the coefficient of correlation is obtained as follows:

$$P.E. = \frac{0.6745 \times \sqrt{1-r^2}}{N}$$

Where,

r = Correlation coefficient

N = Number of pairs of observations

If the value of ' r ' is less than the probable error, there is no evidence of correlation, i.e. the value of ' r ' is not at all significant. Then, if the value of ' r ' is more than six times of the probable error, the coefficient of correlation is practically certain, i.e., the value of ' r ' is significant.

Here, the researcher has been calculating the correlation coefficient between import and export L/C to know the relationship of these variables. This relationship result helps the management for policy formulation in the coming days.

3.6 Limitations of the Methodology

To carry out the research work, various financial and statistical tools are used. Similarly, descriptive as well as analytical analysis of letter of credit has been carried out however these tools and techniques have been some limitations. For research purpose, the five-year data are used in analyzing the financial and statistical tools, which may mislead the research work, as it is not sufficient to make projections for future regarding the performance of the bank. As far as the financial tools concerned, only ratio and trend analysis has been carried out to know the performance of the bank. With regard to statistical tools, the researcher carried out different statistical tools to make the result study. More concise but it may not be the valid measurement. Although, there were certain limitations during the research work, it is not so crucial that it can weaken the basic findings of the study.

CHAPTER 4

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This is the most important chapter of the study. In this chapter the data's collected will be analyzed and presented mathematically. All the above mention financial and statistical tools will be used to present the data.

A letter of credit is an instrument where in a bank authorizes another bank to debit, its account for payment to the exporter upon submission of specified documents and fulfillment of stipulated condition in respect of shipment of goods or services rendered and required by importer. The request to open letter of credit will be made by the importer to its bank detailing release payment to the exporter.

The main propose of this study is to examine the performance in terms of 'Analysis of letter of credit business of NIBL'. Here various comparative figure related to letter of credit (such as import L/C outstanding, export L/C outstanding, commissions earned) for 5 years are presented for growth analysis and another banks figure for the same period is also presented foe competitive analysis.

4.2 Context Analysis.

In this part of the study, an analysis of the context of the letter of credit such as contents of L/C, Documents used in L/C, discrepant documents found in L/C, Amendments made in the L/C, pre-requisites for L/C etc are curtained out.

▪ **Contents of letter of credit**

Letter of credit must contain the following information:

1. Name and address of issuing bank
2. A statement regarding application of UCPDC (uniform customs and practice for documentary credit).
3. L/C number and address of the applicant.
4. Name and address of the applicant.
5. Name and address of the beneficiary.
6. L/C value (currency and amount).
7. Terms of delivery.
8. Tenor of bills of exchange.
9. Nominated banks.
10. Details of the goods (amount, quality, brands name etc)
11. Method of shipment.
12. Document Require.
13. Date and place of expiry.
14. If any further instruction.

Documents used in letter of credit

Documentation constitutes a very important element in smooth execution of export order. It is therefore essential that the exporter clearly prepares and assembles the document called for the contract of L/C. documents usually required is classified as follows:

1) 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 bills of lading (B/L), 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 pre-payable” will not be accepted. If the credit is silent, bank accept transport document stating “freight yet to be paid”. The transport document may also include about **transshipment** i.e. unloading and reloading of vessel to another during the course of ocean carriage.

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 have been sent through airway. The date of issuance of the air transport document will be deemed 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 will accept the document which contains the name and signature of the carrier, bears the indication of the receipt, and indicates that has been received for shipment, mentions the place of shipment and destination as per credit, and meets all other requirements of credit.

2) **Commercial invoice and packing lists**

The commercial invoice is a document that is sent to the bank by the beneficiary’s bank after the goods has been shipped. It is same as the pro-forma

invoice but it consist the invoice No. and date as well as the buyer's order No. Universally recognized set of international trade terms, such as FOB, CIF etc is also presented in the document. The number of packages, description of goods, quality, rate and amount is specified along with the eight digit harmonic code. The preformed invoice details and the commercial invoice details should match each other.

3) Insurance document

Insurance documents use one of the important documents required for L/C transaction. UCP600 devotes this document as it is very complex nature. All the originals of insurance document issued and signed by insurance companies, underwrites or their agents are to be presented. The cover notices issued by the broker are not acceptable. Date of issuance must be on or before the date of shipment or it must be proved by the specific notation that the cover is effective from the date of shipment. The insurance cover must be the currency of credit and at least for 110% of CIF value.

4) Certificate of origin

The origin of the goods is precisely started in a credit and in many cases (e.g. commodities) the origin can considerably influence the price of the goods, hence it need to 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 are certified by the beneficiary himself.

5) Other documents

Other documents demanded by the L/C besides these mentioned above are bill of exchange, drafts and Inspection certificate. There can be others too.

Discrepant document

After receiving the documents, it needs to be thoroughly checked with terms and condition of L/C. if any documents contain any discrepancies which is not be accepted by the issuing bank, then the bank immediately informs the settlement bank and the client within seven working days as per UCP act. If the issuing bank fails to inform the settlement bank then the bank is bound to remit the payment even though the document contains any discrepancies. If the client accepts the discrepancies then he immediately has to submit an acceptance letter to the bank before retiring the documents and remitting the payment.

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 contract the beneficiary to get the document corrected, if possible.
- The paying bank can contract the issuing bank in order to get their permission to take up documents despite the discrepancies stated.
- The paying and can sent document to the issuing bank for payment authorization or in case of major discrepancies, for collection.

The largest proportion of documents is dishonored due to error in presentation and the majority of discrepancies are in the invoice.

Amendments in the documentary credit

The seller after receiving letter of credit that he cannot meet one or more conditions of the credit he can request to change conditions of letter of credit. The terms and condition of letter of credit can be changed by amendment. To amend an irrevocable letter of credit the seller must first contract his account party regarding the change. If

	Revocable L/C	Irrevocable L/C	Conformed L/C
Who applies for amendment	Account party	Account party	Account party
Who applies amendment	Issuing bank	Issuing bank beneficiary	Issuing bank beneficiary confirming bank

Requested change or amendment is acceptable; to the account party he should notify the issuing bank of the amendment. For the amendment to be effective the issuing bank, the confirming bank (if applicable) and the beneficiary does not have to approve the amendment.

In case of revocable letter of credit may be amending or whole letter of credit may be cancelled by the issuing revocable letter of credit cannot cancel offer, but beneficiary has presented his document and had then accepted/paid.

Pre-requisites opening L/C

While opening letter of credit, applicant has to submit various important documents. NRB has directed that applicant have to submit various document related to the import trade. Those documents are given as follows:

1. Income tax renewed certificate.
2. Firm registration certificate (duly renewed) .
3. Should have income certificate, PAN certificate and VAT certificate.

