

# CHAPTER 1

## INTRODUCTION

### 1.1 Background of the study

A bank is a financial institution that serves as a financial intermediary. The term 'bank' may refer to one of several related types of entities.

**A central bank** circulates money on behalf of a government and acts as its monetary authority by implementing monetary policy, which regulates the money supply.

**A commercial bank** accepts deposits and pools those funds to provide credit, either directly by lending, or indirectly by investing through the capital markets. Within the global financial markets, these institutions connect market participants with capital deficits (borrowers) to market participants with capital surpluses (investors and lenders) by transferring funds from those parties who have surplus funds to invest to those parties who borrow funds to invest.

**A savings bank** (known as a "building society" in the United Kingdom) is similar to a savings and loan association (S&L). They can either be stockholder owned or mutually owned, in which case they are permitted to only borrow from members of the cooperative.

Because of the important role depository institutions play in the financial system, the banking industry is highly regulated, and government restrictions on financial activities by banks have varied over time and by location. Current global bank capital requirements are referred to as Basel II. The oldest bank still in existence is Monte dei Paschi di Siena, headquartered in Siena, Italy, which has been operating continuously since 1472. Bank's main earning is interest. Bank gives lower interest on deposit and gets higher interest on loan. With this difference, bank makes money. National development of any country depends upon economic development of that country and the economic development of the country is not possible without the support of financial institutions of that country.

"Banking Business" means the business of receiving from the general public money on current, deposit, savings or other similar account repayable on demand or with a period of call or notice, paying and collecting cheques drawn by or paid in by customers, the making of advances to customers.

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 houses established to safeguard peoples' money. Banks use the

money deposited to give out as loans and for other investments. Banks provide an easy way to pay bills through current account mostly known as cheque account. Money that is deposited in bank accounts earns additional amounts for depositors in terms of interest. Banks 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, Drafts, Promissory Notes, bill of exchange, Traveler's cheque, and SWIFT (Society for Worldwide Interbank Financial Telecommunication) Service etc. It also provides services that don't involve real money like Letter of Credit and Guarantees.

There are several authors defining the term bank in their own way. Some of the definitions are:

According to Kent, "A bank is defined as an organization whose principle operations are concerned with the accumulation of the temporarily idle money of the general public for the purpose of advancing to other for expenditure."

According to Sayer, " Ordinary banking business consists of changing cash for bank deposit for cash, transferring bank deposit from one person or another giving bank deposit in exchange for bills of exchange, government bonds, the secured or unsecured promises of businessman to repay etc."

According to Oxford Dictionary, "A bank is an establishment or custody of money received from or on behalf of its customers, its essential duty is to pay their draft on it, its profit arises from its use of the money left unemployed by them."

### **1.1.1 Development of Modern Banking**

With reference to historical undertakings, the origination of modern banking took place in medieval Italy, despite of strong Christian prohibitions against usury (the charging interest) according to the canon law. By the twelfth and thirteenth century Florence, Genoa and Lucca had become the centre of finance and trade. The first bank called Bank of Venice was setup in the year 1157 A.D. to finance the monarch during wars. Then came The Bank of Barcelona which was established in 1401 A.D. and Bank of Genoa in 1407 A.D. Through this the banking concept slowly spread to the rest of the Western Europe.

The bankers migrated to England and other parts of the country from Italy and spread the idea of modern banking in general. Their contributions are considered highly significant for the development of modern banking. The Bank of England was founded in 1694 A.D. through which the growth of the bank accelerated with the Banking Act, 1833 A.D. in United Kingdom. In terms of popular category, Bank of Amsterdam held a prestigious position and has even been claimed responsible for modern day stock exchange as well.

### **1.1.2 History of Banking in Nepal**

In our country, the banking industry has always been acting as a major force towards economic development and enhancing the financial market. This industry in our country has always been a reason for economic prosperity. Banking industry is completely service-oriented, and from decades has been providing various kinds of banking services and facilities. Like in the other countries, goldsmiths, merchants and moneylenders were the ancient bankers of Nepal. In ancient time private moneylenders used to grant loan to public. For granting loan, they used to charge very high interest rates. Therefore, they frequently failed to pay back the loan, their securities used to be forfeited, and people were exploited. At that time, there were no organized institution to fulfill the need of the money; people were compelled to depend on private moneylenders.

During the tenure of King Jayasthiti Malla, around 14<sup>th</sup> century, people were divided into 64 groups. TANKADHARI is one of them who dealt with lending of money to the people. As the main objective of the TANKADHARI was to earn profit from the higher interest charged. In order to protect people from exploitation, Prime Minister Ranodip Singh established TEJARATH ADDA in the 19<sup>th</sup> century. The TEJARATH ADDA was responsible for providing loans to the people working in the government office based on the security and the public based on collateral. It was the first step toward the institutional development of banking in Nepal. TEJARATH ADDA was not able to satisfy the needs of public, as it did not accept deposits from them. Thus the government felt the need of organized institution to provide banking services and established Nepal Bank Limited in 1937 A.D. as the first bank of Nepal. Nepal entered the modern banking system from this period and is known as the golden age in the history of banking.

Nepal Rastra Bank (NRB) was established in 2013 Baishak 14 (1956 A.D.), as the Central Bank under NRB Act 2012 B.S. The main function of the Central Bank was to supervise banking industry and to guide the basic monetary policy of the nation. NRB's major aims 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 exchange reserves.

The total numbers of commercial banks existing in Nepal are:

SN	Commercial Banks	Estd. Date	Head Office
1	Nepal Bank Ltd	1937/11/15	Kathmandu
2	Rastriya Banijaya Bank	1966/01/23	Kathmandu
3	Nabil Bank	1984/07/16	Kathmandu
4	Nepal Investment Bank Ltd	1986/02/27	Kathmandu
5	Nepal Standard Chartered Bank	1987/01/30	Kathmandu
6	Himalayan Bank Ltd	1993/01/18	Kathmandu
7	Nepal SBI Bank Ltd	1993/07/07	Kathmandu
8	Nepal Bangladesh Bank Ltd	1993/06/05	Kathmandu
9	Everest Bank Ltd	1994/10/18	Kathmandu
10	Bank of Kathmandu Ltd	1995/03/12	Kathmandu
11	Nepal Credit & Commerce Bank Ltd	1996/10/14	Kathmandu
12	Lumbini Bank Ltd	1998/07/17	Narayangadh
13	Nepal Industrial & Commercial Bank Ltd	1998/07/21	Biratnagar
14	Macchapuchhre Bank Ltd	2000/10/03	Pokhara
15	Kumari Bank Ltd	2001/04/03	Kathmandu
16	Laxmi Bank Ltd	2002/04/03	Birgunj
17	Siddhartha Bank Ltd	2002/12/24	Kathmandu
18	Agriculture Development Bank Ltd.	2006/03/16	Kathmandu
19	Global Bank Ltd.	2007/01/02	Birgunj
20	Citizens Bank International Ltd.	2007/06/21	Kathmandu
21	Prime Commercial Bank Ltd.	2007/09/24	Kathmandu

22	Sunrise Bank Ltd.	2007/10/12	Kathmandu
23	Bank of Asia Nepal Ltd.	2007/10/12	Kathmandu
24	Grand Bank Nepal Ltd.	2008/05/25	Kathmandu
25	NMB Bank Ltd.	2008/06/05	Kathmandu
26	Kist Bank Ltd.	2009/05/07	Kathmandu
27	Janata Bank Nepal Ltd.	2010/04/05	Kathmandu
28	Mega Bank Ltd.	2010/07/23	Kathmandu
29	Commerz and Trust Bank Nepal Ltd.	2010/09/20	Kathmandu
30	Civil Bank Ltd.	2010/11/26	Kathmandu
31	Century Commercial Bank Limited.	2011/03/10	Kathmandu
32	Sanima Bank Ltd.	2004	Kathmandu

Source: Nepal Rastra Bank

**Table 1:** List of Commercial Banks in Nepal

In the mid-1980s, three foreign commercial banks opened branches in Nepal. The Nepal Arab Bank co-owned by the Emirates Bank International Limited (Dubai), the Nepalese government and the Nepalese public. The French partners, Rastriya Banijya Bank, Rastriya Beema Sanstha (National Insurance Corporation), and the Nepalese public jointly owned the Nepal Indosuez Bank. Nepal Grindlays co-owned by a British firm called Grindlays Bank, Local financial interests, and the Nepalese public, which now is known as Standard Chartered Bank Nepal Limited. In 1993 A.D., Himalayan Bank Ltd was established under a joint venture with Habib Bank Ltd of Pakistan and Nepal SBI under a joint venture between employee's provident fund and SBI. In 1994 A.D., Nepal Bangladesh Bank Ltd. established under a joint venture with IFIC Bank Ltd of Bangladesh. Then several banks get approval to make operation as a commercial bank from Nepal Rastra Bank.

## 1.2 Statement of the Problem

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 the understanding of both parties. However the industrialization gave birth to present foreign trade where goods and services are bought and sold from one country to another. When goods are bought and sold abroad then such transactions could become very complicated for a number of reasons like time hazard of journey, custom formalities, import/export 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 transactions. The buyer should know what he is getting for the money that he 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 written instrument issued by the bank (The issuing bank) on the behalf of the buyer (The applicant) in favor of the seller expressing its definite 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 to both the buyer and seller. The seller can demand the payment from the issuing bank after presenting the required documents. Sellers also have option to avoid shipment of the goods, when he feels that any term and condition not met. On the other hand, buyer also have the right to put 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.

In a typical trade transaction, whether it is local or international, there are two basic parties to the transaction, namely, Buyer and Seller. They enter into a Sale contract and as per the terms of contract, the seller supplies the goods or services to buyer and the buyer in turns pays for the goods/services received from the sellers. We can say that a typical trade transaction where goods move from seller to buyer and as a normal sequel to this, money flows from buyer to seller.

Theoretically this exchange process appears very simple. But in practice this exchange process is associated with several complexities exchange is taking place between commercial parties, residing in two different countries. The possible reasons for the exchange process getting complicated are:

- ) Buyer and seller are separated by long distances and may not know each other,

- ) Buyer and seller are governed in two different countries which are two different sovereign political entities,
- ) Buyer and seller are governed by two different legal systems,
- ) Seller and buyer are governed by different trade and exchange conditions,
- ) Currencies of seller and buyer are different,

In addition to the above the commercial parties may be operating in different markets, marketing condition trade practices, and financial and commercial conditions. As such, the commercial sale contract between the buyer and seller constitutes an understanding between the two parties as to the modalities governing the shipment of goods and payments of value towards the goods. In order to facilitate the trade and settlement of payments thereof Letter of Credit is considered to be one of the convenient alternatives against Advancement Payment, Open Account and Collection Modalities.

A Letter of Credit is a definite undertaking issued by a bank on behalf of its customer to pay certain sum of money to named beneficiary provided the terms and conditions of the credit are fully met. Letter of credit is a commitment/undertaking in the form of written instrument by a bank on behalf of its customer (known as buyer/importer) to pay the "counter value" of goods/services within a given date to its supplier (known as seller/exporter) according to agreed stipulations and against presentation of specified documents as specified in the instrument. Letters of credit are used primarily in international trade transactions of significant value, for deals between a supplier in one country and a customer in another. In such cases, the International Chamber of Commerce Uniform Customs and Practice for Documentary Credits applies (UCP 600 being the latest version). The parties to a letter of credit are usually a beneficiary who is to receive the money, the issuing bank of whom the applicant is a client, and the advising bank of whom the beneficiary is a client. Almost all letters of credit are irrevocable, i.e., cannot be amended or canceled without prior agreement of the beneficiary, the issuing bank and the confirming bank, if any.

The technical term for Letter of credit is 'Documentary Credit'. At the very outset one must understand is that Letters of credit deal in documents, not goods. The idea in an international trade transaction is to shift the risk from the actual buyer to a bank. Thus a LC (as it is commonly referred to) is a payment undertaking given by a bank to the seller and is issued on behalf of the applicant i.e. the buyer. The Buyer is the Applicant and the Seller is the Beneficiary. The Bank that issues the LC is referred to as the Issuing Bank which is generally in the country of the Buyer. The Bank that Advises the LC to the Seller is called the Advising Bank which is generally in the country of the Seller.

The specified bank makes the payment upon the successful presentation of the required documents by the seller within the specified time frame. Note that the Bank scrutinizes the 'documents' and not the 'goods' for making payment. Thus the process works both in

favor of both the buyer and the seller. The Seller gets assured that if documents are presented on time and in the way that they have been requested on the LC the payment will be made and Buyer on the other hand is assured that the bank will thoroughly examine these presented documents and ensure that they meet the terms and conditions stipulated in the LC. This report studies all the aspects involved in the process of Letter of Credit Business in the context of Nepal Investment Bank Ltd.

More specifically, this study seeks to address the following issues in Letter of Credit mechanisms:

- ) What is the importance of Letter of Credit (LC) in Nepalese trade perspective? How does LC help Nepalese importers to import goods and services from the foreign countries?
- ) What are the procedures of opening a LC in Nepal Investment Bank Ltd. and how do the banks help the buyers to ease the procedures to open LC as a LC opening bank?
- ) What are the common problems faced by the buyers in international trade transactions?
- ) What are the common problems faced by the Nepal Investment Bank Ltd. in operations of LC in international trade perspective?
- ) What are the benefits and losses to our country through LC to import goods and services in Nepal?
- ) Is Nepal Investment Bank Ltd (NIBL) performing up-to-the expectation as it has targeted in terms of its L/C business?
- ) Is the existence of the Letter of Credit benefiting the organizations that are involved in the International Trade?
- ) Is the Central Bank monitoring the L/C operations of the commercial banks in order to control money laundering?
- ) What are the pre-requisites for opening L/C in NIBL?
- ) What are the problems existed during the L/C transactions in NIBL?

### **1.3 Objectives of the study**

The main objective of this study is to examine Letter of Credit operations in Nepal Investment Bank Ltd. and analyze co-ordination of the LC operation with the Foreign Exchange Policy of Central Bank of Nepal i.e. Nepal Rastra Bank (NRB). Also the objective of this study is to study all the aspects of the Letter of Credit transaction and to examine how it facilitates the International Trade in today's world.

The other specific objectives of the study are:

- ) To study and examine the pre-requisites and required documents for opening letter of credit.



- ) To evaluate the co-ordination between LC operation, NRB Foreign Exchange Policies and International rules for LC guidelines i.e. (UCPDC 600) Uniform Customs and Practices for Documentary Credits 600.
- ) To analyze the sample bank's LC transactions with overall national volume of LC business.
- ) To study about the nation's total import and export through LC.
- ) To evaluate the LC business and profitability of the sample bank.
- ) To analyze how to reduce import volume and enhance the export volume of the country through LC.
- ) To provide recommendations to the concerned banks on the basis of the study findings.
- ) To assess the processes and operations in respect to Letter of Credit.
- ) To evaluate the benefits of L/C.
- ) To find out the trend of L/C operations.
- ) To identify the problems in L/C operations.
- ) To make suggestion and recommendations based on the study.

#### **1.4 Significance of the study**

This research will be fully based on the statistics and information provided by the bank and will be very helpful to those who want to study on the Letter of Credit issues. This research is beneficial to importers, exporters, bankers, professionals and individuals who want to know about the LC.

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 **Letter of Credit** country to a seller in another. So there is a guaranteed means of payment for both buyer and seller. Being a developing country, Nepal must do import and export transaction through a safe means and the L/C 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.