4. The customer should be current account holder.
5. The photocopies of the proprietor/partner/director.
6. The proprietor/partner/director name should be registered
7. Limit approval or review period bank should collect the copy of firm's financial documents, CIB report or board minutes.
8. Customer should be credit worthiness in the market.
9. Permission is required from the NRB in case of applicant is an individual or non registered firm.
10. In case of private limited, minute must be presented; among those articles of association (AOA) and memorandum of association (MOA) are the most.
11. Performa invoice/sales contract issued by beneficiary/indenter

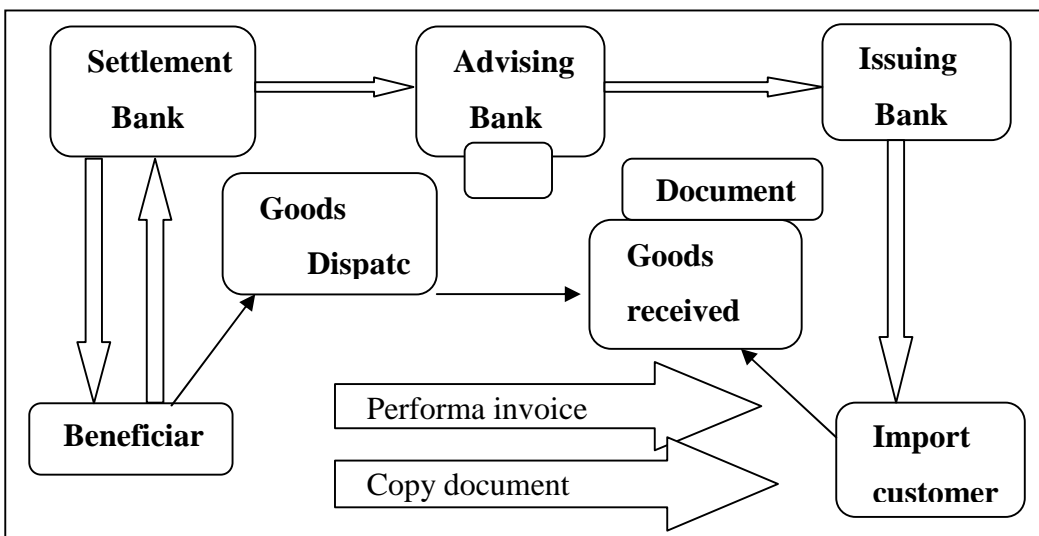
There must be following indication details.

- Description of goods(name, brand and model No. of goods)
 - Harmonic code
 - Country of origin
 - Unit price and quantity
 - Total price
12. L/C applicant duly filled up signed and stamped by opener/account/applicant
 13. Bi.Bi.Ni.3 (not required for L/C opened in IRS and NRS)
 14. Garment of association recommendation's letter (to import fabric for India only)
 15. Trade and export promotion committee(to import wool only)
 16. Insurance policy in case of L/C opened on FOB, FOR C&F basis.
 17. Importer restricted Items:
 - a. Arms and explosive products
 - b. Radio frequency transmission product

- c. Narcotic product:- like, cigarette ,tobacco, heroin
- d. Liquors, wins- inland revenue departments approval is required
- e. Products made of recycled plastic granules
- f. Gold, silver and precious metals (gold is very recently remove)
- g. Ozone deflecting product –must be CFC free.
- h. Beef.

Operation of letter of credit

Figure 2



Scrutinizing of application

- L/C application must be filled properly.
- Under open general license (OGL) only L/C can opened for product.
- The Bi.Bi.Ni from no. 3 should be filled and signed properly.
- The firm’s registration and income TAX/VAT must be updated.
- Performa invoice should be attached with quantity amount, harmonic code and certificate of origin.
- Signature of authorized person and the stamp of the company should be verified.

Process of approval

- When the application is certified, it is sent for approval from the concerned authority.
- If the case is within limit and without any dues it is approved.
- In case of non-limit holders or new client approval is made through concerned authority.
- L/C has to be processed and passed the same day the application is received. A register is maintained clearly showing the time application was received, processed from the department. Proper monitoring and follow up is done by the TFD (trade finance dept.)

After approval has been obtain

- The margin for L/C taken and held in the L/C margin account prior to the issue of the L/C.
- Banks margin for L/C is 10% or above depending on the client, however this can be lowered for selected clients by special approval.
- The commission and the telex charges have to be charged.
- The L/C liability has to be booked properly.
- The Bi.Bi.Ni from No. 3 need to be separated and copies should be sent to NRB and custom and original field by the bank.

Formation of letter of credit

- After the above process, the L/C format has to be made according to the application and other documents.
- Selection of the transmission means and format should be made accordingly.

Transmission of letter of credit

- L/C can be sent through mail, courier, telex and SWIFT

- The date and time should be noted after L/C has been sent.

Amendment of letter of credit

- Proper request for amendment should be made.
- Amendments must be signed by the authorized persons.
- Bi.Bi.Ni from No.3 must be filled and signed properly as well.
- Amendment must not NRB directives.

Cancellation of letter of credit

- Applicant must request the issuing bank for the cancelling of L/C. then the issuing bank informs the advising bank and advising banks informs the beneficiary for consent. Under mutual understanding of the buyers and seller the L/C is cancelled.

Documents required under import letter of credit

- Draft
- Commercial invoice
- Packing list
- Certificate of origin
- Insurance copy and transport document

Documents required releasing the goods from customs

- For industry 2% margin is taken and for trading 10% margin is taken for the custom purpose.
- Bi,Bi.Ni. from no.4 is filled in quadruplicate as follow:
 - First two copies to importers, for the submission to customers.
 - Third copy to be sent to NRB.
 - Forth copy to be retained by the bank

- Each copy of the documents mentioned in L/C along with copy of L/C and pro-forma invoice is separated.

- These documents are compiled and kept in an envelope for sealing.

Settlement of letter of credit after arrival of original documents

- It must be checked whether documents are as per the L/C terms and others and any discrepancies found.

- Exchange rate details should be confirmed with the treasury department before giving them to the client.

- If the documents are found to have discrepancies in them, client should be informed and a telex should be sent to the settlement bank mentioning the discrepancies.

- Refusal of discrepant documents has to be informed within seven days from the receipt of document as per UCP-600.

Mode of payment

- **Sight payment credit:** In this type of credit the draft is at sight basis i.e. when the documents are presented to the bank, the payment should be made immediately after receiving the documents. The normal time for the payments given by UCP-600 is seven working days after receiving the drafts at sight.

- **Acceptance credit:** In this type of credit, the draft are drawn at certain time from sight i.e. the issuing bank must sent payment of the draft value from the days mentioned in the draft from the acceptance of the draft by the buyers. When the issuing bank receives the documents, it informs the applicant for its acceptance. When the buyers accept the draft value, the buyer's bank advice the due date i.e. the date of payment according to the days mentioned in the draft.

- **Draft payment credit:** If a credit is issues deferred payment until a future date without stipulating that the draft are to be drawn, it fails into the category of deferred payment credit and the advising bank will not call for drafts.

- **Negotiation credit:** a credit can be “freely negotiable” which means negotiable with any bank but negotiation can be restricted to a particular bank. If a credit is freely negotiable, then any bank may negotiate it.
- **Transferable credit:** A transferable credit is that where one credit can be transferable between more than one party by way of breaking the original value or the full amount.
- **Back to back credit:** This type of credit is opened against the backing of another credit received on the customer favor i.e. the payment under the back to back credit will be made after the full and final realization of payment of documents received under the credit received in the customers favor. The customer who also goods abroad submits their export L/C to import the raw material to prepare the goods for export against their export L/C in the bank. When they make shipment of the goods and presents documents for negotiated. The bank makes the payment of the import L/C.

Some of the important directives of NRB

1. Applicant for opening L/C should mandatory fill in the presented form.
2. At the time of retirement of documents Bi.Bi.Ni. Form 4 should be prepaid in quadruplicate. First two goes to importer for submission to custom office and clearance of goods. Third to NRB and forth is related by bank.
3. Documentary credit serial number for the L/C payable in Indian currency should be separate.
4. Bi. Bi.Ni. Form no 3 &4 should be submitted to NRB on daily basis by bank situated in KTM valley and weekly in other case (out of valley). A copy of Bi.Bi.N must be sent to the custom office.
5. Requirement for the opening L/C firm registration certificate, Performa invoice or invoice or contract specifying value and quantity of the goods to be imported.