Letter of credit is one of the most important financial instrument in today's industrial world. L/C is a guarantee that the Bank provides on behalf of its customer (buyer) to any supplier of the goods that upon delivering the goods to the buyer, the supplier will promptly get the payment. Generally, while importing goods from one country to another it takes around 3 to 4 weeks depending on the means of transportation. There are of course other means of payment like Telex Transfer or Draft, but If the payment is made via Telex Transfer or Draft, the buyer has to pay cash now and receive the goods only after 3 to 4 weeks days. This unnecessarily blocks his fund for

that period which he may use for some other purpose. If the same transaction is done through a Bank's L/C, the buyer has to deposit normally only 5% to 10% of the total value of the goods to be imported, (this is called margin or cash Margin) which gives him opportunity to use the fund until he physically receives the goods. But Margin depends upon the creditworthiness of the customer. Bank may ask the buyer to provide some other collateral along with the Margin if it is not sure about the creditworthiness of the buyer but whatever the arrangement it's confirmed that the client will pay the remaining amount only after he received the goods and It's also confirmed that he use his fund for 3 to 4 weeks for some other purpose. This is an important aspect of Letter of Credit.

### **1.5 Limitations of the study**

There are some limitations that weaken the generalization i.e. inadequate coverage of industries, time constraints, reliability of statistical tools used and other variables. This study is simply a partial fulfillment of the requirement of Masters of Business Studies (MBS) program so this study will be limited by following:

) As the basic principle and standard for the LC operations are as per the rule set by central bank's foreign exchange department and UCPDC 600 it is strongly realized that the sample bank i.e. NIBL singly is able to represent the LC procedure to the rest of the commercial banks and enough to cover the study. This study concentrates only on LC operations practiced by the commercial banks in Nepal.

) The main objective of this study is to fulfill partial requirement of Master Degree. Stipulated time and resources are also limitation of this study. 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.

) This study consist only an operation activity and compliance with the central bank's policy so the findings may not ensure wide applicability in all types of enterprises running in different situations.

Major portion of analysis and interpretations have been done on the basis of available primary, secondary data and information. Thus, reliability of the study is based on trueness of the collected data, statistics and information. It is based on the secondary data source such as annual report of the concerned bank, and other related journals, magazines, books. Moreover there are not much written articles or books available in the market on Letter of Credit. Also the up-to-date and complete data were very difficult to obtain from the bank due to inability of concerned authorities to provide the required data. Moreover the bank did not provide some data that they considered as its business secrecy.

) The reality of the study fully depends on questionnaires, which are duly filled by the respondents. Only selected financial and statistical tools and techniques have been employed in this study.

) Only one bank has been chosen for the study and the overall financial position of NIBL can't be judged by this report.

## **1.6 Organization of the study**

This study is organized into five chapters. Each is denoted to some aspects of the study. The rationale behind this kind of organization is to follow a simple research methodology or approaches. The contents of each chapters of the study are briefly mentioned here:

### **Chapter 1: Introduction**

Chapter 1 contains the background of the study, statement of the problem, objectives of the study, significance of the study, limitations of the study and organization of the study.

### **Chapter 2: Review of the Literature**

Chapter 2 includes a discussion on the conceptual framework and review of the major empirical works of the topic letter of credit and the profile of sample bank i.e. Nepal Investment Bank Ltd. The conceptual consideration and review of related literature conducted in this chapter provide a framework, with the help of which the study has been accomplished.

### **Chapter 3: Research Methodology**

Chapter 3 describes research methodology employed in the study. This chapter deals with introduction, research design, nature and sources of data, method of data, population and sample, data collection procedure, tools and techniques used for the analysis, financial and statistical tools.

### **Chapter 4: Data Presentation and Analysis of Data**

Chapter 4 contains of presentation and analysis of the data which describes with the empirical analysis of the study. In this chapter, all collected relevant data are analyzed and interpreted. It will explain the major findings of the study also. It presents the presentation and analysis of the performance of Nepal Investment Bank Ltd in terms of

Import L/C, Export L/C, and Income from Commission on L/C transaction.

## **Chapter 5: Summary of findings, Conclusion and Recommendation**

It includes summary and conclusion of the study. On the basis of the results from data analysis, the researcher concludes about the research work. Besides it also gives important suggestions to Nepal Investment Bank Ltd. for better improvement. The list of bibliography and appendices are given at the last of references.

# CHAPTER 2

## REVIEW OF LITERATURE

Review of literature comprises of previous research study articles concerned with this study and other studies with a view for supplement the present research and such review adds to the dimension of the study. This chapter deals with review of books, review of reports, review of research papers, review of articles, review of unpublished publication etc.

### 2.1 Conceptual Framework

Letter of credit is widely used instrument in the field of international trade. It is basically a mechanism, which allows importers/buyers to offer secure terms of payment to exporters/sellers in which a bank (or more than one bank) gets involved. The 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 international trade.

The operations of L/C are governed by UCPDC (Uniform Customs and Practice for Documentary Credit) on force published by ICC (International Chamber of Commerce), Paris, France. 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 in 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 of Letter of Credit

Letter of credit is written instrument issued by the bank (The issuing bank) on behalf of the buyer (The applicant) in favor of the seller expressing its definite 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 to both the buyer and seller. At the very outset one must understand is that Letters of credit deal with the documents, not the goods. The idea in an 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 presenting the required documents. Sellers also have option to avoid shipment of goods, when he feels that any term and condition not met. On the other hand, buyer also have the right to put 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 is a payment undertaking given by a bank to the seller and is issued on behalf of the applicant i.e. the buyer. The Buyer is the Applicant and the Seller is the Beneficiary. The Bank that issues the L/C is referred to as the Issuing Bank which is generally in the country of the Buyer. The Bank that Advises the L/C to the Seller is called the Advising Bank which is generally in the country of the 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 the Bank scrutinizes the 'documents' and not the 'goods' for making payment. Thus the process works both in favor of both the buyer and the seller. The seller gets assured that if the documents are presented on time and in the way that they have been requested on the L/C the payment will be made and buyer on the other hand is assured that the bank will thoroughly examine these presented documents and ensure that they meet all the terms and conditions stipulated in the L/C.

Letter of credit in effect is a 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 importer that he will receive the goods for which payments has been assured.

### **2.1.2 Parties Involved In Letter of Credit**

1. **Applicant:** An applicant is the one who requests his bank to issue a letter of credit in favor of an exporter to cover the purchase of goods and agrees to pay as per the terms of the contract through 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 LC. The applicant should be well aware of the status of the beneficiary and understand the terms and conditions mentioned in the underlying contract.

2. **Issuing Bank:** The issuing bank is the bank, which issues L/C on behalf of the applicant. It is the applicant's bank. The buyer mentions the terms and conditions 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 been opened.

3. **Advising Bank:** The advising bank is the correspondent situated in the place where the seller is situated. It is the bank where credit has been sent. The advising bank gives message to the seller about the opening of credit in his favor through a cable message.

4. **Negotiating Bank:** The negotiating bank is the bank, which negotiates the bills of exchange or drafts 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:** Sometimes the seller insists that a bank in his own country must confirm the credit. Bank giving confirmation is known as confirming bank. Here, one of the merits from seller's 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 is the beneficiary of the L/C. The issuing bank makes assumptions that the terms and conditions mentioned in the credit should be strictly followed and relevant documents are 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 may ask to draw a bill of exchange on them and will discount the bill for him so that he can get his money immediately.

### 2.1.3 Types of Letter of Credit

#### 1. **Revocable and Irrevocable LC:**

The Applicant (buyer), usually with the prior agreement of the Beneficiary (seller), requests its bank to issue the Letter 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. 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 underlying 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 funds 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 canceled without the consent of the Issuing Bank, the Confirming Bank (if the Letter of Credit is confirmed) and the Beneficiary. LC issuing bank's obligation is to pay set forth at the bottom of the undertaking.

## **2. Confirmed and Unconfirmed LC:**

When 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 Bank's Letter of Credit stating whether the Advising Bank is merely advising or is 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 Bank's advice. If the Advising Bank is merely advising, the advice, 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 Bank is Irrevocable Letter of Credit. Beneficiaries of such advices are dependent on the commercial stability of the Issuing Bank and the political and foreign exchange stability of the country in which the Issuing Bank is 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, the 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 Confirming Bank is the bank 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 ABC bank (buyer's bank) issues its Irrevocable Letter of Credit and requests that Citibank, New York to 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. An advising bank also takes responsibilities for honoring drawing. In the case of Unconfirmed L/C, advising bank does not add confirmation and neither take responsibilities for honoring drawing.

## **3. Back-to-Back LC:**

The term used to describe a credit issued by the bank for its customer against the banking of another credit received in the customers favor.

## **4. Transferable and non-transferable LC:**

In Transferable L/C, beneficiary has power to transfer the credit to another party. Such credit is possible to pass on to more than one party by way of breaking the original value of the credit. Here beneficiary gives the power of drawing bill to someone else. Non-transferable L/C means beneficiary has no right to transfer the power of drawing bills to someone else.

## **5. Red Clause and Green Clause LC:**

Red Clause L/C gives authority to advising bank to make cash advance to the beneficiary before he presents document, to enable him to purchase the raw material needed to produce finished product required for shipment under terms of credit. In Green Clause L/C, it authorize advising bank to make cash advance in the line of Red Clause of L/C, to



enable beneficiary for procurement of raw material to produce finished product for shipment with storage facility. In both the cases, advance recovered from the amount payable to beneficiary upon presentation of document.

## **6. Sight and Usance L/C:**

In sight L/C, payment done to the beneficiary is as soon as documents presented to the paying bank. In case of Usance L/C, terms of the credit made are for 30, 60, 90, 120, 180, 365 days or even more. Therefore, settlement of payment would be on the future date depending on the terms of credit. In other words, all such L/C is required to be open only on sight basis. The exception on this provision is the L/C opened for machinery and capital goods.

## **7. Revolving Credit:**

If the amount of drawing is re-instated and made available to the beneficiary for shipment the L/C is called revolving L/C. In revolving L/C the original value or a part of the original value or any other value as per the terms is re-instated after certain occurrence i.e. upon completion of first shipment or upon completion of certain period or upon notification is made by the issuing bank or applicant.

### **2.1.4 Benefits of Letter of Credit**

The main objectives of L/C system 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.
- ) Reduces or eliminates the commercial credit risk as payment certainty is by the bank, which issues an irrevocable L/C. The seller no longer needs to rely on the willingness and capability of the buyer to make payment.
- ) Reduces certain exchange risk and political risk while not eliminating them.
- ) May not require actual segregation of cash, since the buyer is not always required to collateralize his L/C obligation to the issuing bank.

) Expand sources of supply for the buyers 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.

) Decisional 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.

) Contractual law customary law-in addition to codified and case law L/Cs' are usually governed by the 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 since 1933 and are the set of universally recognized rules that are helping L/C to operations grow.

) The UCP rules 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 bank's individual adherence and notification to the ICC, or by incorporation of the UCP in the L/C itself.

## **3. Assures Expert Examination of Documents**

) 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 the L/C and the UCP rules.

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

) 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 are complied with.

### **2.2 Brief profile of Nepal Investment Bank Ltd. (NIBL)**

Nepal Investment Bank was established in 1986 A.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 Agricole Indosuez in Nepal Indosuez Bank Ltd.

The name of the bank changed to Nepal Investment Bank Ltd. with the approval of NRB, Company Registrar's office and from Bank's AGM with the following shareholding structure:

### Capital

Shareholders	Percentage
Group of companies	50
Rastra Banijya Bank	15
Rastra Beema Sanstha	15
General Public	20

**Table 2 Share Structure of Nepal Investment Bank Ltd.**

*(Source: annual report of NIBL)*

The holding of shares by public also implies that NIBL is one of the listed companies in NEPSE. Nepal Investment Bank Limited came into existence under Company act 2021 B. S. and Commercial Bank Act 2031, in the year 2042 B.S., Magh 6th (1986 /02 /27).

Under Commercial Bank Act 2031, the bank started its operation as a commercial bank with the permission of NRB, on 2042 B. S., Magh 22 nd .

### 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 profits 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 economic condition of the country.
- ) To perform banking transaction within Nepal and outside Nepal, receive deposits, give out loans and advances, discounting bills, promissory notes, foreign exchanges, buy and sale 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 as per the rules and regulations.

### **Branches of NIBL**

The registered office of NIBL is located at Durbar Marg, Kathmandu. This is also the head office of the bank and all the major functioning including making rules and policymaking, issuance of securities, treasury operations, payment and settlement, international banking are done through this branch. NIBL has aimed to open 50 branches. The branch offices of NIBL including their official addresses and corresponding addresses are:

1. KATHMANDU HEAD OFFICE Durbar Marg, P.O. Box 3412 Tel: 4228229, 4242530 (DISA) Fax: 977-1-4226349, 4228927 Swift: NIBLNPKT	
2. SEEPADOLE BRANCH	3. BIRGUNJ BRANCH
4. PULCHOWK BRANCH	5. BANEPA BRANCH
6. JEETPUR BRANCH	7. NEWROAD BRANCH
8. BIRATNAGAR BRANCH	9. BUTWAL BRANCH
10. BHAIRAHAWA BRANCH	11. POKHARA BRANCH
12. PUTALISADAK BRANCH	13. NARAYANGARH BRANCH
14. JANAKPUR BRANCH	15. NEPALGUNJ BRANCH
16. THAMEL BRANCH	17. KALIMATI BRANCH
18. BIRTAMOD BRANCH	19. BATTISPUTALI BRANCH
20. DHANGADI BRANCH	21. GONGABU BRANCH
22. SURKHET BRANCH	23. JUMLA BRANCH
24. BOUDHA BRANCH	25. HETAUDA BRANCH
26. PALPA BRANCH	27. LUKLA BRANCH

28. NAYA BANESHWOR BRANCH	29. DHUMBARAHI BRANCH
30. BHOTAHITI BRANCH	31. TULSIPUR BRANCH
32. TRIPURESHWOR BRANCH	33. DAMAULI BRANCH
34. KRISHNANAGAR BRANCH	35. GAIGHAT BRANCH
36. LAZIMPAT BRANCH	37. PARSА BRANCH
38. MAHARAJGUNJ BRANCH	39. LALBANDHI BRANCH
40. LAGANKHEL BRANCH	41. WALING BRANCH

**Table 3: Branches of Nepal Investment Bank Ltd.**

*(Source: annual report of NIBL)*

The above listed are the total number of branches currently existing of NIBL. These branches have been trying their best to render their services to the public. Since, this bank has received licensed from NRB, in the future period this bank can open its branches all over the country and provide service to enhance the banking industry. NIBL is managed by a team of experienced bankers and professionals and have proved to be a reliable bank, which is also reflected by the fact that NIBL had been awarded The Bank of the Year 2003 , 2005, 2008 and 2010 by the banker of the London based financial times group. NIBL is committed to be The Nepali Bank with Global connection.

### **2.3 Review of related research works**

During any research work, the previous studies cannot be ignored because they provide foundation to the present study. In other words, there has to be continuity in research. This continuity in research is ensured, by sinking the present study with the past research. Literature review is basically a stock taking' of available literature in this field of research. The main purpose of literature review is to find out what studies have been done in the field of 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 ends in the research. Thus some books, unpublished materials and previous research studies in the topic of Letter of Credit have been reviewed. Though sufficient literature does not exist related to this subject, it has been tried to include all possible information in this report. From the Library of Nepal Investment Bank Ltd., I found that Mr. Kunjan K.C. (2006 A.D.) has conducted a Study titled Letter of Credit Process of Nepal Investment

Bank Ltd. . Its main objective was to find out the process of Letter of Credit especially in context of Nepal Investment Bank Ltd. and to provide recommendations 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 to country and also from bank to bank. It is advised that banks in Nepal should follow the Directives of NRB as well as ICC Guidelines before opening of L/C. Due to efficient and effective management and modernized technology used by NIBL, there should be further improvement in the technology so that there is drastically rise in the L/C transaction. Mr. Sajjan Kansakar (2007 A.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 Technology 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-border 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 confirming bank.

#### **2.4 Research Gaps**

The researches previously conducted were on the whole performance of the banks whereas this research focuses particularly on the performance of L/C business and in the context of NIBL. There were no reports available specifically written on this subject. This report is related exclusively to L/C business of NIBL.

# 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 and interpret the Letter of Credit Business of NIBL. Research methodology may be expressed in other words as process of arriving to the solution of the problem through planned and systematic dealing with collection of the data and analysis of the figure.

### 3.2 Research Design

Research work is designed to obtain answers for the research question. 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 discussions and the provided materials, the study has been conducted.

### 3.3 Nature and Source of Data

Information is the lifeblood of any research. So, the significance of the research depends upon the nature, availability and accuracy of the information, together with the true information, the data collection matters the most to fulfill the objectives of his study.

Data and information that have been used in this study were collected from the following Sources.

- Financial Statements of NIBL
- Different & Periodical reports of Trade Finance Department of NIBL
- Published as well as unpublished materials
- Various Reports and Directives of NRB.
- Books related to the subject matter
- Related materials available in the Library of NIBL.
- Some web 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 Dept. of NIBL. And the available matters related to the subject in 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 a record.

### 3.5.2 Statistical Tools:

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

#### i) Correction 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 one variable in the linearly related to other 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 corrected series.

Symbolically, correlation coefficient can be expressed as follows:

$$r = \frac{n \sum xy - (\sum x)(\sum y)}{\sqrt{n(\sum x^2) - (\sum x)^2} \sqrt{n(\sum y^2) - (\sum y)^2}}$$

Where,

r = Correlation coefficient between x and y

n  $\sum$  x y = Number of product observation and sum of product x and y

$\sum$  x  $\sum$  y = Sum of product x and sum of product y

#### ii) 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:



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

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, however there are various financial tools to measure the financial performance of the bank. With regard to statistical tools, the researcher carried out different statistical tools to make the result 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

The main purpose of this study is to examine the Performance in terms of Letter of Credit business of NIBL. Here various comparative figures related to Letter of Credit (such as Import LC outstanding, Export LC outstanding, commissions earned) for 5 years are presented for growth analysis and another banks figures for the same period is also presented for competitive analysis.

### 4.2 SWOT analysis

Everyone has some certain strength and weak points. These may be either visible or concealed. Strength and weakness are within us and to some extents are under our control. We can manipulate these to suit a particular situation on the other hand opportunities and threats are beyond our control. An organization should try to exploit the opportunities and avoid the threats. A successful organization is the one that may carry its own SWOT analysis. SWOT is basically a common sense approach to management that can be applied to any situation with a little bit of imagination.

Now let's see a brief SWOT analysis of:

#### **S - Strength**

Quality Service:

The services offered by the bank are faster and reliable which has enabled it to be one of the leading banks in Nepal.

Established Presence:

It has been established in Nepal since 1986 that means it has been here for more than 20 years of quality service and had earned goodwill in the financial market.

Location:

The bank has taken time to decide on the location of its outlets very sensibly and has managed to provide its services from the locations that are convenient to its customers.

Innovative attitude:

It has always welcomed technological changes and implemented the latest technologies that make it No. 1 technologically. It is the first to introduce the Visa Debit Card in Nepal. It is the first one to provide Internet banking (though limited access and facility only).

## **W – Weakness**

### Promotional Activities:

It spends a lot of money on promotional activities each year but not as successful compared to other banks due to well-trained team of such activities. It should build up a team for the same to get better results or the activities and to save a lot of unnecessary effort and money.

### Limited Outlets:

It has limited branches as compared to other government banks as well as commercial banks especially in the rural area. Hence it should open more branches including in the rural Areas.

## **O – Opportunities**

### Increasing earnings of people:

A slow but steady growth of lower class to middle and middle class people to upper middle class and upper middle class people to high class due to growing remittance from abroad as hundreds of people are going abroad for employment. It should focus in the sector of remittance which is the great chances for the income generation.

### Growth in Industries:

Though due to present political situation the industries have not been able to perform up to the expected level, there are still lots of possibilities should explore the market to capture its share on time.

## **T – Threats**

### Competition and New Entrants:

The growing number of finance companies and then turning to development banks, moreover NRB has licensed to few more banks to operate recently and also planning to allow international banks to open their outlets in Nepal. In this scenario has to face a lot of competition in the days ahead so it should be better prepare for the situation on time.

The above is just a glimpse illustration of a SWOT analysis of Nepal Investment Bank Ltd. It is highly recommended that one should do a SWOT analysis taking all the variables into account to get a clear picture and to help it draw a future course of action.

## **4.3 Context Analysis**

In this part of the study an analysis of the context of the letter of credit such as Contents of LC, Documents used in LC, Discrepant Documents found in LC, Amendments made in the LC, Pre-requisites for opening LC etc are carried out.

## **CONTENTS OF LETTER OF CREDIT**

Letter of credit must contain the following information:

1. Name and address of LC issuing bank.
2. A statement regarding application of UCPDC (Uniform Customs and Practice for Documentary Credit).
3. LC number and date.
4. Name and address of the applicant.
5. Name and address of the beneficiary.
6. LC value (currency and amount).
7. Terms of delivery.
8. Tenor of bills of exchange.
9. Nominated bank.
10. Details of the goods (amount, quantity, unit price, quality, specifications, brand name etc)
11. Method of shipment.
12. Documents required.
13. Date and Place of expiry.
14. Special instructions or terms & conditions, if any.

## **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 LC. In any trade, documents are used to record a written evidence of having carried out a transaction. International trade is no exception. In fact, it calls for execution of more documents than in local trade. Following documents are required in Letter of Credit.

### **1. Financial Documents**

As the name indicates financial documents are the documents which perform the function of obtaining finance, collection of payments etc. the most common financial document used is a bill of exchange.

#### **Bills of Exchange**

It is an instruments in writing, containing an order signed by the maker, directing a certain per to pay a certain sum of money only to the order of a person to the bearer of the instrument. It is commonly known as a Draft or "Hundi". It has three basic parties namely, Drawer, Drawee and Payee. The person to whom the bill is addressed is called the Drawee and the person to whom the payment is to be made is called the Payee.

### **2. Commercial Documents**

The documents which are needed by the buyer and seller for their normal commercial transactions are termed as commercial documents. Some of the commercial documents are as follows:

#### **a. Proforma Invoice**

As the name suggests, is a Proforma of the invoice. It is prepared by an exporter and sent to the importer for necessary acceptance. Proforma Invoice must mention importer's and exporter's details, Proforma or contract no. and its' date, harmonic code number (is an internationally standardized system of names and numbers for classifying traded products developed and maintained by the World Customs Organization), Incoterms, country of origin of the goods, quantity and unit price of the goods, description of the goods, etc. The invoice consists of the terms of payment and the detail information about port of discharge, port of Loading and the final destination of the goods.

#### **b. Commercial Invoice**

It contains the names of the exporter, importer and the consignee and the description of goods. It has to be signed by the exporter. It is required to be presented before different authorities for different purposes. Commercial invoice is also called Export Invoice. The commercial invoice is a document that is sent to the bank by the beneficiary's bank after the goods has been shipped. The pro-forma invoice details and the commercial invoice details should match each other. There is no standard format for commercial invoice but it normally contains following:

- }) Date, Name and address of seller and buyer
- }) Order number/contract number/Proforma invoice number and details of Letter of Credit
- }) Description/ quantity of goods
- }) Terms of sale (INCOTERMS) i.e. a universally recognized set of definitions of international trade terms, such as FOB, CIF, C&F etc.
- }) Port of shipment and port of destination
- }) Eight digit harmonic code number of the imported goods.
- }) Value of goods and unit prices
- }) Shipping marks or number of packages.

#### **c. Packing List**

This statement gives the packing details of goods in a prescribed format. It is a very useful document for customs at the time of examination and for warehouse keeper of the buyer to maintain a record of inventory and to effect delivery.

#### **d. Certificate of Origin**

This certificate issued by the local Chamber of Commerce indicates that the goods, which are being exported, are actually manufactured in a specific country mentioned therein. It is sent by the exporter to the importer and is useful for the clearance of goods from the customs authority of the importing country. The origin of the goods is precisely stated in a credit and in many cases the origin can considerably influence the price of the goods; hence, it needs 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 is certified by the beneficiary himself.

#### **e. Certificate of Analysis and Quality**

It indicates the inner composition, quality, technical composition and nature of the goods broadly described in the invoice. This certificate may be given by the exporter himself or an institution which is competent or nominated to give such a certificate. In certain types of goods like chemicals, food articles, cloths, oil etc. this certificate is generally called for so that the goods exported confirm to the desired quality/standard analysis.

#### **f. Health Certificate**

When live animals or plants etc are exported generally the importer insists on the certificate of health by a recognized agency indicating the health and transportability of the export product. Sometimes, this certificate may also be required as per the laws of either importer's country or exporter's country.

### **3. Transport Documents**

In international trade the goods move from the warehouse of the exporter to the warehouse of the importer. The goods may move by land, water or air or a combination of one or more of these modes. In international trade such transport documents are more in number and it is very important to know the significance of each type of document. One of the most important aspects to be remembered with regard to any transport document is that it must show the name of the carrier.

#### **a. Bill of Lading**

This is a transport document representing movement of goods by water. A Bill of Lading is a format receipt given by the ship owners or their authorized agents stating that the goods mentioned therein (quantity, quality, description etc.) are shipped to specified date and vessel and are deliverable to the person mentioned therein or to her order after payment of all dues of shipping company.

The transport document describes about the means through which the buyer is receiving the goods. If the credit calls for marine or ocean Bill 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 to Collect". 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 the vessel to another during the course of ocean carriage.

It contains:

- ) Shipping Company's name and address
- ) Consignee's name and address
- ) Port of loading and port of destination

- )Shipping marks and particulars
- )Number of packages and the goods
- )Gross weight and net weight
- )Freight details and name of the vessel
- )Signature of the shipping company's agent

#### **b. Airway Bill**

This receipt issued by an airline company or its agent for carriage of goods is a contract between the owner of the goods and the carrier. It should indicate freight pre-paid or freight to collect. The first three digit of the Airway Bill number represents the code, which identifies the carrier. 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.

#### **c. Truck/Rail Consignment Note**

It is used when trade is between two neighboring countries physically attached together or one of the trading partners is a landlocked country. It is issued by trucking or rail transport Company and goods are usually delivered against surrender of consignee copy. It is usually issued in a non-negotiable form. 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; indicates that goods have been received for shipment; mentions the place of shipment and destination as per credit; and meets all other requirements of credit.

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.

### **4. Risk Covering Documents**

As the name indicates these are the documents which represent the insurance cover against the physical risks to the goods that are moving from exporter to overseas importer. These documents are:

#### **a. Insurance Policy**

It is document detailing all the terms of a contract of insurance and risks covered by the contract. Normally, it is issued in negotiable form and rights under the contract could be assigned by endorsement and delivery.

#### **b. Insurance certificate**

This documents obtained from the freight forwarder is used to assure the consignee that insurance will cover the loss or damage to the cargo during transit (marine/air insurance). Insurance Document is one of the important documents required for LC

transaction. All the originals of insurance document issued and signed by insurance companies, underwriters or their agents are to be presented. The cover notes issued by the broker are not acceptable. Date of issuance must be on or before the date of shipment or it must be proved by the specific notation that the cover is effective from the date of shipment. The insurance cover must be in the currency of credit and at least for 110% of CIF value.

#### **DISCREPANT DOCUMENT:**

In simple terms, a discrepancy is “anything that doesn’t comply with the terms and conditions of the LC”. The documents sent of negotiating bank should be in compliance with the terms and conditions stated in the LC. If there is any alteration in documents than the documents are said to be discrepant documents. Issuing bank will liable to make the permission of discrepant documents.

After receiving the documents, it needs to be thoroughly checked with terms and conditions of LC. If any documents contain any discrepancies which is not be accepted by the issuing bank, then the bank immediately informs the negotiating bank and the applicant within five working days as per UCP 600 Act. If the issuing bank fails to inform the negotiating bank then the issuing bank is bound to remit the payment even though the documents contain any discrepancies. If the applicant accepts the discrepancies then the issuing bank immediately has to remit the payment to the negotiating bank deducting its discrepancy charges as mentioned in the LC.

#### **AMENDMENTS IN THE DOCUMENTARY CREDIT**

The letter of credit can be amended if both the applicant and the beneficiary need any changes in the letter of credit acceptable by all the parties involved in the LC i.e. LC issuing bank, applicant, beneficiary, LC advising bank. Sometimes applicant or beneficiary may face some difficulties during shipment or production of the goods or any complications then they need LC amendment which was already issued. For this the LC issuing bank transmits SWIFT MT 707 for the LC Amendment fulfilling all the requirements.

If both applicant (issuing bank) and beneficiary agree to amend the LC, the advising bank will amend and transmit it to the advising bank. Extension of latest date of shipment and validity of credit, addition of clause, deletion of any clause, are some of the example of amendment. If the amendment is of changing the customs point of entry into Nepal, then as per NRB circular, we should take permission of Department of Commerce.

#### **PRE REQUISITES FOR OPENING AN LC**

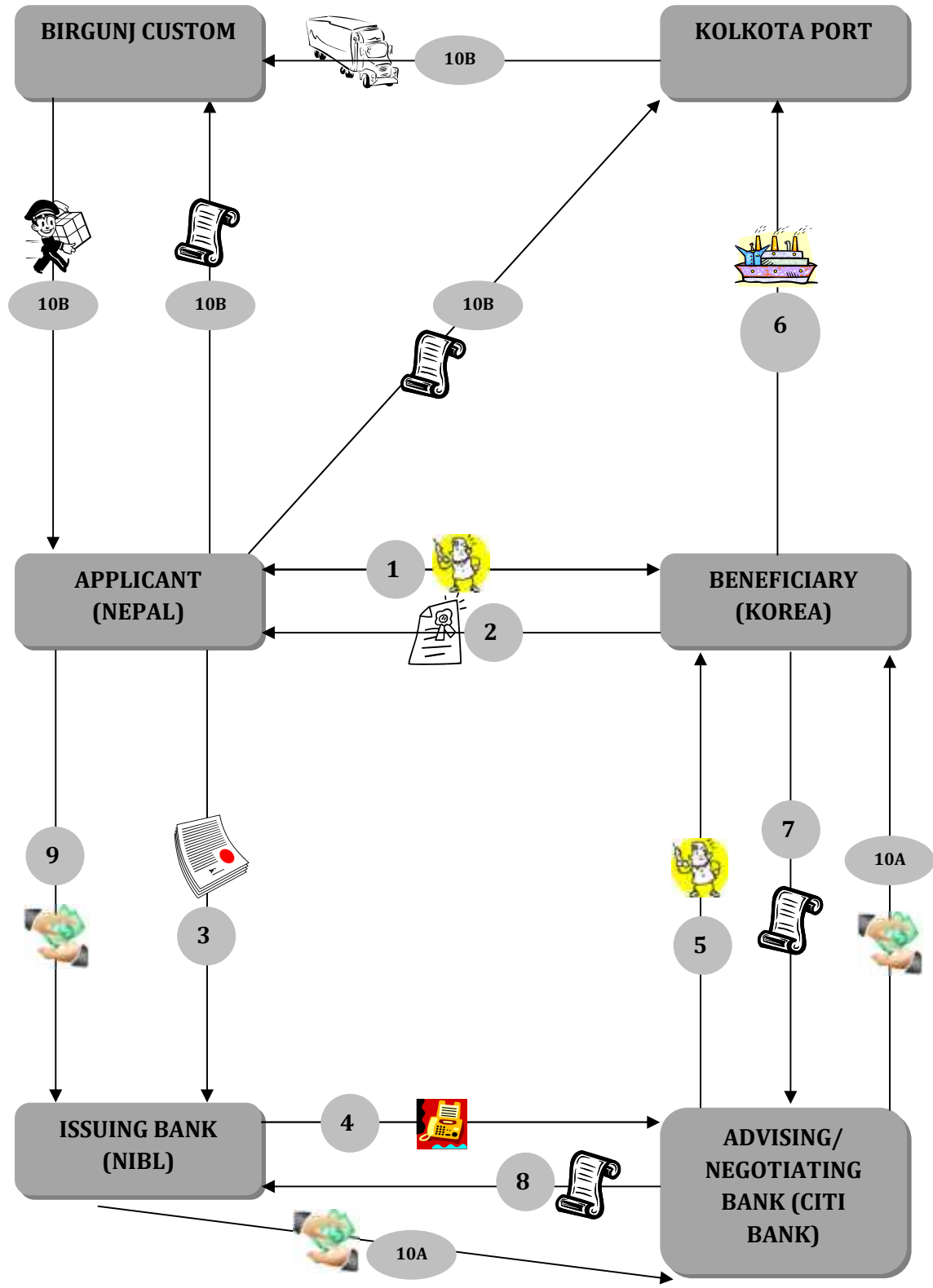
Before opening Letter of Credit following pre-requisites are to be fulfilled by the opener.