- 6.** Documentary credit with clauses like “all discrepancies acceptable” shall not be open nor shall be amended resulting to such arrangement.
- 7.** No documentary credit shall be amended to enhance the L/C amount by more than 10% without prior approval. However such approval is not required; where amended amount is US\$1000 or less.
- 8.** The central office of each commercial bank shall compulsory follow up all documentary credit for more than US \$50000.
- 9.** In the case of cancelling of import L/C all documents made available by bank to the importer shall compulsorily be received back.
- 10.** Documentary credit received through correspondent bank should only be accepted.
- 11.** Payment to the beneficiary by must be made through correspondent bank. Direct payment to the beneficiary by way of draft is strictly prohibited.
- 12.** Payment of import bill than US \$1000 by demand draft requires NRB approval.
- 13.** No. payment or otherwise transaction can be made of the transport document prior to the date of opening of documentary credit or the date of amendment (if any).
- 14.** Commercial bank accepts a “transport document” if that present to bank with 45 days of issue.
- 15.** All commercial bank should inform NRB within 7 days of opening L/C with a cash margin of 50% or more
- 16.** Along with Bi.Bi.Ni. Form no .4, all commercial banks should forward following documents to the concerned customers office. Amendments in L/C if any, commercial invoice, transport document, certificate of origin, packing list.
- 17.** Procedure should be followed before submitting Bi.Bi.Ni. From no.4 to the concern customers office. Document must be submitted in sealed envelope.

Bank should maintain separated file for each customer's office. Non-receipt of document from customs office within reasonable time or document receipt does not matched with the bank copy must be informed to NRB.

18. A bank can issue Bi, Bi.Ni form no.4 on the basis of copy document only, if concerned bank had received full payment from the value of goods. The original document must be submitted to bank within 21 days from the date of issue of Bi.Bi.Ni. From no.4, if the bank does receive original documents within such time it must refer to NRB, further bank should not accept other copy of document of defaulter.

19. No commercial bank can issue a documentary credit with "red clause".

20. Concerned authority must issue the certificate of origin. However if importer abroad accepts the certificate issue by the producer, above rule can be exempted.

21. Pro-forma invoice or indent must contain description of goods, country in which the goods are produced, unit price, quality and total price.

22. Half yearly internal audit report of each bank licensed to issue L/C must be sent to NRB.

23. If original document do not match copy documents bank should inform NRB and hold the L/C till NRB gives clearance.

24. The back to back L/C can be opened against confirmed and irrevocable L/C only. Payment shall be made only out of the proceed of export of the finished product of the concern raw material.

Prohibition regarding the opening of letter of credit

Opening of letter of credit for certain things are prohibited by the NRB, Nepal govt. and the head office of related bank. Opening of letter of credit for things like tetracycline, boron, readymade garments, clove, video cassette, plastic scraps, titanium dioxide, shoes doxycycline, and raw material for medicine,

flasks, lunch box are prohibited. A part from these if the applicant request the bank to open the L/C for other things that do not have harmonic code, bank should open only after taking the permission of the loan investment department. However, 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 used for making opium. L/C cannot be opened for import of the illegal product. Government has prohibited the opening of the L/C for the export of the rice. Besides these, **Nepal investment bank** prohibited these things:

- Arms and ammunitions
- Jewelries/precious stones
- Narcotics
- Wild life products like elephant tusk, skin and beef

Problem while opening letter of credit

Opening procedure of L/C is long, legal and complicated process. Therefore, parties involved in this process face many problems. The main faced by the opening banks and customers can be follows:

1. NRB has instructed all the commercial banks to open L/C on the basis of the status of commercial banks find the terms 'status' very vague.
2. Employees of commercial banks involved in L/C transaction have to be responsible if anything goes wrong in the transaction. However, employees of Nepal govt.'s department of commerce and taxation department from where people get import license and income tax clearance certificate respectively to open L/C are not responsible.

3. Government makes valuation for goods to be imported, is usually undervalued, and gives foreign currency accordingly. As the given currencies are not sufficient to pay the bill, importers are compelled to get foreign currency illegally.
4. Something the client of the bank turns out to be fraud. In such case bank has to face many problems. Sometimes client does not come to collect the document; banks have to pay to the exporter even though the goods are in the banks possession.
5. The new customer has deposit around 100% L/C takes around 15 to 30 days for settlement. Therefore the customer cannot use the amount, as if gets freeze.
6. If the party is new then exporter does not believe and ask for advance payment to deliver goods for which NRB does not provide permission. For this purpose, they have to use the other reputed importer's account to pay them.
7. If a firm's has not exceeded more than one year period from its registration, they have to pay tax in advances of L/C amount. Issuing bank charges 10% tax of L/C amount and send it to the tax office. Within that one-year, they have to pay advance tax payment every time they open L/C.
8. The major problem of L/C is as per UCP up to 5% tolerance is allowed but as per NRB rules; no specific tolerance on the value and quantity is allowed.

4.4 Analysis of basic indicators:

Ratio analysis

Ratio analysis is one of the tools of financial analysis. Under this ratio analysis, various ratios have been calculated and interpreted. It is widely used as a tool of financial analysis, as a systematic use of ratio to interpret the financial statement so that the strength and weakness of firms as well as its historical performance and current financial conditions can be defined. Ratio analysis enables the

business owner/manager to spot trends in a business and to compare its performance and condition with the average performance of similar business in the same industry. To do this compare own ratios with the average of business similar to owns and compare own ratios for several successive years, watching especially for any unfavorable trends that may be starting. Here, ratio analysis may provide the all early warning indicators that allow us to solve problems.

Here, Ratio analysis may helps in business of **import/export**, to compare goods of historical and present data's. L/C is one of the most important approaches that have been developed to facilitate the respective client from effective management process in financial sector. It is a system approach for attaining effective management process. The analysis of **Letter of credit** is formal expression of commercial banks goods and objective stated in financial terms in which the **success or failure** of any banks largely depends. It may be regarded As the indicator for determining profit. Especially, the following groups of ratios have been selected for analysis:

Loan and advance related to L/C transaction:

The bank can open L/C in many countries through its expending list of corresponding bank to facilitate the import requirement of it corporate of business clients. Loan and advance related to difference transaction like, loan and advance related deposit, non-performing assets, interest income, and net profit etc. Normally, Loan is provided in two types: **Trust receipt** and **packing credit**. Trust receipt loan is provided to facilitate the corporate/business client to meet its working capital requirement for purpose of meeting the gap in its assets conversion cycle, the bank can provide loans against import Letter of credit as per the central bank (NRB) directives and Packing credit packing credit provides on exporter with financing purchase import of raw material, processing and

packing of the goods meant for exports. This smoothens the exporter's cash flow while the goods are being packed and waiting for shipment. The advance is repaid when the goods are shipped.

4.5 Analysis of Import L/C

The importer (applicant) imported different products from outside of the country. In this condition, the importer of applicant opened import L/C for safe payment. The bank has record of the data like the no. of L/C of particulars month and their equivalent amount in NPR and from that No. of L/C of particulars month are accumulated to make it total L/C of fiscal years so here the total amount of L/C and number of L/C issued are taken as two variables for comparison.