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



2. Income Tax Certificate, PAN Certificate, VAT Certificate (any one)
  3. The customer should be account holder of the bank.
  4. The photocopies of the Citizenship of the Proprietor/Partners/Directors.
  5. The Proprietor/Partners/Directors name should not be registered in black list or defaulter list.
- 
6. Limit approval or review period bank should collect the copy of Customer/Firm's financial document, Credit Information Bureau (CIB) report or Board Minute (if Co is P. Ltd).
  7. Customer should be better creditworthiness in the market
  8. For the import of following merchandise prior approval is required before opening of the LC.
    - a. For import & export of Liquors VAT approval must be taken.
    - b. Ministry of Commerce has determined / restricted not to import certain quantity like Post Dana (Poppy seed) so if some importer wants to import Poppy seed more than determined quantity he must submit the approval from the concerned Ministry of the Nepal Government.
    - c. Trading firms do not import old clothes, Scrap and machinery but if somebody wants to import those goods he must get the permission from Ministry of Population & Environment.
    - d. Permission from Ministry of Population & Environment for import of merchandise which destroys the Ozone layer
  9. Approval/recommendation letter is required from concerning authority for import like wool, cotton, medicine, edible oil, non-alcoholic fruit drinks etc.
  10. Either approved limit or cash margin (cash or equivalent cash) required before LC opening.
  11. Import Restricted Items:
    - a. Arms and Explosive Products.
    - b. Radio Frequency Transmission Products.
    - c. Narcotic Products – Cigarette, Tobacco, Heroin.
    - d. Inland Revenue Department's approval is required for Liquors, Wines.
    - e. Products made of Recycled Plastics granules
    - G. Ozone Deflecting products – must be CFC free.
    - h. Beef

# OPERATIONS OF LETTER OF CREDIT



**Figure 1: Import LC Operation Process**

Letter of Credit is widely used instrument in the field of international trade. Letter of credit is written instrument issued by the bank (the issuing bank) on the behalf of the buyer (the applicant) in favor of the seller expressing its definite undertaking to affect payment for the specific amount, provided the seller (beneficiary) complies with the terms and conditions stipulated in the letter. Letter of Credit is of different types and has different formats. The operation which I am going to discuss is of Opening Import Letter of Credit.

In this example, there is a Buyer or Applicant or Importer, from Nepal; Seller or Beneficiary or Exporter, from Korea; an Issuing Bank (Nepal Investment Bank Ltd. NIBL), An Advising Bank (Citi Bank); Kolkata Port (from where most of the imported goods came); and Birgunj Custom (from where most of the goods come from Abroad. Let's explain this process one by one.

1. First of all, Applicant and Beneficiary make the negotiation in which Applicant wants to buy certain goods (let's say Machine), and Beneficiary agrees to sell it. They made a contract in which they decide what to purchase/sell, how much to buy/sell, from where to make shipment (for e.g. Kolkata Port via Birgunj Customs Office to Kathmandu), etc. after their negotiation Applicant asks to send Pro-forma Invoice (P/I).
2. Then Beneficiary sends Pro-forma Invoice to Applicant to open LC.
3. After getting Pro-forma Invoice Applicant goes to Issuing Bank (NIBL) to open Import LC. Bank opens LC on the behalf of the Applicant in favor of the seller after analyzing Pro-forma Invoice and necessary documents including LC form.
4. Then, Issuing Bank (NIBL) sends SWIFT to Advising Bank (Citi Bank) via Message Type 700.
5. After receiving the SWIFT from Issuing Bank, Advising Bank informs the Beneficiary that SWIFT message has been received. Then Beneficiary starts to send goods (machine) to Applicant.
6. In this stage, Beneficiary ships the goods through a shipping line or company to Kolkata port in India. Shipping Company issues Bill of Lading (B/L) in 3 original copies and sends to the Beneficiary. In this same stage, Beneficiary prepares the necessary documents as mentioned in documents required clause in LC such as Commercial Invoice, Packing and Weight List, Certificate of Origin, Bill of Lading, Insurance Certificate etc.
7. After that Beneficiary sends those documents to his bank. In this stage, the Advising bank becomes the Negotiating Bank.
8. The Negotiating Bank checks the documents and forwards to the Issuing Bank through courier, this is the process of LC Documents Negotiation.
9. After receiving the documents, the Issuing Bank informs the Applicant. Applicant makes necessary payments to the bank for the amount of the documents then the Issuing Bank gives the documents including Bi.Bi.Ni. No. 4 to the Applicant to release the goods from Kolkata Port in India and Birgunj Customs Office in Nepal. The Issuing Bank keeps one set of those documents for its record purpose.
10. The Issuing Bank pays the amount of the documents to the Negotiating Bank via SWIFT message. After getting the payment Negotiating Bank sends the amount to

the Beneficiary.

11. Applicant sends one set of documents to the Kolkata Port for the release of his goods from the port for this, he can appoint his agent. After release of the goods from Kolkata port, the goods are sent to Birgunj Customs Office in Nepal. The Applicant sends one set of documents including Bi.Bi.Ni. No. 4 to the Customs Office for the release of his goods. After this Applicant receives the goods.

## **PROCESS TO OPEN IMPORT LETTER OF CREDIT**

### **1. Scrutinizing of application**

- ) LC application must be filled properly without any corrections.
- ) The Bi. Bi. Ni. form no. 3 should be filled and signed properly.
- ) The firm's registration and income TAX/VAT must be updated.
- ) Proforma Invoice should be attached mentioning description of the goods, quantity, unit price, detail name and address of applicant and beneficiary, Proforma invoice no. and its date, Incoterms, 8 digit harmonic code and country of origin of the importing goods.
- ) Signature of authorized person and the stamp of the company should be verified.

### **2. Process of approval**

- ) When the application is certified, it is sent to be approved from the concerned authority.
- ) If the case is within limit and without any dues, it is approved and can be done by LC department itself.
- ) In case of non-limit holders or new client approval is made through concerned authority.
- ) A register is maintained clearly showing the time application was received, processed from the department. The department does proper monitoring and follows up.

### **3. After the approval**

- ) The cash margin for LC is to be debited from the applicant's account and held in the LC margin account.
- ) The LC commission and the SWIFT charges have to be debited from the applicant's account. (such cash margin and commission is expressed in percentage and is approved by the bank's management authority)
- ) The LC liability has to be booked properly.
- ) The Bi.Bi.Ni form no.3 needs to be separated and the copies should be sent to NRB and custom and original filed by the bank.

### **4. Formation of LC**

- ) After the above process, the LC format has to be made according to the application and other documents.
- ) Local LC is sent through courier and foreign LC through SWIFT.

### **5. Amendment of LC**

- ) Proper request for amendment should be made.
- ) The authorized person must sign amendment form.
- ) Bi.Bi.Ni form no. 3 must be filled and signed properly as well.
- ) Amendment must not violate any NRB directives.

#### **6. Cancellation of LC**

Cancellation of LC means the reverse of established LC. Applicant must request the issuing bank for the cancellation of LC. Then, the issuing bank informs the advising bank and advising bank informs the beneficiary for consent. Under mutual understanding of the buyer and seller, the LC can be cancelled.

#### **7. Documents required for releasing the goods from customs**

- ) BBNi form no.4 is filled in quadruplicate as follows:
  - o First two copies to importers, for the submission to the concerned customs office.
  - o Third copy to be sent to NRB for reporting.
  - o Fourth copy to be retained by the bank.
- ) Each copy of the documents mentioned in LC along with copy of LC and Proforma invoice is separated.
- ) These documents are compiled and kept in an envelope for sealing.

#### **8. Settlement of LC upon arrival of original documents**

- ) It must be checked whether documents are as per the LC terms and orders for any discrepancies. If the documents are clean without any discrepancies the payment must be made within 5 working days from the date of receipt of the documents.
- ) Exchange rate details should be confirmed with the Treasury department before giving them to the client.
- ) If the documents are found to have discrepancies on them, client should be informed and a SWIFT should be sent to the negotiating bank mentioning the discrepancies within 5 working days of receipt of the documents by the LC issuing bank.

#### **Settlement of LC after arrival of original Documents**

Settlement of LC means the reversal of LC contingent and makes the payment as per payment terms stated. Customer either books loan or pay 100% cash to make the payment of LC and settle it. If the customer doesn't come the bank in stated time then the bank will effect payment by settling LC booking it into BLC. This is a forced settlement of LC. It is common in Nepalese banking.

LC Documents must be checked whether it is as per the LC terms and conditions or not and any discrepancies found, it must be noted. Exchange rate details should be confirmed with the Treasury Department before giving them to the client. If the documents are found to have discrepancies on them, client should be informed and a SWIFT should be sent to the settlement bank mentioning the refusal of discrepant documents has to be informed within five working days from the receipt of documents as per UCP-600.

## **Mode of payment in LC**

### **1. Sight LC**

In sight LC, payment is to be made immediately upon presentation or demand. In this type of credit, the draft is at sight basis i.e. when the documents are presented to the buyer's bank, the payment should be made immediately after receiving the documents. The normal time for the payments given by UCP 600 is five working days after receiving the drafts at sight.

### **2. Usance LC**

In Usance LC, payment is to be made at future date against Bills of Exchange. 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. For example: Usance period is defined in the LC as "90 days from Bill of Lading Date or "60 days from Airway Bill Date" or "30 Days from Consignment Note Date", etc.

### **3. Deferred LC**

It is similar to Usance LC, the difference is that, it is payable at future date without bill of Exchange. If a credit is issues deferred payment until a future date without stipulating that the draft are to be drawn, it falls into the Category of deferred payment credit and the advising bank will not call for drafts.

## **Some of the important directives of Nepal Rastra Bank (NRB)**

1. LC Application form should mandatory fill for opening LC.
2. At the time of retirement of document Bi.Bi.Ni. Form no. 4 should be prepared in quadruplicate. First two goes to the importer for submission to the concerned customs office and clearance of the goods. Third to NRB and fourth is retained by the bank.
3. Bi.Bi.Ni. Form 3 & 4 should be submitted to NRB on daily basis by bank situated in kathmandu valley and weekly in other case (out of valley). A copy of Bi.Bi.Ni. 3 must be sent to the concerned customs office.
4. Requirement for the opening LC firm registration certificate, Pro-forma Invoice or Contract specifying value and quantity of the goods to be imported.
5. Documentary credit with clauses like all discrepancies acceptable shall not be either open nor shall be amended resulting to such arrangement.
6. The central office of each commercial bank shall compulsorily follow up all Documentary Credit for more than US \$50,000.
7. Documentary credit received through correspondent bank should only be accepted.
8. Payment to the beneficiary must be made through correspondent bank. Direct payment to the beneficiary by way of draft is strictly prohibited.

9. 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). Commercial bank accepts a transport document if that is presented to the bank within 45 days from its issuance.
10. All commercial bank should inform NRB within 7 days of opening LC with a Cash margin of 50% or more.
11. Along with Bi.Bi.Ni. Form no. 4, all commercial banks should forward following documents to the concerned customs office. Copy of Amendments in LC if any, Commercial Invoice, Transport Document (Bill of Lading / Airway Bill / Consignment Note / Railway Receipt), Certificate of Origin, Packing List.
12. Procedure should be followed before submitting Bi.Bi.Ni Form no. 4 to the concerned customs office. Document must be submitted in sealed envelope. Bank should maintain separated file for each customs office. Non-receipt of Bi.Bi.Ni. Form No. 4 from customs office within reasonable time or document receipt does not match with the bank copy must be informed to NRB.
13. There is a provision to issue Bi.Bi.Ni. Form No. 4 on the basis of copy document received from the applicant but the payment is made only after receiving the original documents from the beneficiary's bank to the LC issuing bank. This provision is made to ease the process of releasing the goods from the concerned customs office as soon as the goods are arrived in the customs office.
14. No commercial bank can issue a documentary credit with Red Clause.
15. Concerned authority must issue the certificate of origin. However if importer accepts the certificate of origin of the goods issued by the beneficiary, above rule can be exempted.
16. Pro-forma invoice or indent must contain description of goods, country in which the goods are produced, unit price, quality and total price.
17. Half yearly internal audit report of each bank licensed to issue LC must be sent to NRB.
18. If original document do not match with copy documents bank should inform NRB and hold the LC till NRB gives clearance.
19. The back-to-back LC can be opened against confirmed and irrevocable LC only. Payment shall be made only out of the proceeds of export of the finished product of the concern raw material.

## **PROHIBITION REGARDING THE OPENING OF LC**

Opening of Letter of credit for certain things are prohibited by the NRB, Nepal Government. 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, and Lunch Box is prohibited. Apart from these, if the applicant requests the bank to open the LC for other things that do not have harmonic code number, 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 LC can be opened in favor of those products to be imported in the country. Ministry of Commerce has prohibited opening up the LC relating the import of the Poppy Seed, which is used for making 'opium'. LC cannot be opened for import of the illegal products. Government has prohibited the opening of the LC 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

## **PROBLEMS WHILE OPENING LC**

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

1. NRB has instructed all the commercial banks to open LC on the basis of the status of the client. Commercial banks find the term 'status' very vague.
2. Employees of commercial banks involved in LC transaction have to be responsible if anything goes wrong in the transaction. However, employees of Nepal Government Department of Commerce and Taxation Department from where people get import license and income tax clearance certificate respectively to open LC are not responsible.
3. Government makes valuation for the 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. Sometimes 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, bank has to pay to the exporter even though the goods are in the banks possession.
5. The new customer has to deposit around 100% margin and the LC takes around 15-30 days for settlement. Therefore the customer cannot use the amount, as it gets freeze.
6. If the party is new then exporter does not believe and asks for advance payment to deliver the 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 has not exceeded more than one year period from its registration, they have to pay tax in advance of LC amount. Issuing bank charges 10% tax of LC amount and send it to the tax office. Within that one-year, they have to pay advance tax payment every time they open LC.
8. The major problem of LC 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.
9. Since LC has different technical terminologies and guided by UCPDC 600 and different NRB circulars for the operation, applicants do not understand all those



technicalities and regulations. Applicants take more time to fill up the LC application form or make mistakes or make corrections in the LC form, so staffs have to give extra time while checking those LC form and explain those terminologies.

10. Sometimes applicants request to open LC by sending the LC application form through fax or e-mail. But bank cannot accept such application form; it must be delivered the original request directly by the customer. Such request is not authenticated in order to open LC.

Above are some of the most important elements of Letter of Credit transactions.