4.5.1 Import L/C in Nepali currency

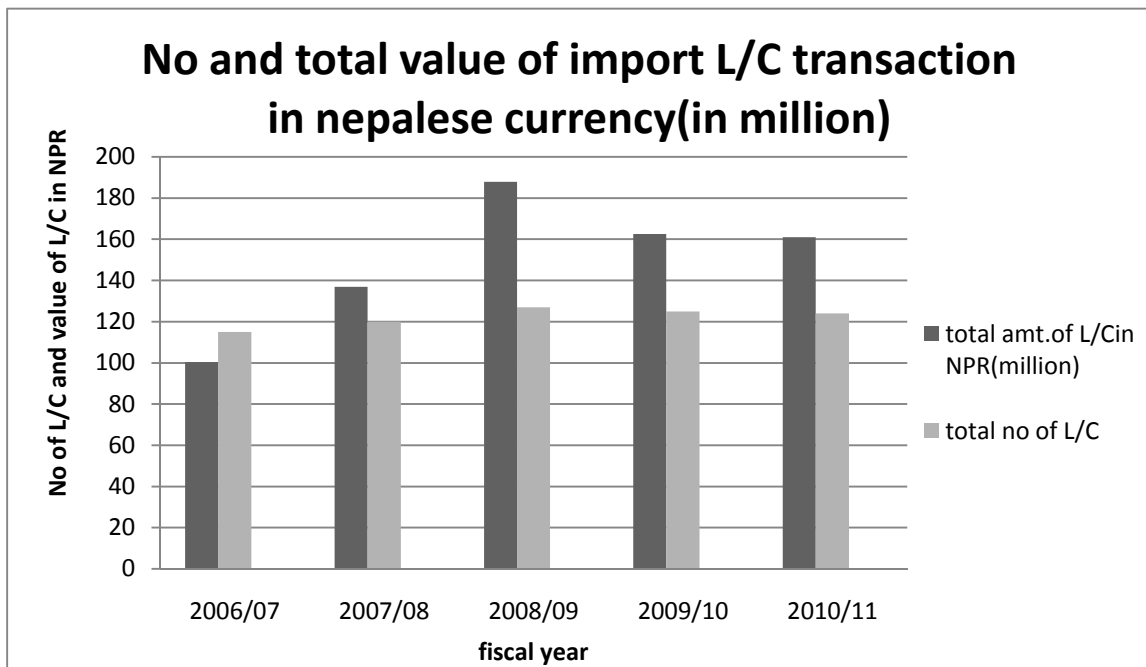
Fiscal years	Total No of L/C	Total amount in NPR
2006/07	115	1,004,683,467.66
2007/08	120	1,368,691,793.70
2008/09	127	1,878,592,843.66
2009/10	125	1,625,437,562.64
2010/11	124	1,610,054,321.50

(Source: NIBL)

Above table 4.5.1 represented the total number of import L/C opened in Nepalese currency and total transaction value of import L/C in Nepalese currency from fiscal year 2006/07 to 2010/11. Total number of import L/C opened in Nepalese currency and total no of L/C was in increasing trend in 2006/07 to 2008/09 then after decreasing trend up to 2010/11. They were 115,

120, 127, and 125,124 in the fiscal year 2006/07 to 2010/11 respectively. Though the number of L/C has been increased but the NPR amt is decreased, it due to discount in commission given to the corporate clients. But then after, transaction value of import L/C in Nepalese currency was increase in up to 2008/09 then after decrease until last year of study period. They were 100.47million in the fiscal year 2006/07, 136.87 million in the fiscal year 2007/08, 187.86 million in the fiscal year 2008/09, 162.54 million in the fiscal year 2009/10, and 161 million in the fiscal year 2010/11 respectively. Here Nepalese currency has been declined as compared to previous fiscal years due to inconsistency situation of country. Following figure more clarify about it:

Figure 4.5.1



4.5.2 Import of L/C in INR currency

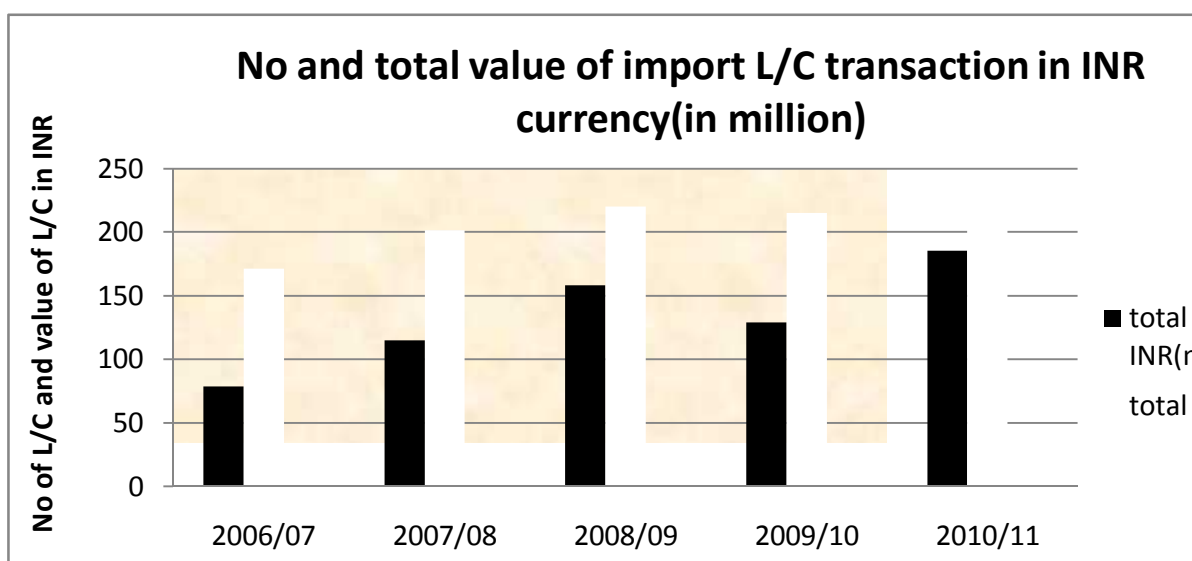
Table 4.5.2 import of L/C INR currency

Fiscal years	Total no. of L/C	Total amt. if L/C in INR(mill)	Total amt. in NPR(mill)
2006/07	171	48.87	78.29
2007/08	201	71.60	114.67
2008/09	220	98.74	157.98
2009/10	215	80.48	128.77
2010/11	225	115.58	184.93

(Source: major indicate of respective bank)

Above table 4.5.2 represented the total number of import L/C opened in Indian currency and total transaction value of import L/C in Indian currency from fiscal year 2006/07 to 2010/11. The total number of import L/C opened in INR currency was increasing trend except 2009/10 over the five years of study period. they are 171, 201, 220, 215 and 225 in fiscal year 2006/07 to 2010/11 respectively. Similarly, total transaction value of import L/C in INR currency was in a increasing trend except 2009/10. They were 78.29 mill in the fiscal year 2006/7, 114.67 mill in the fiscal year 2007/8, 157.98 mill in the fiscal year 2008/9, 128.77 mill in the fiscal year 2009/10, 184.93 mill in the fiscal year 2010/11 respectively. Following figure more clarify about it:

Figure 4.5.2



4.5.3 Import of L/C in US dollar

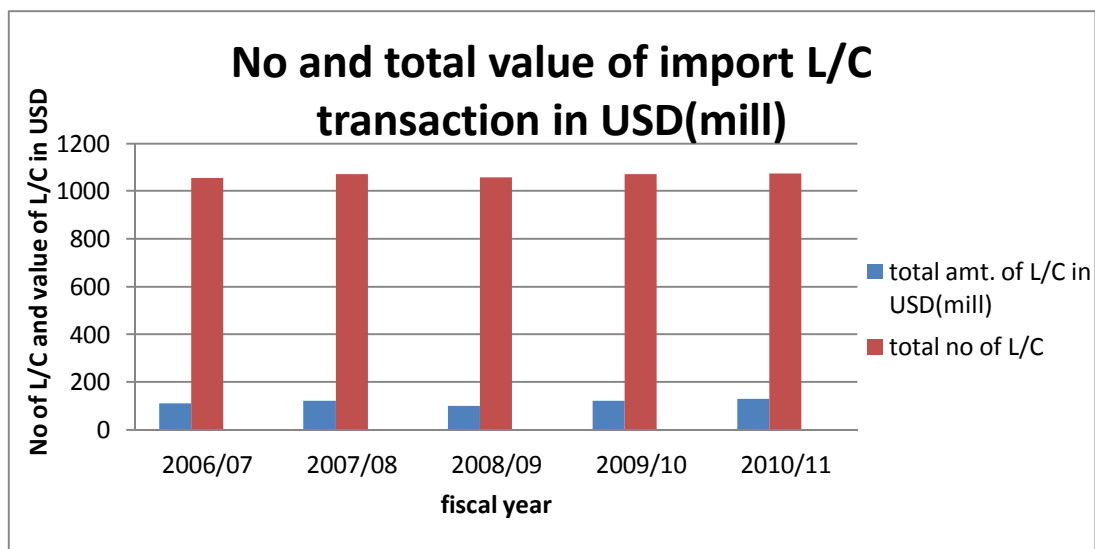
Fiscal years	Total no. of L/C	Total amt. of L/C in USD(mill)
2006/07	1057	11.02
2007/08	1071	11.20
2008/09	1060	10.78
2009/10	1072	11.34
2010/11	1074	12.02

(Source: NIBL)

Above 4.5.3 represented the total number of import L/C opened In US dollar and total transaction value import L/C is US dollar from 2006/07 to 2010/11. Total number of import L/C opened in US dollar was in increasing trend except 2008/09 over five years study period. They were, 1057, 1071, 1060, 1072, and 1074 in the fiscal year 2006/07 to 2010/11 respectively. Likewise, total transaction value of import L/C in US dollar was also in increasing trend except 2008/09 over the study period. They were 11.02, 11.20, 10.78, 11.34 & 12.02

millions in the fiscal year 2006/07 to 2010/11 respectively. Here total number of import L/C opened US dollar and total transaction value of import in US dollar was increasing trend as compared to previous fiscal year. Now we more clarify the below figure:

Figure 4.5.3



4.5.4 Import of L/C in EURO

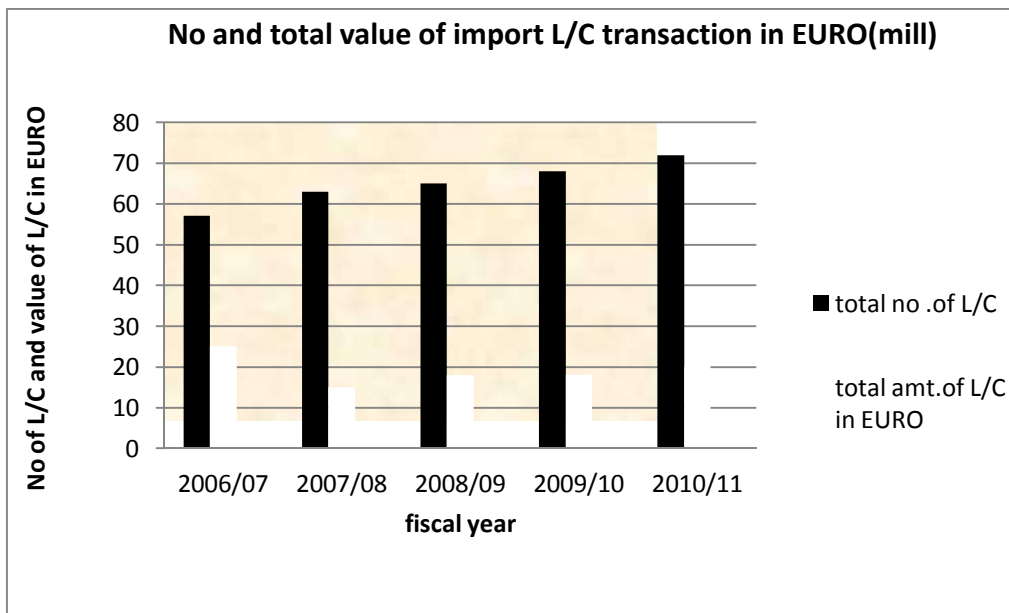
Table 4.5.4 import of L/C in EURO

Fiscal year	Total no. of L/C	Total amt. of L/C in EURO(mill)
2006/07	57	5.14
2007/08	63	2.38
2008/09	65	3.42
2009/10	68	3.78
2010/11	72	4.2

(Source: NIBL)

Above table 4.5.4 represented the total number of import L/C opened in EURO and total transaction value of import L/C in EURO from fiscal year 2006/07 to 2010/11. Total number of import L/C opened in EURO was in increasing trend over the years of study period. They were 57, 63, 65,68,and 72 in the fiscal year 2006/07 to 2010/11 respectively. Likewise, total transaction value of import L/C in EURO was also in fluctuating trend over the study period. They were, 5.14, 2.38, 3.42, 3.78 & 4.2 in the fiscal year 2006/07 to 2010/11 respectively. Here total number of import L/C opened in EURO and total transaction value of import L/C in EURO was fluctuating trend as compared to previous fiscal year. Following figure more clarify about it:

Figure 4.5.4



4.5.5 Import of L/C in JPY

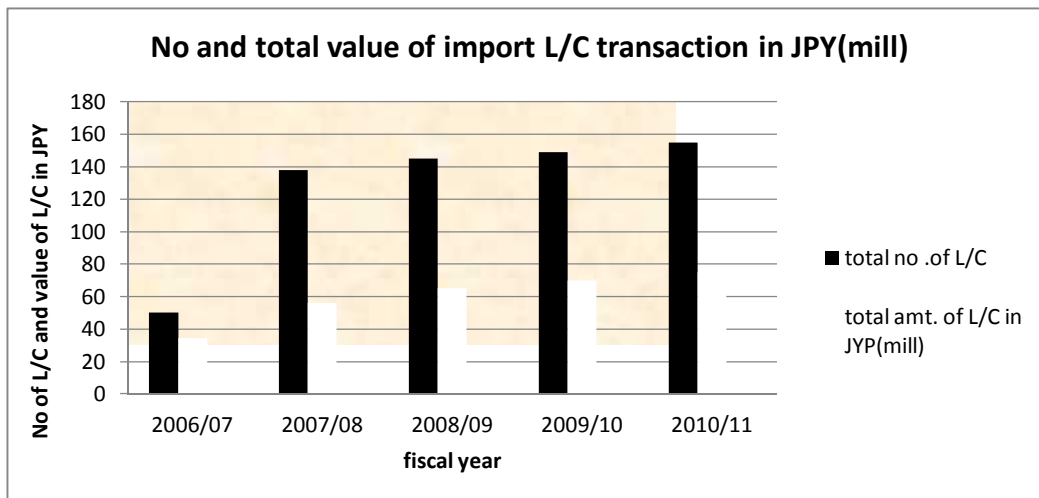
Table 4.5.5 import of JPY

Fiscal year	Total no. of L/C	Total amt. of L/C in JYP(Mill)
2006/07	50	34.32
2007/08	138	56.07
2008/09	145	65.08
2009/10	149	69.84
2010/11	155	74.92