#### 4.4. Analysis of Basic Indicators:

##### Ratio analysis

Ratio analysis is one of the tools of financial analysis. Under ratio analysis, various ratios have been calculated and interpreted. For the sake of interpretation and analysis of those ratios calculated, both the methods of vertical and horizontal analyses have been implemented. Specifically, the following groups of ratios have been selected for analysis:

##### 4.4.1 Total Loans & Advances to Total Deposit Ratio

Commercial banks utilize the outsider's fund for profit generation purpose. Loans & advances to total deposit ratio shows whether the banks are successful to utilize the outsiders funds (i.e. total deposits) for the profit generating purpose on the Loans & Advances or not. Generally, a high ratio reflects higher efficiency to utilize outsider's fund and vice-versa. The ratio can be calculated by using following formula:

$$\text{Total Loans \& Advances to Total Deposit Ratio} = \frac{\text{Total Loans \& Advances}}{\text{Total Deposits}}$$

**Table 4.4.1 Total Loans & Advances to Total Deposit Ratio**

<b>Fiscal Year</b>	<b>Total Loans &amp; Advances (in millions)</b>	<b>Total Deposit (in millions)</b>	<b>Ratio (in percent)</b>
2006/2007	17,769	24,489	72.56
2007/2008	27,529	34,452	79.91
2008/2009	36,827	46,698	78.86
2009/2010	40,948	50,094	81.74
2010/2011	41,887	50,138	83.54
<b>Average</b>			<b>79.32</b>

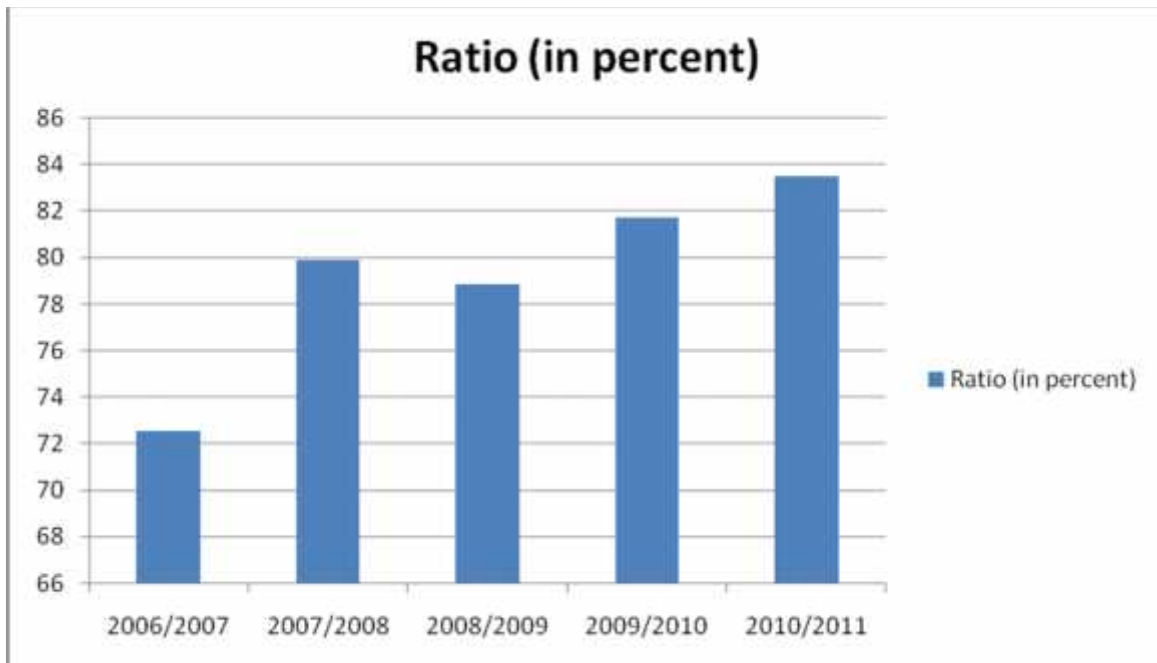
*(Source: annual report of NIBL)*

Table 4.4.1 shows the total loan & advances to total deposit ratio of NIBL. The ratios were 72.56% in the fiscal year 2006/2007, 79.91 in the fiscal year 2007/2008, 78.86%

in the fiscal year 2008/2009, 81.74% in the fiscal year 2009/2010 and 83.54% in the fiscal year 2010/2011. In an average, the ratio remains at 79.32% during the five-year study period. The ratio is in a decreasing trend except in the fiscal year 2008/2009.

The bank has higher average total loans & advances to total deposit ratio during the five year study period. It indicated that bank has more liberal lending policy and able to utilize the collected funds. These are shown in the following diagrams.

**Figure: 4.4.1 Total Loans & Advances to Total Deposit Ratio of NIBL**



#### 4.4.2 Non-Performing Assets to Total Loans & Advances Ratio

NRB has directed all the commercial banks to create loan loss provision against the doubtful and bad debts. Non-performing assets to total loans & advances ratio shows the actual figure of NPA over the total lending of the bank. It is the base ratio to measure efficiency of lending department. Here, lower ratio reflects higher efficiency to provide good lending and vice versa. The ratio is calculated by using following formula:

$$\text{Non-Performing Assets to Total Loans \& Advances Ratio} = \frac{\text{Non performing Assets}}{\text{Total Loans \& Advances}}$$

**Table 4.4.2 Non-Performing Assets to Total Loans & Advances Ratio**

<b>Fiscal Year</b>	<b>Ratio</b>
2006/2007	2.37
2007/2008	1.12
2008/2009	0.58
2009/2010	0.62
2010/2011	0.94
<b>Average</b>	<b>1.126</b>

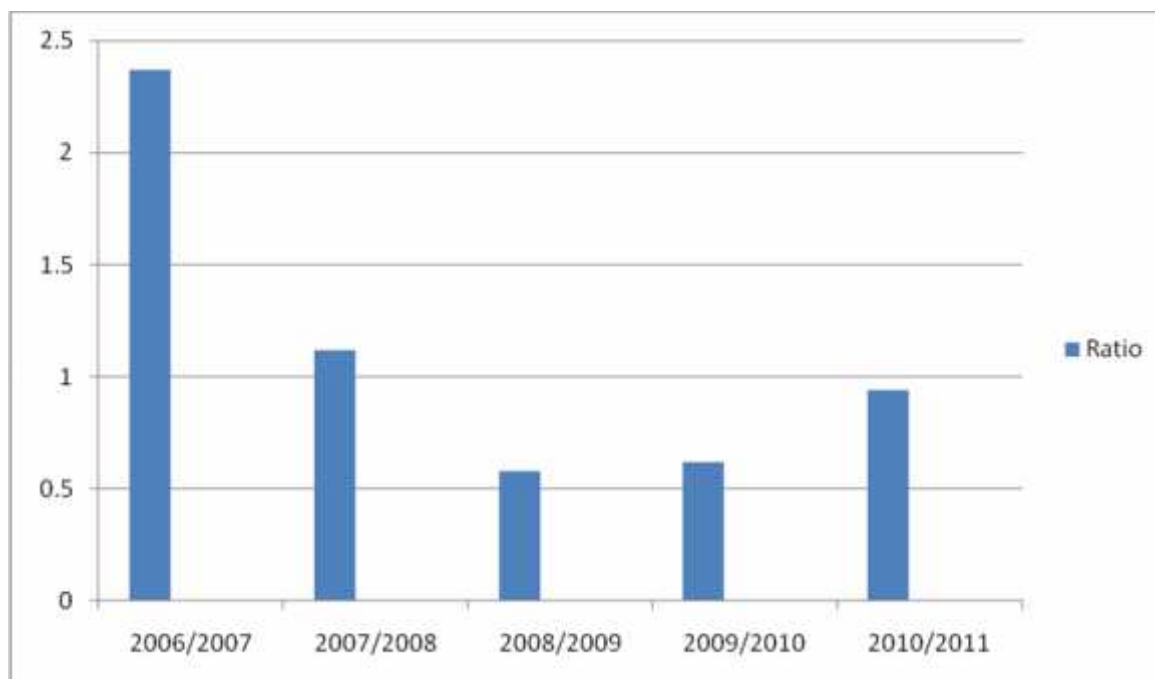
*(Source: annual report of NIBL)*

Table 4.4.2 shows the non-performing assets to total loans & advances ratio of bank. This ratio shows the bad credit and doubtful credit of bank over the total credit granted. The non-performing assets to total loans & advances ratio of the bank were 2.37% in the fiscal year 2006/2007, 1.12% in the fiscal year 2007/2008, 0.58% in the fiscal year 2008/2009, 0.62% in the fiscal year 2009/2010 and 0.94% in the fiscal year 2010/2011. The average ratio remains at 1.13% during the five-year study period. The ratio is in a decreasing trend except in the fiscal year 2009/2010 and 2010/2011.

The bank has higher average ratio of non-performing assets to total loans & advances rather it was in decreasing trend in the following years of study period. It indicated that bank has not efficient credit management team and strict policy even it was satisfactory.

These are shown in the following diagram:

**Figure: 4.4.2 Non-Performing Assets to Total Loans & Advances Ratio of NIBL**



#### 4.4.3 Interest Income to Total Loans & Advances Ratio

Interest Income to Total loans & Advances Ratio shows the income as interest from total loans & advances. It is useful to know the fact that whether the loan has given good return or not. We can increase interest income by taking good issuing and recovery credit policy. High return shows the soundness of credit policy. It is calculated by using the following formula:

$$\text{Interest Income to Total Loans \& Advances Ratio} = \frac{\text{Interest Income}}{\text{Total Loans \& Advances}}$$

**Table 4.4.3 Interest Income to Total Loans & Advances Ratio**

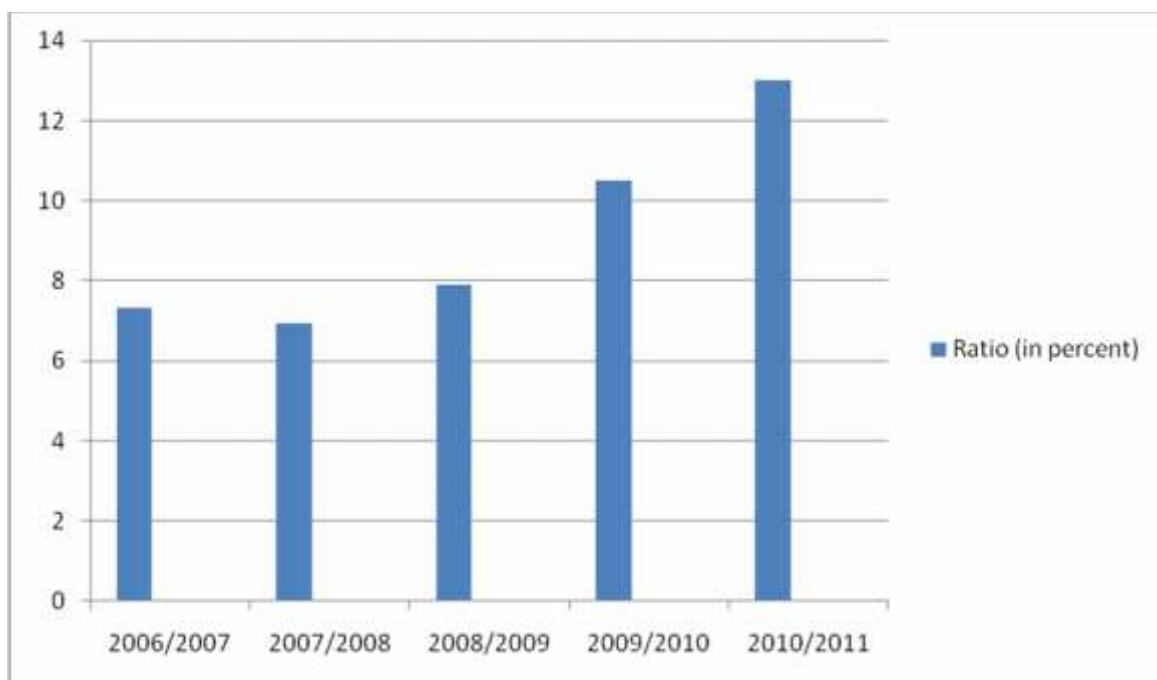
Fiscal Year	Ratio (in percent)
2006/2007	7.33
2007/2008	6.93
2008/2009	7.89
2009/2010	10.51
2010/2011	13.00
<b>Average</b>	<b>9.132</b>

(Source: annual report of NIBL)

Table 4.4.3 shows the interest income to total loans & advances ratio of the bank. The ratios were 7.33% in the fiscal year 2006/2007, 6.93% in the fiscal year 2007/2008, 7.89% in the fiscal year 2008/2009, 10.51% in the fiscal year 2009/2010 and 13% in the fiscal year 2010/2011. The average ratio remains at 9.13% during the five-year study period. The ratio is in a decreasing trend except in fiscal year 2007/2008 because growth rate of total loan & advances is more than the growth rate of total income over the study period.

In an aggregate, the ratio is in an increasing trend. It is a good symptom of the bank that it can earn from interest to pay for the depositor's of the bank. These are shown in the following diagram:

**Figure: 4.4.3 Interest Income to Total Loans & Advances Ratio of NIBL**



#### 4.4.4 Net Profit to Total Loans & Advances Ratio

This ratio measures the earning capacity of commercial banks through its fund mobilizations for loans & advances. If signaling effect does not exist, there is always direct relationship between total loans & advances and net profits. It means, if one variable out of them is increased, that absolutely increased another variable and vice-versa. Higher ratio indicated greater success to mobilize funds as loans and advances and vice versa. Mostly loans and advances include cash, credit, over-draft, bills purchased and discounted.

$$\text{Net profit Total Loans \& Advances Ratio} = \frac{\text{Net Profit}}{\text{Total Loans \& Advances}}$$

**Table 4.4.4 Net Profit to Total Loans & Advances Ratio of NIBL**

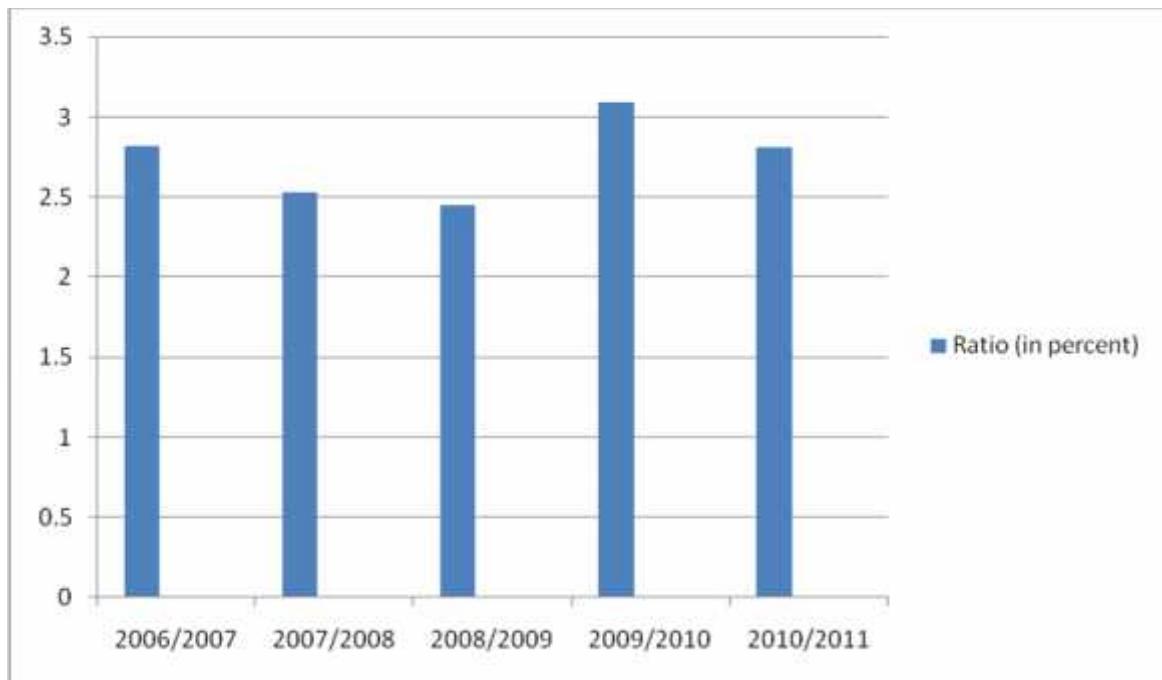
<b>Fiscal Year</b>	<b>Ratio (in percent)</b>
2006/2007	2.82
2007/2008	2.53
2008/2009	2.45
2009/2010	3.09
2010/2011	2.81
<b>Average</b>	<b>2.74</b>

*(Source: annual report of NIBL)*

Table 4.4.4 shows the net profit to total loans & advances of the bank. The ratios were 2.82 in fiscal year 2006/2007, 2.53% in fiscal year 2007-2008, 2.45% in fiscal year 2008-2009, 3.09% in fiscal year 2009-2010, and 2.81% in 2010/2011. In an average, the ratio remains at 2.74% during the five-year's study period. Though the ratio is in decreasing trend except in the fiscal year 2009/2010, the figures are too much competitive trend i.e. there is no significant changes except in the fiscal year 2009/2010.