(Source: NIBL)

Above table 4.5.5 represented the total number of import L/C opened in JPY and total transaction value of import L/C in JPY from fiscal year 2006/07 to 2010/11. Total number of import L/C opened in JYP was in increasing trend over five years of study period. They were, 50, 138,145,149 & 155 in the fiscal year 2006/07, 2007/08, 2008/09, & 2010/11 respectively. Likewise, total transaction value of import L/C in JYP was also in increasing trend over the study of five years period. They were 34.32million in the fiscal year 2006/07, 56.07million in the fiscal year 2007/08, 65.08 million in the fiscal year 2008/09, 69.84 million in the fiscal year 2009/10 and 74.92 million in the fiscal year 2010/11 respectively. Here total number of import L/C opened in JYP and total transaction value of import L/C in JYP was increasing trend as compared to previous fiscal year. Following figure more clarify about it:

Figure 4.5.5



4.6 Analysis of Export L/C

In the present globalization market, the exporter (beneficiary) exported different products from own (inside) country. In this circumstance, the beneficiary concern with advising bank for export L/C. that's mean, export L/C is opened by the exporter in his/her own country for safe payment. The actual amount of export L/C may deviate because the final amount varies according to quality of goods actually exported by the exporter because of causes in L/C like "partial shipment allowed". Since bank has not kept the record of actual amount of goods exported finally by the exporter or beneficiary and there is not more data regarding value maintained by bank only of NPR and USD. Even though the total amount of L/C and the number of L/C opened are not exactly dependent variables to each other, both of these variables are presented on the same chart for comparison.

4.6.1 Export of L/C in Nepali currency

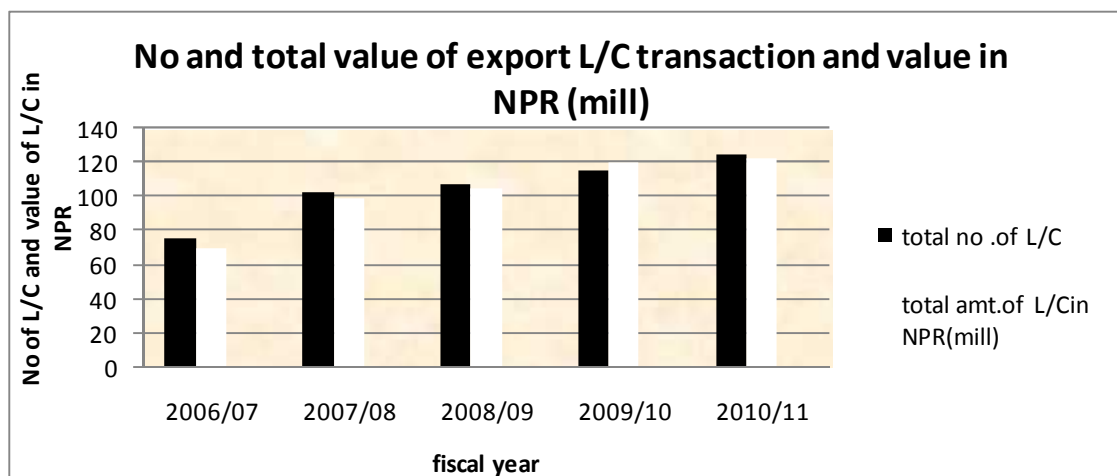
Table 4.6.1 export of L/C in Nepali currency

Fiscal year	Total no. of L/C	Total amt. of L/C in NPR(mill)
2006/07	75	69.39
2007/08	102	98.31
2008/09	107	105.08
2009/10	115	120.52
2010/11	125	122.63

(Source: NIBL)

Table 4.6.1 depicted the total number of export L/C opened and total transaction value of export L/C in Nepalese currency from fiscal year 2006/07 to 2010/11. Total number of export L/C opened in Nepalese currency was increasing trends. They were, 75, 102, 107, 115 & 125 in the fiscal year 2006/07, 2007/08, 2008/09, 2009/10 & 2010/11 respectively. Similarly, total transaction value of export L/C in Nepalese currency was also in continuously increasing trend over the last year of study period. They were, 69.39 mill in the fiscal year 2006/07, 98.31 mill in the fiscal year 2007/08, 105.08 mill in the fiscal year 2008/09, 120.52 mill in the fiscal year 2009/10, & 122.63 mill in the fiscal year 2010/11 respectively. In the fiscal years total transaction value of export L/C in Nepalese has been increased as compared to previous fiscal years it is due to inconsistency situation of the country as well as in industrial sector. This can be clarifying by following diagram:

Figure 4.6.1



4.6.2 Export of L/C in USD

Table 4.6.2 export of L/C

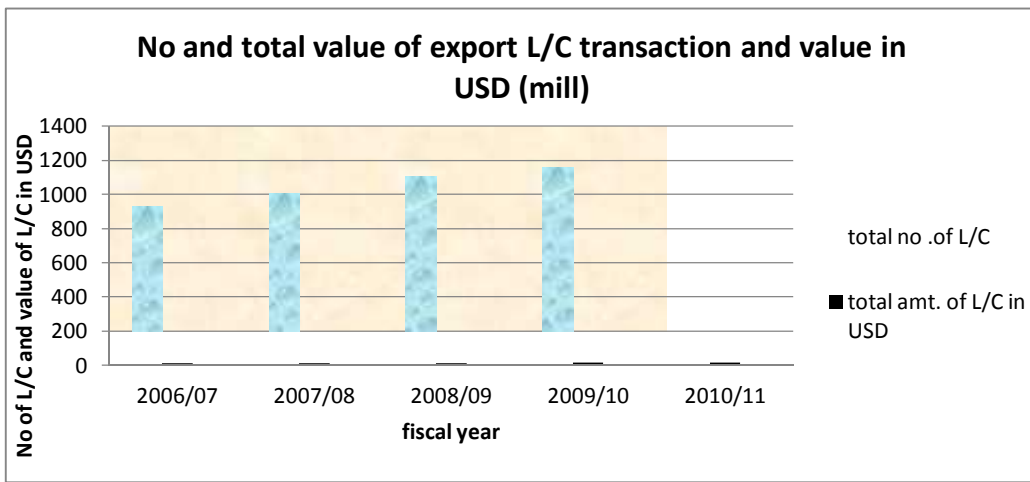
Fiscal year	Total no of L/C	Total amt. of L/C in USD(mill)
2006/07	929	12.31
2007/08	1004	12.89
2008/09	1110	14.07
2009/10	1160	14.92
2010/11	1205	15.04

(Source: NIBL)

Table 4.6.2 depicted the total number of export L/C opened and total transaction value of export L/C in USD from fiscal year 2006/07 to 2010/11. Total number of export L/C opened in USD was in increasing trend. They were 929, 1004, 1110, 1160 & 1205 in the fiscal years 2006/07, 2007/08, 2008/09, 2009/10 & 2010/11 respectively. Similarly, total transaction value of export L/C in

Nepalese currency was in continuously increasing trend over the last year of study period. They were 12.31mill, in the fiscal year 2006/07, 12.89 mill, in the fiscal year 2007/08, 14.07mill, in the fiscal year 2008/09, 14.92 mill, in the fiscal year 2009/10, & 15.04 mill, in the fiscal year 2010/11 respectively. This can be clarifying by following diagram:

Figure4.6.2



4.7 Correlation coefficient (r)

The purpose of regression analysis is to identify a relationship correlation may be defined as the degree of linear relationship existing between two or more variables. These variables are said to be correlation when change in the value of one results change in another variable. Correlation may be positive, negative or zero. Correlation can be classified as linear or non-linear. Here, we study simple correlation only. In simple correlation the effect of others is not included rather these are taken as constant considering them to have no serious effect on the dependent variable.