In this reason we can say management of the bank is having good lending policy as well as they are investing in those sectors, which have high return with low risk. Interest spread rate is also a crucial factor for determination of net profit. These can be shown in the following Diagram:

**Figure: 4.4.4 Net Profit to Total Loans & Advances Ratio of NIBL**



#### 4.5 Analysis of Import LC

The importer (applicant) imported different products from outside of the country. In this condition, the importer or applicant opened import LC for safe payment. The bank has record of the data like the number of LC opened in different currency in particular month or year and their equivalent amount in NPR and from that number of LC of particular month or year is accumulated to make it total LC of the fiscal year. So here the total amount of LC and number of LCs issued is taken as two variables for comparison.

##### 4.5.1 Import LC in Nepali currency

**Table: 4.5.1 Import LC in Nepali currency**

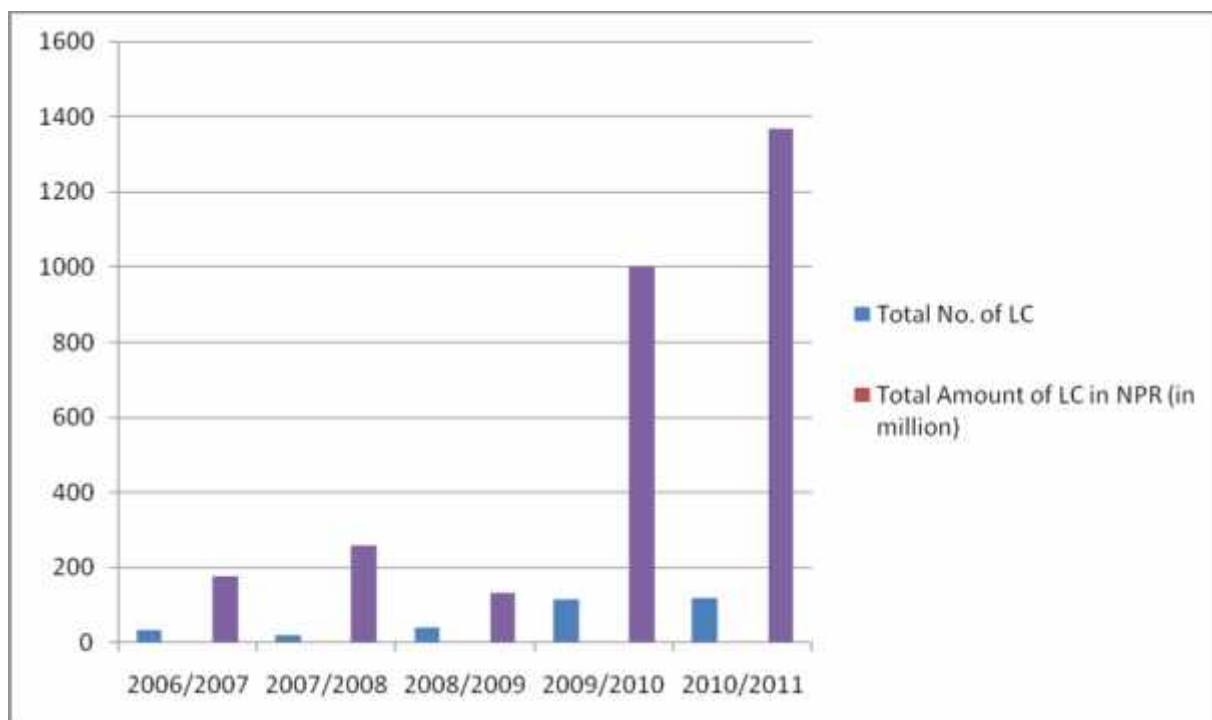
Fiscal Year	Total No. of LC	Total Amount of LC (in NPR)
2006/2007	33	177,165,278.48
2007/2008	22	260,917,020.77
2008/2009	40	132,631,892.47
2009/2010	115	1,004,683,467.66
2010/2011	120	1,368,691,793.70

(Source: LC Department, Nepal Investment Bank Limited)

Above table 4.5.1 represented the total number of import LC opened in Nepalese currency and total transaction value of import LC in Nepalese currency from fiscal year 2006/2007 to 2010/2011. The total number of import LC opened in Nepalese currency was in increasing trend over the five years of study period except in year 2007/2008. They were 33, 22, 40, 115 and 120 in fiscal year 2006/2007, 2007/2008, 2008/2009, 2009/2010 and 2010/2011 respectively.

Similarly, the total transaction value of import LC in Nepalese currency was in increasing trend except in yr 2008/2009. The transaction value of import LC in Nepalese currency was continuously in increasing trend until to the last year of the study period. They were Rs. 177.17 million in the fiscal year 2006/2007, Rs. 260.92 million in the fiscal year 2007/2008, Rs. 132.63 million in the fiscal year 2008/2009, Rs. 1,004.68 million in the fiscal year 2009/2010 and Rs. 1,368.69 million in the fiscal year 2010/2011 respectively. In fiscal year 2008/2009 total transaction value of import LC has been declined as compared to previous fiscal year due to political inconsistency of the country. Following figure more clarifies about it:

**Figure 4.5.1 Total No. and Total value of Import LC transaction in Nepalese Currency (in millions)**





#### 4.5.2 Import of LC in INR Currency

**Table 4.5.2 Import of LC in INR Currency**

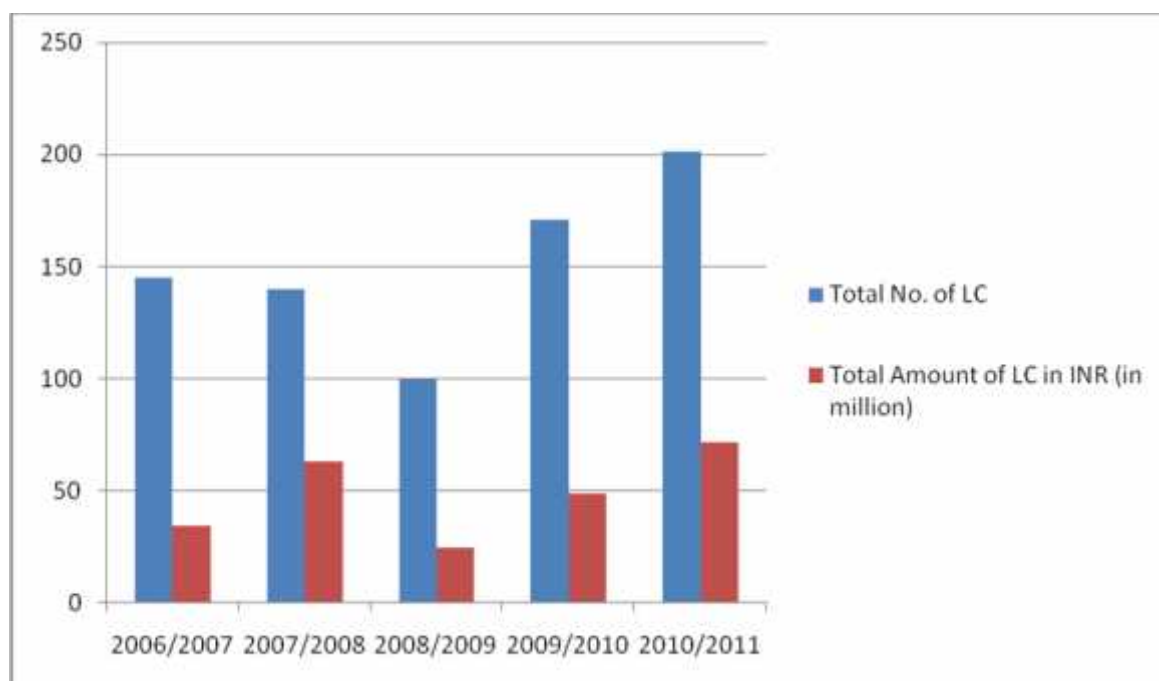
<b>Fiscal Year</b>	<b>Total No. of LC</b>	<b>Total Amount of LC in INR (in millions)</b>	<b>Total Amount of LC in NPR (in millions)</b>
2006/2007	145	34.50	55.25
2007/2008	140	63.24	101.28
2008/2009	100	24.93	39.93
2009/2010	171	48.89	78.29
2010/2011	201	71.60	114.67

(Source: LC Department, Nepal Investment Bank Limited)

Above table 4.5.2 represents the total number of import LC opened in Indian currency and total transaction value of import LC in Indian currency from fiscal year 2006/2007 to 2010/2011. Total number of import LC opened in INR currency was first in a decreasing trend and then in an increasing trend over the five years of the study period. They were 145, 140, 100, 171 and 201 in fiscal year 2006/2007, 2007/2008, 2008/2009, 2009/2010 and 2010/2011 respectively.

Similarly, total transaction value of import LC in INR currency was in an increasing trend except in year 2008/2009. They were INR 34.50 million in the fiscal year 2006/2007, INR 63.24 million in the fiscal year 2007/2008, INR 24.93 million in the fiscal year 2008/2009, INR 48.89 million in the fiscal year 2009/2010 and INR 71.60 million in the fiscal year 2010/2011 respectively. Following figure more clarifies about it:

**Figure 4.5.2 Total No. and Total value of Import LC transaction in INR Currency (in millions)**



#### 4.5.3 Import of LC in US dollar

**Table 4.5.3 Import of LC in US dollar**

Fiscal Year	Total No. of LC	Total Amount of LC in USD (in millions)
2006/2007	1,287	7.90
2007/2008	1,165	9.65
2008/2009	842	8.57
2009/2010	1,057	11.20
2010/2011	1,071	11.02

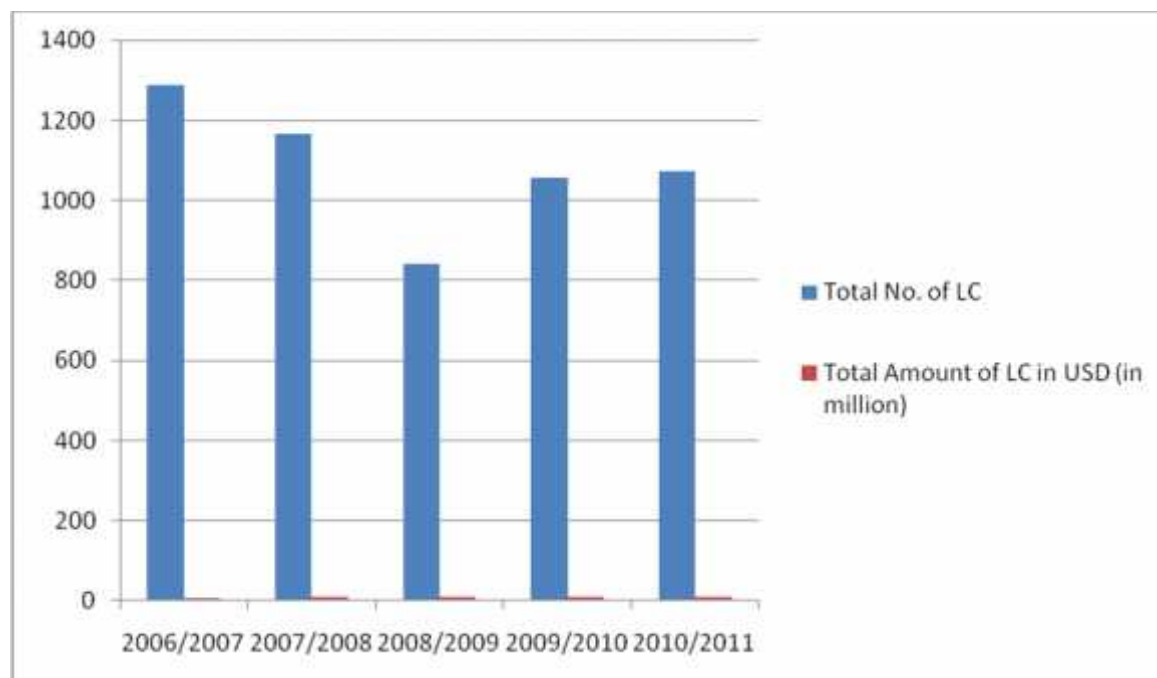
(Source: LC Department, Nepal Investment Bank Limited)

Above table 4.5.3 represents the total number of import LC opened in US dollar and total transaction value of import LC in US dollar from fiscal year 2006/2007 to 2010/2011. Total number of import LC opened in US dollar was in fluctuating trend over the five years of the study period. They were, 1,287, 1,165, 842, 1,057 and 1,071 in the fiscal year 2006/2007, 2007/2008, 2008/2009, 2009/2010 and 2010/2011 respectively.

Likewise, total transaction value of import LC in US dollar was also in fluctuating trend. They were, USD 7.90 million in the fiscal year 2006/2007, USD 9.65 million in the fiscal year 2007/2008, USD 8.57 million in the fiscal year 2008/2009, USD 11.20 million in the fiscal year 2009/2010 and USD 11.02 million in the fiscal year 2010/2011 respectively.

Here, total number of import LC opened in US dollar and total transaction value of Import LC in US dollar was fluctuating by trend as compared to previous fiscal years. Following figure more clarifies about it:

**Figure 4.5.3 Total No. and Total value of Import LC Transaction in USD (in millions)**



#### 4.5.4 Import of LC in EURO

**Table 4.5.4 Import of LC in EURO**

Fiscal Year	Total No. of LC	Total Amount of LC in EUR (in millions)
2006/2007	85	1.10
2007/2008	65	1.56
2008/2009	51	1.62
2009/2010	57	5.14
2010/2011	63	2.38

(Source: LC Department, Nepal Investment Bank Limited)

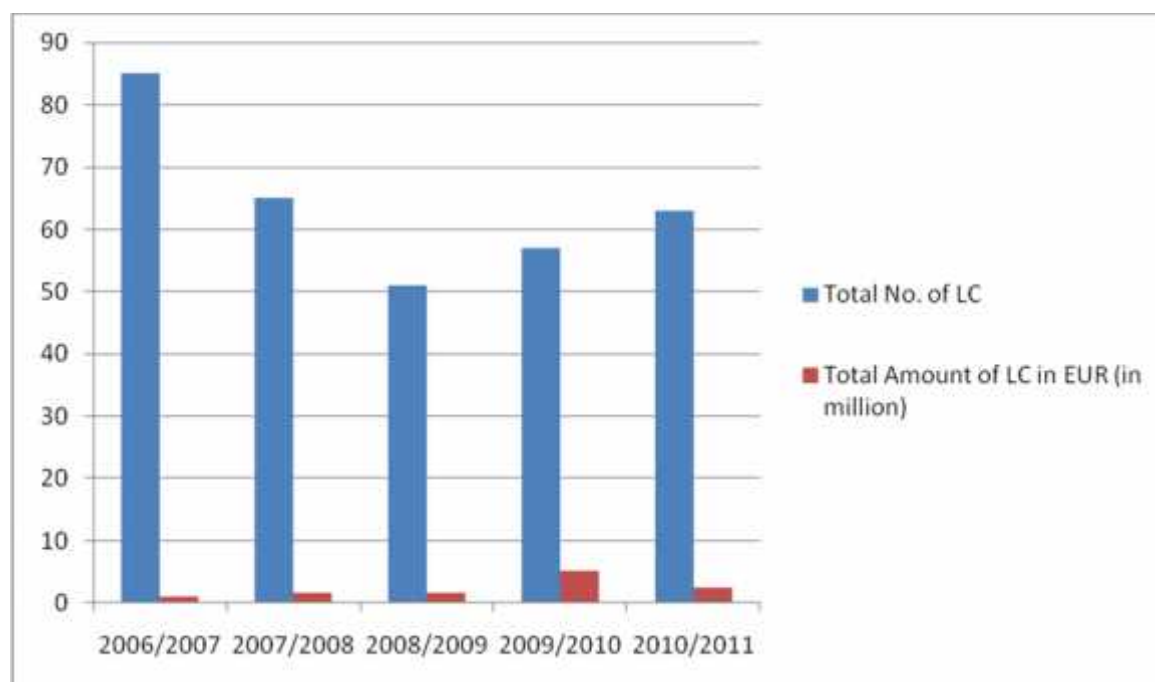
Above table 4.5.4 represents the total number of import LC opened in EURO and total transaction value of import LC in EURO from fiscal year 2006/2007 to 2010/2011. Total number of import LC opened in EURO was in fluctuating trend over the five years of the study period. They were 85, 65, 51, 57 and 63 in the fiscal year 2006/2007, 2007/2008, 2008/2009, 2009/2010 and 2010/2011 respectively.

Likewise, total transaction value of import LC in EURO was also first in increasing trend and in last year of the study period it is in decreasing trend. They were, EUR 1.10 million in the fiscal year 2006/2007, EUR 1.56 million in the fiscal year 2007/2008, EUR

1.62 million in the fiscal year 2008/2009, EUR 5.14 million in the fiscal year 2009/2010 and EUR 2.38 million in the fiscal year 2010/2011 respectively.

Here, total number of import LC opened in EURO and total transaction value of import LC in EURO was fluctuating by trend as compared to previous fiscal years. Following figure more clarifies about it:

**Figure 4.5.4 Total No. and Total value of Import LC transaction in EURO Currency (in millions)**



#### 4.5.5 Import of LC in GBP Currency

**Table 4.5.5 Import of LC in GBP Currency**

Fiscal Year	Total No. of LC	Total Amount of LC in GBP (in millions)
2006/2007	11	0.46
2007/2008	15	0.61
2008/2009	7	0.49
2009/2010	4	0.33
2010/2011	13	0.52

(Source: LC Department, Nepal Investment Bank Limited)

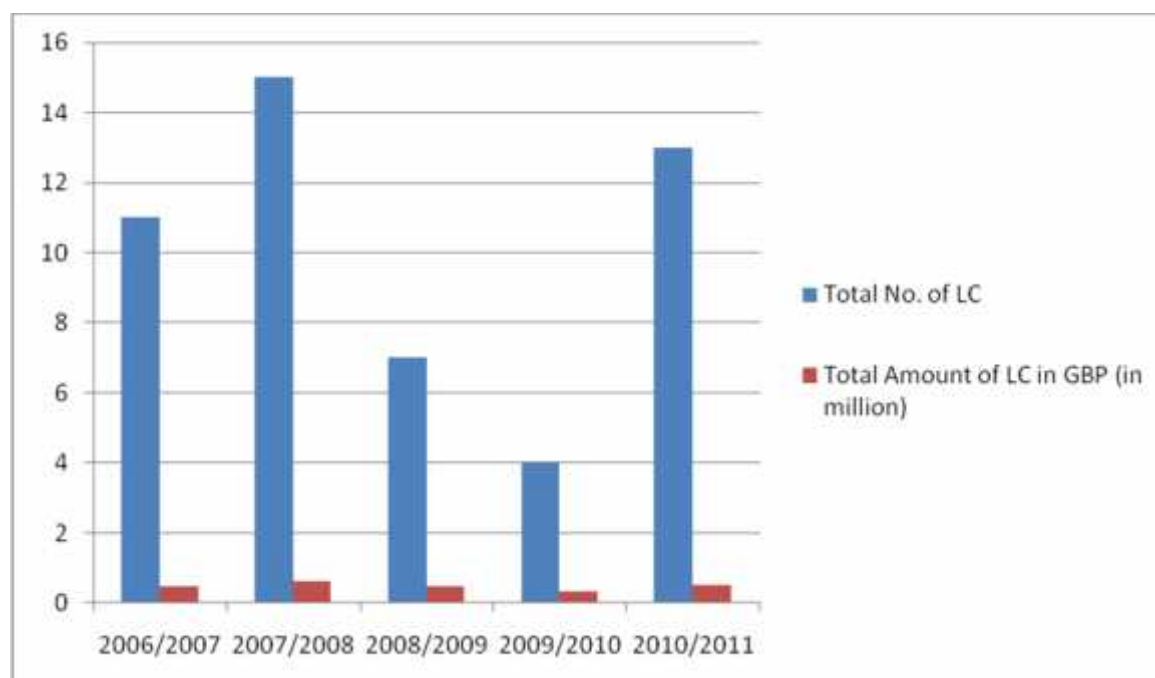
Above table 4.5.5 represents the total number of import LC opened in GBP and total transaction value of import LC in GBP from fiscal year 2006/2007 to 2010/2011. Total number of import LC opened in GBP was in fluctuating trend over the five years of the study period. They were, 11, 15, 7, 4 and 13 in the fiscal year

2006/2007, 2007/2008, 2008/2009, 2009/2010 and 2010/2011 respectively.

Likewise, total transaction value of import LC in GBP was also in fluctuating trend, i.e. first increased, then after decreasing and then increasing trend over the study period. They were, GBP 0.46 million in the fiscal year 2006/2007, GBP 0.61 million in the fiscal year 2007/2008, GBP 0.49 million in the fiscal year 2008/2009, GBP 0.33 million in the fiscal year 2009/2010 and GBP 0.52 million in the fiscal year 2010/2011 respectively.

Here, total number of import LC opened in GBP and total transaction value of import LC in GBP was fluctuating by trend as compared to previous fiscal years. Following figure more clarifies about it:

**Figure 4.5.5 Total No. and Total value of Import LC transaction in GBP Currency (in millions)**



#### 4.5.6 Import of LC in JPY

**Table 4.5.6 Import of LC in JPY**

Fiscal Year	Total No. of LC	Total Amount of LC in JPY (in millions)
2006/2007	32	14.61
2007/2008	29	14.33
2008/2009	36	13.43
2009/2010	50	34.32
2010/2011	138	56.07

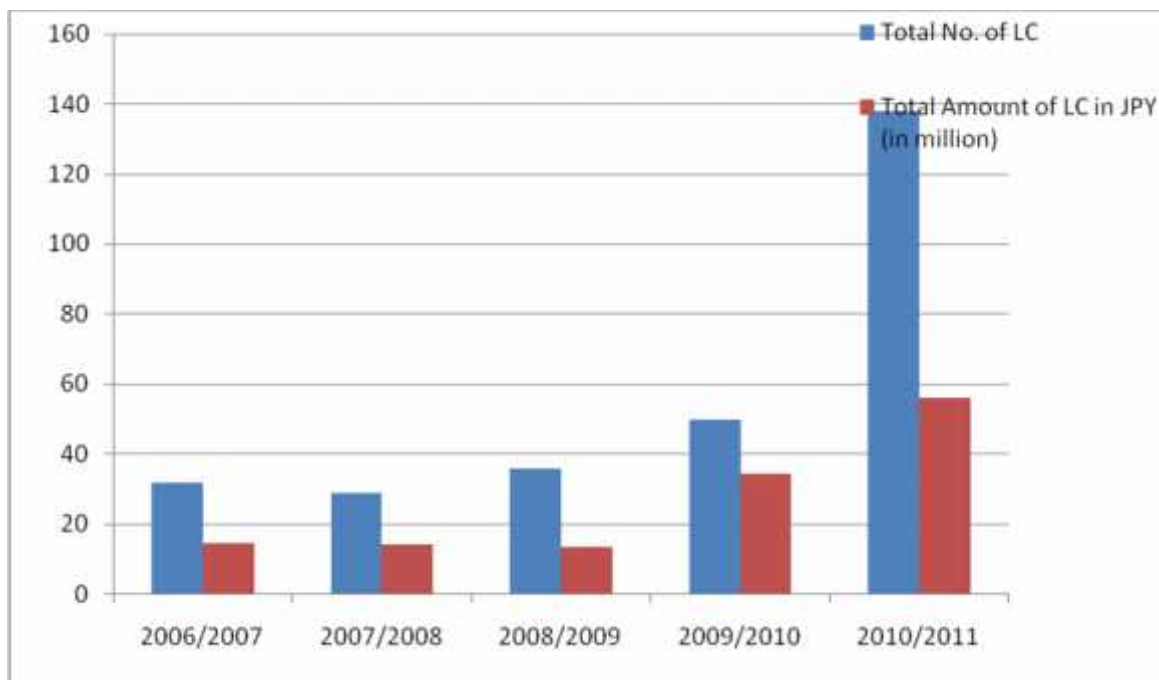
(Source: LC Department, Nepal Investment Bank Limited)

Above table 4.5.6 represents the total number of import LC opened in JPY and total transaction value of import LC in JPY from fiscal year 2006/2007 to 2010/2011. The total number of import LC opened in JPY was in fluctuating trend over the five years of the study period. They were, 32, 29, 36, 50 and 138 in the fiscal year 2006/2007, 2007/2008, 2008/2009, 2009/2010 and 2010/2011 respectively.

Likewise, total transaction value of import LC in JPY was also in fluctuating trend, i.e. first decreased then in increasing trend over the study period. They were, JPY 14.61 million in the fiscal year 2006/2007, JPY 14.33 million in the fiscal year 2007/2008, JPY 13.43 million in the fiscal year 2008/2009, JPY 34.32 million in the fiscal year 2009/2010 and JPY 56.07 million in the fiscal year 2010/2011 respectively.

Here, total number of import LC opened in JPY and total transaction value of import LC in JPY was fluctuating by trend as compared to previous fiscal years. Following figure more clarifies about it:

**Figure 4.5.6 Total No. and Total value of Import LC transaction in JPY Currency (in millions)**



## 4.6 Analysis of Export LC

In the present globalization market, the exporter (beneficiary) exported different products from own (inside) country to foreign (outside) country. In this circumstance, the beneficiary concerns with advising bank for export LC. The actual amount of export LC may deviate because the final amount varies according to quantity of goods actually exported by the exporter because of the clauses in LC like "Partial Shipment allowed". Since bank has not kept the record of actual amount of goods exported finally by the exporter or the beneficiary and there is not more data regarding the Export of LC in other currency. This analysis is based on the record of document value maintained by the bank only of NPR and USD currency. Even though the total amount of LC and the number of LC opened are not exactly dependent variables to each other, both of these variables are presented on the same chart for the comparison.

### 4.6.1 Export LC in Nepali currency

**Table 4.6.1 Export LC in Nepali Currency**

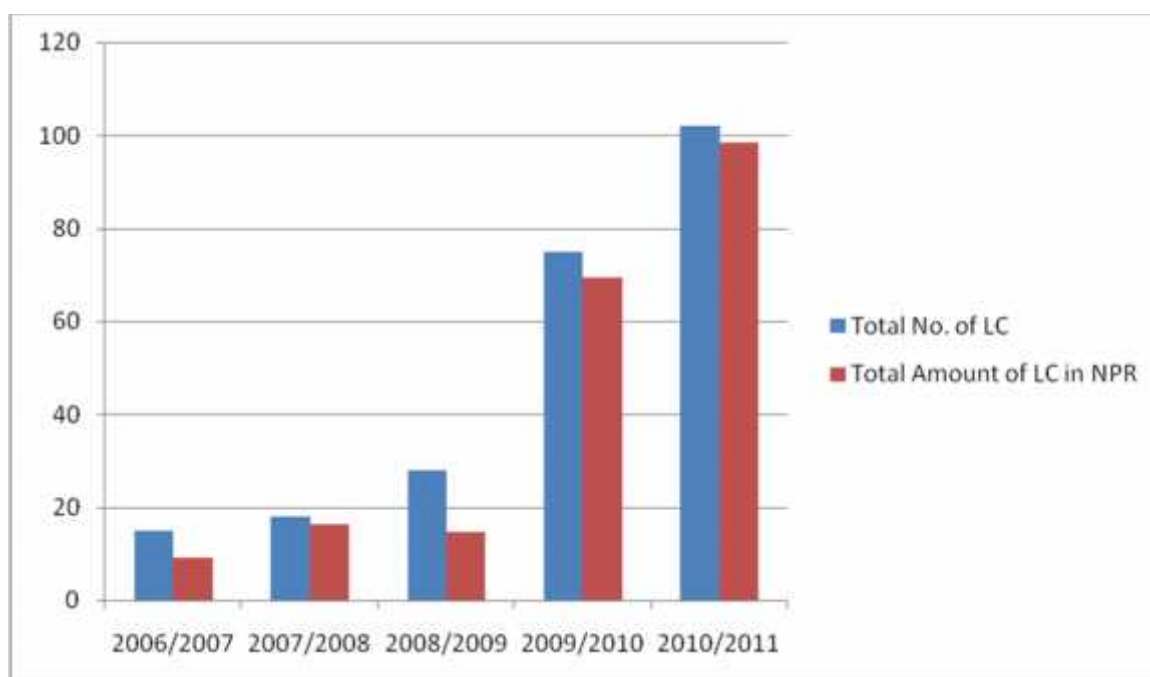
<b>Fiscal Year</b>	<b>Total No. of LC</b>	<b>Total Amount of LC in NPR (in millions)</b>
2006/2007	15	9.26
2007/2008	18	16.23
2008/2009	28	14.57
2009/2010	75	69.39
2010/2011	102	98.31

(Source: LC Department, Nepal Investment Bank Limited)

Table 4.6.1 depicts the total number of export LC opened and total transaction value of export LC in Nepalese currency from fiscal year 2006/2007 to 2010/2011. Total number of export LC opened in Nepalese currency was in increasing trend. They were, 15, 18, 28, 75, 102 in the fiscal year 2006/2007, 2007/2008, 2008/2009, 2009/2010 and 2010/2011 respectively.