It is calculated as

$$r = \frac{n \sum XY - \sum X \sum Y}{\sqrt{(n \sum X^2 - (\sum X)^2)} \sqrt{(n \sum Y^2 - (\sum Y)^2)}}$$

Where,

r = correlation coefficient between X&Y

$n \sum XY$ = number of product observation and sum of product X&Y

$\sum X \sum Y$ = sum of product X and sum of product Y

Probable Error:

The probable error of the correlation helps in interpreting its value. With the help of probable, it is possible to determine the reliability of the value of the coefficient in so far as it depends on the conditions of random of sampling. The probable error of the coefficient of correlation is obtained as follows:

$$P.E = 0.6745 \times \frac{1-r^2}{n}$$

Where,

r = correlation coefficient

n = number of pairs of observation

If the value of 'r' is less than the probable error, there is no evidence of correlation, i.e. the value 'r' is not at all significant. Then, if the value 'r' is more than 6 times of the probable error, the coefficient of correlation is practically certain, i.e. the value of 'r' is significant.

Here, research has been calculating the correlation coefficient between total transaction value of import L/C in NPR and total transaction value of export L/C in US dollar to know the relationship of these variables. This relationship result helps the management for policy formulation in coming days.

4.7.1 computation of correlation coefficient between total transaction value of import L/C in Nepalese currency(X) and total transaction value of export L/C in Nepalese currency(Y) of bank.

Table 4.8.1 correlation coefficient between import(X) and export(Y) L/C in Nepalese currency (mill)

Fiscal year	X	Y	X ²	Y ²	XY
2006/07	100.46	69.39	10092.21	4814.97	6970.92
2007/08	136.87	98.31	18733.39	9664.86	13455.69
2008/09	187.86	105.68	3529.38	11168.26	19853.04
2009/10	162.54	120.52	26419.25	14525.07	19589.32
2010/11	161.00	122.63	25921	15038.12	19743.43
Total ()	748.73	516.53	84695.23	55211.28	79612.4

Where

X = value of import L/C in Nepalese currency

Y = value of export L/C in Nepalese currency

$$X = 748.73, \quad Y = 516.53, \quad X^2 = 84695.23, \quad Y^2 = 55211.28, \quad XY = 79612.4 \text{ and} \\ n = 5$$

$$r = \frac{n \sum XY - \sum X \sum Y}{\sqrt{(n \sum X^2 - (\sum X)^2)(n \sum Y^2 - (\sum Y)^2)}}$$

Therefore,

$$r = -0.32$$

$$\text{Then, P.E} = 0.6745 \times \frac{1-r^2}{n} \\ = 0.134$$

$$\text{Therefore, 6 times P.E} = 6 \times 0.134 \\ = 0.802$$

Result & discussing,

Correlation coefficient(r)	Relationship	Probable error(P.E)	6times P.E	Test r<6P.E
-0.32	-ve correlation	0.134	0.802	Not significant

The above calculation of correlation coefficient between total transaction value of import L/C in Nepalese currency and total transaction value of export L/C in Nepalese currency of the bank “ -0.32” .That means there is negative correlation between these export and import variables. And the computation of probable error shows that there is not significant relationship between these variables. If means the two variables X and Y move opposite direction.

4.7.2 Computation of correlation coefficient between total transaction value of import L/C in USD(X) and total transaction value of export L/C in USD(Y) of bank.

Table 4.8.2 correlation coefficient import(X) and export (Y) L/C of US dollar(mill)

Fiscal year	X Import	Y Export	X ²	Y ²	XY
2006/07	11.02	12.31	121.44	151.54	135.66
2007/08	11.20	12.89	125.44	166.15	144.37
2008/09	10.78	14.07	116.20	197.96	151.67
2009/10	11.34	14.92	128.60	222.61	169.19
2010/11	12.02	15.04	144.48	226.20	180.78
Total()	56.36	69.23	636.16	1161.61	781.67

Where,

X = value of import L/C in USD

Y = value of export L/C in USD

$$X = 56.36, \quad Y = 69.23, \quad X^2 = 636.16, \quad Y^2 = 1161.61, \quad XY = 781.67$$

Now we use in formula:

$$r = \frac{n \sum XY - \sum X \sum Y}{\sqrt{(n \sum X^2 - (\sum X)^2)} \sqrt{(n \sum Y^2 - (\sum Y)^2)}}$$

Therefore correlation coefficient (r) = 0.098

Again,

$$P.E = 0.6745 \times \frac{1-r^2}{n}$$

$$= 0.69$$

$$6 \text{ times P.E} = 4.14$$

Result and discussion;

Correlation coefficient(r)	Relationship	Probable error(P.E)	6times P.E	Test
0.098	+ve correlation	0.69	4.14	Not significant

The above table of correlation coefficient between total transaction value of import L/C in US dollar and total transaction value of export L/C in US dollar of bank “0.098”. That means there is positive correlation between these two variables. And the computation of probable error shows that there is not significant relationship between these two variables. It means if one variable is increased that obviously decreased another variable in terms of 0.098 and but not significant at all time.

Major findings of this study

The major finding of this study is letter of credit business in NIBL; we see that its whole import transaction is greater than export. Hence we can say that import to Nepal, as a whole in increasing trend then that export.

The major findings of these studies are as following points:-

- The total transaction value of import L/C in Nepalese currency was increase in up to 2008/09 then after decrease until last year study period. The transaction value of import L/C in Nepalese currency were 100.47million in fiscal year 2006/07, 136.87 million in fiscal year 2007/08, 187.86million in fiscal year 2008/09, 162.54 million in fiscal year 2009/10 and 161million in fiscal year 2010/11. Here, Nepalese currency has been declined as compared to previous fiscal year due to inconsistency situation of country.
- The total number of import L/C opened in Indian currency and total transaction value of import L/C in Indian currency from fiscal year 2006/07-2010/11. Then total number of import L/C opened in Indian currency was increasing trend except 2009/10. Total transaction value import L/C in INR currency was in a increasing trend they were 78million in fiscal year 2006/07, 114.6million in fiscal year 2007/08, 157million in fiscal year 2008/09, 128.77million in fiscal year 2009/10 and 184.93 million in fiscal year 2010/11 respectively.
- The total number of import L/C opened in US dollar and total transaction value import L/C is US dollar from 2006/07-2010/11. Total number of import L/C opened in US dollar was in increasing trend except

2008/09 over 5 year's period. Likewise total transaction value of import L/C in US dollar was in increasing trend. They are 11.02million in fiscal 2006/07, 11.20million in fiscal year 2007/08, and 10.20million in fiscal year 2008/09, 11.34 million in fiscal year 2009/10 and 12.02million in fiscal year 2010/11.

- The total number of import L/C opened in EURO and total transaction value of import L/C in EURO from fiscal year 2006/07-2011/11 was in increasing trend over the five years study period. Total transaction value of import L/C in EURO was fluctuating trend. They are 5.14million in fiscal year 2006/07, 2.38million in fiscal year 2007/08, 3.42million in fiscal year 2008/09, 3.78million in fiscal year 2009/10 and 4.2million in fiscal year in 2010/11. The total transaction value is increasing trend due to increase in industrial sector.
- Total number of import L/C opened in JYP and total transaction value of import L/C in JYP from fiscal year 2006/07-2010/11 was in increasing trend over five years period, and total transaction value of import L/C in JYP was also in increasing trend they were 34.32million in fiscal year 2006/07, 56.07million in fiscal year 2007/08, 65.08million in fiscal year 2008/09, 69.84million in fiscal year 2009/10 and 74.92million in fiscal year 2010/11.
- The total number of export L/C opened and total transaction value of export L/C in Nepalese currency from fiscal year 2006/07-2010/11 which was increasing trend of total number of export L/C on Nepalese currency and total transaction value of export L/C in Nepalese currency

was also in continuously increasing trend over the last year of study period. They were 69.39million in fiscal year 2006/07, 98.31million in fiscal year 2007/08, 105.08million in fiscal year 2008/09, 120.52million in fiscal year 2009/10 and 122.63million in the fiscal year 2010/11. Total transaction value of export L/C in Nepalese has been increased as inconsistency situation of the country as well as industrial sector.

- The total number of export L/C opened and total transaction value of export L/C is USD fiscal year 2006/07-2010/11 was in increasing trend, Total transaction value of export L/C were 12.31million in fiscal year 2006/07, 12.8million in fiscal year 2007/08, 14.07million in fiscal year 2008/09, 14.92million in 2009/10 and 15.04million in fiscal year 2010/11 respectively.
- The correlation coefficient between total transaction value of import L/C in Nepalese currency and total transaction value of export L/C on Nepalese currency of bank is (-32) that means negative correlation between export and import valuation.
- The correlation coefficient between total transaction value of import L/C in US dollar and total transaction value of export L/C in US dollar of bank 0.098 that means there is positive correlation between these two variables.

CHAPTER 5

SUMMERY, CONCLUSION AND RECOMMENDATIONS

5.1 Summaries

Nepal is economically a backward country. Government of Nepal has taken many measures for raising the economy of country. Thus the Government took the liberalization of foreign exchange system and the present international trade system came into existence in Nepal. In any country where exchange control measure is applicable, generally L/C is beneficiary for overseas trade.

International trade is a key to worldwide prosperity. It can stimulate gross domestic product of country. While international trade continues to grow as a part of global economy, more attention and emphasis have been focused on understanding the key aspects of trade finance transactions. International trade is obviously very important for global economy growth. The growth of international trade and financing can offer new opportunities for buyers and sellers between two countries or more. It is impossible for a country to produce domestically everything for its citizens need or demand. The great benefit of exporting is that large revenue and profit opportunities are to be found in foreign markets. Many of the world's largest companies derive over half of their sales from outside their home countries.

Letter of credit has played a great role in the development of international trade. The terms and condition used in the letter of credit vary from country to country and also from one bank to another bank. It is advised that bank in Nepal should follow directives of Nepal rastra bank as well as UCP 600 guidelines set by ICC for regulating letter of credit. The efficient and effective management

and modern technology by the introduce of SWIFT, Reuters has enhanced L/C transaction in the country due to which there seems drastic improvement in letter of credit transaction. In today's era of globalization and this phenomenon letter of credit seems to be the reliable source for enhancing business. The increasing number of commercial bank including joint venture bank after the restoration of democracy has definitely played the position role towards L/C transaction with the new technology and modern facilities.

The whole report is based on the “**Analysis of letter of credit business of NIBL**”. The report focuses more on the operational part so as to aware people about the L/C and to provide general idea of operation of L/C business, which is one of the most important financial tools concerned to international trade and finance.

The first chapter of the study paper deals about the basic concept and plan of the study. This chapter basically presented research issues, basic objectives, limitations of the study and brief introduction of study.

The second chapter deals with literature review helped the research to provide knowledge about the development and progress made by the earlier scholars on the concerned field of study. Is also helped the research work, undertaken by him. It discussed about some related concept used in the study. It is summarized the findings of previous literature to provide knowledge about the background of work done by earlier research work a to step duplicate of the previous work.

The third chapter deals with the research methodology. My thesis is analytical and there data to presents the study of five years period with theory that has limited methodology tools to analyze my topic.

The forth chapter deals with objective of my study which basically focus on the procedure for opening letter of credit, prohibitions regarding opening L/C,

problem while opening L/C, examine the directive of NRB on L/C activities, and the import and export analysis of data presentation.

Major finding

- L/C is a most widely used financial tool in today's international trade and finance.
- NIBL has contributed a lot in the international trade and finance by way of providing L/C facility, apart from other regular banking facilities.
- Businessmen prefer to make payment through L/C while importing goods from abroad than any other instrument (telex, Draft, swift, etc.) because it is the safest mean of payment and it also gives guarantee that the goods (as per the requirement or agreement) will be received.
- From the study of L/C business of NIBL, we see that its import transaction is greater than export. Hence we say that the import to Nepal as a whole is also in an increasing trend than export.

5.2 conclusions

The report has drawn out the operation of L/C including the bank, its origin, and evolution and banking history in Nepal and its working style. L/C acts as an agent between importer and exporter. It provides means of settlement of foreign trade transactions.

NIBL is playing a bigger role for the development of international trade. Letter of credit service provided by the bank contributes to the development of the nation. Usually the procedure of opening a letter of credit is similar to all banks but some variation can be found in terms and conditions, which differ from bank to bank. It is necessary that all banks

of Nepal follow the directives of the Nepal bank and ICC guidelines before opening letter of credit.

Nevertheless, NIBL is one of the leading banks in Nepal, which is helping people and the nation as a whole by providing different services and facilities. Its objectives are not only to make profit to its shareholders but also to contribute in the development of the nation.

5.3 Recommendations

With an intense competition at all the area of every sector, NIBL needs to provide services that are prompt, consumer friendly and are less expensive to customers. L/C documentation and overall process should be executed with in shortest possible time frame. However, in doing so the bank needs to be cautious, as it demands a through verification of customer details and documents.

In order to survive in the cut-throat competition decreasing the margin level, that bank not guarantees a good L/C unless detail analysis are done. In order to differentiate services from other banks a unique approach to consumer services needs to be facilitated such that it includes not only a satisfied customer but further ensure customer only delight. Things to be considered are:

- Bringing more promptness in the work flow procedure
- Adopting efficient marketing to encourage more of the customers to benefit from this facility providing NIBL.
- Rules laid down by NRB regarding L/C transactions are inconsistent with the international practice. This caused difficulty to business people for the banks. Hence it is recommended that the bank focus on coordination approach for the change of such policy.

- From the figures, tables and pictures presented in this report, it is obvious that NIBL. Since the management is taken over by Nepalese, has been going on aggressively to capture more and more of market share, which is good but it is recommended that the credit worthiness of the customer be checked before providing and credit facility.
- Rules laid down by NRB regarding L/C transaction are inconsistent with the international practice. This has caused difficulty to the bank for international trade so that earning of bank was in decreasing trend.
- There should be sound coordination between NRB, NIBL and other commercial banks so as to deliver L/C service and other supporting services smoothly. So that joint effort can be carried out in making any decision like change in service, changes interest rates, lending criteria, L/C terms etc.
- Training should be provided to staffs of bank about on letter of credit operation; right man should be kept in right place according to their capacity and willingness to work. There must be need of defining their job, provide quick service to customers and also able to convince the people that bank is for their benefit rather than profit.
- The new standards were designed to make the bank management more accountable of L/C operation. Besides, it should also be conducted to investigate what are the reasons of L/C efficiency or inefficient.

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