Similarly, total transaction value of export LC in Nepalese currency was also in continuously increasing trend over the last year of study except in fiscal year 2008/2009. They were, NPR 9.26 million in the fiscal year 2006/2007, NPR 16.23 million in the fiscal year 2007/2008, NPR 14.57 million in the fiscal year 2008/2009, NPR 69.39 million in the fiscal year 2009/2010 and NPR 98.31 million in the fiscal year 2010/2011 respectively. In fiscal year 2008/2009 total transaction value of export LC in has been decreased, but the number of export LC opened has been increased as compared to previous fiscal year it is due to inconsistency situation of the country as well as in the industrial sector. Nepalese political inconsistency hampers the import and export trend of the country as the trade policy frequently changes. This can be clearer by the following diagram:

**Figure 4.6.1 Total No. and Total value of Export LC transaction in NPR Currency (in millions)**



#### 4.6.2 Export LC in USD

**Table 4.6.2 Export LC in US Dollar**

Fiscal Year	Total No. of LC	Total Amount of LC in USD (in millions)
2006/2007	85	3.28
2007/2008	64	3.98
2008/2009	108	5.48
2009/2010	65	4.41
2010/2011	44	2.99

(Source: LC Department, Nepal Investment Bank Limited)

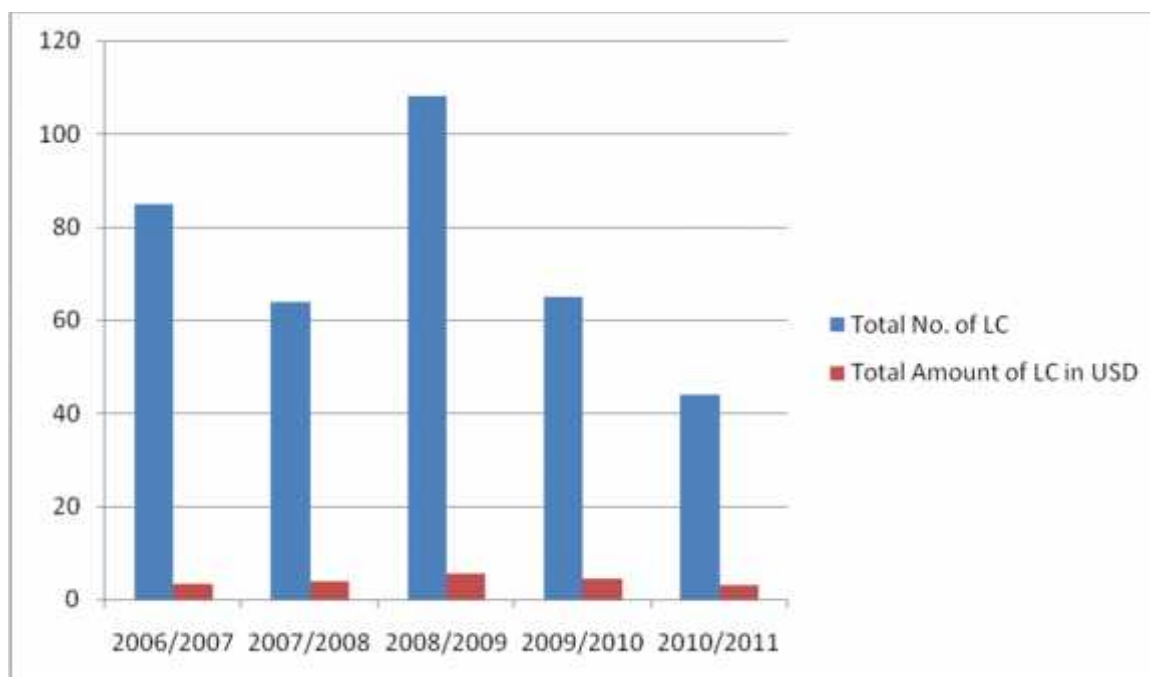
Table 4.6.2 depicts the total number of export LC opened and total transaction value of export LC in USD from fiscal year 2006/2007 to 2010/2011. Total number of export LC opened in USD was inconsistent. They were 85, 64, 108, 65 and 44 in the fiscal year 2006/2007, 2007/2008, 2008/2009, 2009/2010 and 2010/2011 respectively.

Similarly, total transaction value of export LC in USD currency was in continuously increasing trend over the last year of study period except in the fiscal year



2009/2010 and 2010/2011. They were, USD 3.28 million in fiscal year 2006/2007, USD 3.98 million in the fiscal year 2007/2008, USD 5.48 million in the fiscal year 2008/2009, USD 4.41 million in the fiscal year 2009/2010, USD 2.99 million in the fiscal year 2010/2011 respectively. This can be clearer by the following diagram:

**Figure 4.6.2 Total No. and Total value of Export LC transaction in USD Currency (in millions)**



#### 4.7 Total Commission earned on LC in NPR

**Table 4.7 Total Commission earned on LC in NPR**

Fiscal year	Total Commission earned in NPR (in thousands)	Total Commission earned in NPR	Annual Growth Rate (in percent)
2006/2007	32,259	32,259,455.00	-
2007/2008	35,917	35,917,161.00	11.34
2008/2009	45,478	45,478,281.00	26.62
2009/2010	61,527	61,527,062.00	35.29
2010/2011	60,998	60,998,455.00	-0.86

(Source: LC Department, Nepal Investment Bank Limited)

Table 4.7 represents the total commission earned by bank from its LC operation over the five years of the study period, i.e. from 2006/2007 to 2010/2011. The bank is able to earn Rs. 32,259 thousand in 2006/2007, Rs. 35,917 thousand in 2007/2008, Rs. 45,478 thousand in 2008/2009, Rs. 61,527 thousand in 2009/2010 and Rs. 60,998 thousand in 2010/2011 as commission charges from LC transactions. Except in the last fiscal year, i.e. in 2010/2011, remaining fiscal year has significant growth rate in commission earned by

the bank over the five years of the study period. The decline in fiscal year 2010/2011 is due to the commission discounted to the corporate clients. The following figure more clarifies about it:

**Figure 4.7 Total commission earned from LC operation**



#### 4.8 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 correlated when change in the value of one results change in another variable. Correlation is of three types. They are Simple, Partial and Multiple Correlations. 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 and y

n  $\sum$  x y = Number of product observation and sum of product x and y

$\sum x \sum y =$  Sum of product x and sum of product y

### Probable Error

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:

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

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, researcher is calculating the correlation coefficient between total transactions value of import LC in NPR and total transaction value of export LC in NPR as well as total transaction value of import LC in US dollar and total transaction value of export LC in US dollar to know the relationship of these variables. This relationship result helps the management for policy formulation in the coming days.

#### 4.8.1 Computation of correlation coefficient between total transaction value of import LC in Nepalese currency (X) and total transaction value of export LC in Nepalese currency (Y) of the bank.

**Table 4.8.1 Correlation coefficient between Import LC (X) and Export (Y) LC of Nepalese Currency (Rs. in millions)**

Fiscal year	X	Y	X <sup>2</sup>	Y <sup>2</sup>	XY
2006/2007	177.16	9.26	31,385.67	85.75	1,640.50
2007/2008	260.92	16.23	68,079.25	263.41	4,234.73
2008/2009	132.63	14.57	17,590.72	212.28	1,932.42
2009/2010	1,004.68	69.39	1,009,381.90	4,814.97	69,714.75
2010/2011	1,368.69	98.31	1,873,312.32	9,664.86	134,555.91
	$\sum x =$ <b>2,944.08</b>	$\sum Y =$ <b>207.76</b>	$\sum X^2 =$ <b>2,999,749.85</b>	$\sum Y^2 =$ <b>15,041.27</b>	$\sum XY =$ <b>212,078.31</b>

(Source: LC Department, Nepal Investment Bank Limited)

**Where,**

X = Value of Import LC in Nepalese currency

Y = Value of Export LC in Nepalese currency

$\sum X = 2,944.08$

$\sum Y = 207.76$

$$\begin{aligned}\sum X^2 &= 2,999,749.85 \\ \sum Y^2 &= 15,041.27 \\ \sum XY &= 212,078.31\end{aligned}$$

And N = 5.

Now,

$$r = \frac{n \sum xy - (\sum x)(\sum y)}{\sqrt{n(\sum x^2) - (\sum x)^2} \sqrt{n(\sum y^2) - (\sum y)^2}}$$

i.e.  $r = 1.0$

Similarly,

$$\begin{aligned}\text{P. E.} &= 0.6745 \times \frac{1-r^2}{\sqrt{N}} \\ &= 0.6745\end{aligned}$$

$$6 \text{ times P.E.} = 6 \times 0.6745 = 4.047$$

#### Summarization Table 1

Coefficient of Correlation (r)	Relationship	Probable Error (P.E.)	6 times P.E.	Significant or Insignificant
1	Perfect Positive Linear Relationships	0.6745	4.047	Significant

The above calculation of correlation coefficient between total transaction values of import LC in Nepalese currency and total transaction value of export LC in Nepalese currency of the bank is 1.0. That means there is perfectly positive correlation between these two variables and the computation of probable error shows that there is significant relationship between these two variables. It means the two variables X and Y move in the same direction as the values for X increases, then values for Y also increases.

**4.8.2 Computation of correlation coefficient between total transaction value of import LC in USD (X) and total transaction value of export LC in USD (Y) of the bank**

**Table 4.8.2 Correlation coefficient between Import LC (X) and Export LC (Y) of US dollar (in millions)**

Fiscal year	X	Y	X <sup>2</sup>	Y <sup>2</sup>	XY
2006/2007	7.90	3.28	62.41	10.76	25.91
2007/2008	9.65	3.98	93.12	15.84	38.41
2008/2009	8.57	5.48	73.44	30.03	46.96
2009/2010	11.20	4.41	125.44	19.45	49.39
2010/2011	11.02	2.99	121.44	8.94	32.95
	<b>Σ x = 48.34</b>	<b>Σ Y = 20.14</b>	<b>Σ X<sup>2</sup> = 475.86</b>	<b>Σ Y<sup>2</sup> = 85.02</b>	<b>Σ XY = 193.62</b>

(Source: LC Department, Nepal Investment Bank Limited)

**Where,**

X = Value of import LC in USD currency

Y = Value of export LC in USD currency

Σ X = 48.34

Σ Y = 20.14

Σ X<sup>2</sup> = 475.86

Σ Y<sup>2</sup> = 85.02

Σ XY = 193.62

And N = 5.

**Now,**

$$r = \frac{n \sum xy - (\sum x)(\sum y)}{\sqrt{n(\sum x^2) - (\sum x)^2} \sqrt{n(\sum y^2) - (\sum y)^2}}$$

**i.e. r = -0.19**

Similarly,

$$\begin{aligned} \text{P. E.} &= 0.6745 \times \frac{1-r^2}{\sqrt{N}} \\ &= 0.29 \end{aligned}$$

**6 times P.E. = 6 X 0.29 = 1.74**

**Summarization Table 2**

<b>Coefficient of Correlation (r)</b>	<b>Relationship</b>	<b>Probable Error (P.E.)</b>	<b>6 times P.E.</b>	<b>Significant or Insignificant</b>
-0.19	Negative Correlation	0.29	1.74	Insignificant

The above table of correlation coefficient between total transaction values of import LC in US dollar and total transaction value of export LC in US dollar of the bank is -0.19. That means there is negative correlation between these two variables and the computation of probable error shows that there is insignificant relationship between these two variables. It means if one variable is increased that obviously decreased another variable in terms of 0.19 and vice versa but not significant at all time.

# CHAPTER 5

## SUMMARY, FINDINGS, CONCLUSION AND RECOMMENDATIONS

### 5.1 Summary

Nepal is economically a backward country. Government of Nepal has taken many measures for raising the economy of the country. Thus the government took the liberalization of foreign exchange system and the present International trade system came into existence in Nepal. In most of the developing countries in one way or other exchange control system/measure exists. In any country where exchange control measures are applicable, generally L/C is beneficial for overseas trade.

In the modern days the role of commercial bank is very significant as it helps trade and commerce of the country as well as International trade. The bank acts as a middleman between buyer and seller. It gives a form of security to both the buyer and the seller, as the bank pays the payment of the LC documents upon compliance of the stated terms and conditions of the LC. It brings an element of confidence for the payment once the goods have been dispatched and the seller also gets the money as soon as required documents are presented after the shipment of the goods. It is a widely accepted method for settling international financial trade transaction.

Nepal being a landlocked country required to use Calcutta (Kolkata) port for transit purpose. Therefore, if Letter of Credit is not established, there is no way that Indian Authorities in Calcutta port can verify that the goods when declared as destined for Nepal really belongs to the Nepalese importer. So, if these goods are imported under L/C system, then documentary evidence can be provided to them for its genuine destination.

The whole report is based on the 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.

Nepal Investment Bank Ltd. is one of the growing commercial bank in Nepal, previously named as Nepal Indosuez Bank Ltd., which was established with the joint Venture between Nepalese and French partners Credit Agricole Indosuez. NIBL has been serving its customers since 1986 and has contributed in the development of the country. Being a member of SWIFT (Society of Worldwide Interbank Financial Telecommunication), this facilitates efficient and speedy fund transfer and messaging towards its valued customers. NIBL plays developing role not only in urban area but also in rural areas. This shows that the bank is genuinely interested in overall development of the country.

## **Major Findings**

- Letter of Credit 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 Letter of Credit facility, apart from other regular banking facilities.
- Businessmen prefer to make payment through L/C while importing goods from abroad than any other instrument because it is the safer means of payment and it also gives guarantee that the goods (as per the requirement or agreement) will be received.
- From the study of Letter of Credit Business of NIBL, we see that its import transaction is far greater than export. Hence we can say that the import to Nepal, as a whole, is also in increasing trend than export.

## **5.2 Conclusion**

The report has drawn out the operation of Letter of Credit including the Bank, its origin, evolution, 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 transaction. NIBL is playing bigger role for the development of international trade. Letter of Credit service provided by the bank contributes in the development of the nation. Usually the procedure of opening L/C is similar to all the banks but some variation can be found in terms and conditions, which differ from bank to bank. It is necessary that all the banks of Nepal follow the directives of the Nepal Rastra 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 objective is 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. Letter of credit documentation and overall process should be executed within shortest possible time frame. However, in doing so the bank needs to be cautious, as it demands a thorough verification of customer details and documents. In order to survive in the cut-throat competition decreasing the margin level, that bank takes from its customer and quicker service will not guarantee a good L/C unless detail analysis are done. In order to differentiate services from other banks a unique approach to consumer service needs to be facilitated such that it includes not only a satisfied customer but further ensures customer delight. Things to be considered are:



- ) Bringing more promptness in the workflow procedure.
- ) Adopting efficient marketing strategy to encourage more of the customers to Benefit from this facility provided by NIBL.
- ) Rules laid down by NRB regarding L/C transactions are inconsistent with the International practice. This has caused difficulty to business people for international trade and decreased in the earning of the Banks. Hence it is recommended that the bank focus on coordinating 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 creditworthiness of the customer be checked before providing any credit facility.

# BIBLIOGRAPHY

## BOOKS

Bandar, D. R. (2004). *“Banking and Insurance”*  
Aayush Publication Private Limited, Kathmandu, Nepal.

Gartener, D. C. (1999). *“Documentary Credit”*  
Indian Institute of Bankers ,Mack Millon India Private Limited, India.

K.C., Shekhar (2004). *“Banking Theory and Practice”*  
Bikash Publishing House Private Limited., India.

Kothari, C.R. (1990) *“Research methodology and methods of analysis”*  
Wiley Eastern Private Limited, New Delhi, India.

Singh, H. B. (2009) Revised Fourth Edition *“Banking and Insurance”*  
Asia Publication Private Limited, Kathmandu, Nepal.

Thapa, K & Neupane, D (2065) *“Banking and Insurance”*  
Ashmita Publication Private Limited, Kathmandu, Nepal.

## OTHER MATERIALS

Gharti, S. (2004) *“General Banking”*  
Institute of Bankers, Kathmandu, Nepal.

Katmandu Frontiers Academy (2004) *“Credit Management”*  
KFA Training Institute, Kathmandu, Nepal.

LC Import/Export data (2006/2007 to 2010/2011)  
Nepal Investment Bank Ltd., Trade and Finance Department, NIBL, Kathmandu, Nepal.

Nepal Rastra Bank (2005) *“Banking & Financial Statistics”*  
NRB, Kathmandu, Nepal.

Nepal Rastra Bank (2007/08) *“Nepal Rastra Bank Directives”*  
NRB, Kathmandu, Nepal.

Nepal Investment Bank Ltd. (2006/07) *“Prospectus of Nepal Investment Bank Ltd.”*  
NIBL, Kathmandu, Nepal.

Nepal Investment Bank Ltd. "*Annual Report (2006/2007 to 2010/2011)*"  
NIBL, Kathmandu, Nepal.

**THESIS**

Kansakar, S. (2007) A Study on Letter of credit business of Nepal Investment Bank Ltd.  
An unpublished Master's Degree Thesis, T.U.