International Marketing
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Lecture – 19
Import Export Procedures

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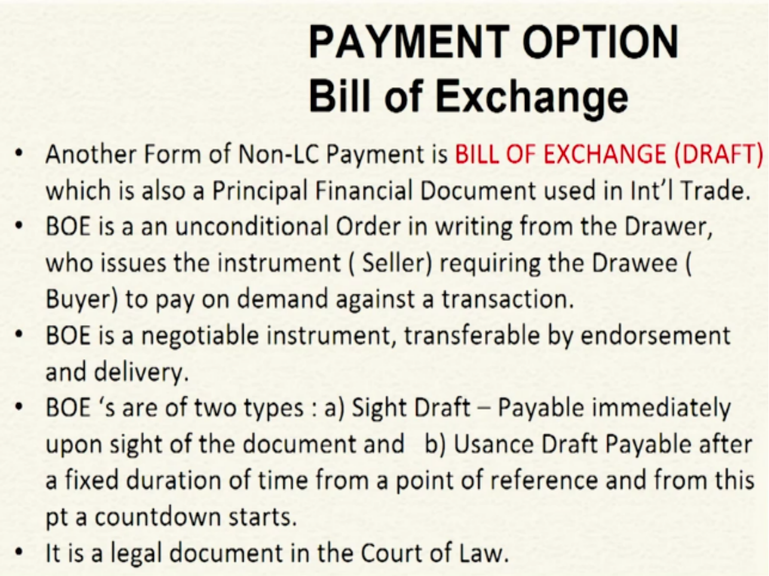

Hello everybody, welcome back. This is my module 4 lecture 19 and we will cover letter of credits. So, here comes the first payment option bill of exchange. So, this is a non-letter of credit payment. So, first let us understand what is a letter of credit payment, what is non letter of credit payment. So, non-letter of credit payment is a bill of exchange or a draft which is also a principal financial document in industrial trade.

So, how it looks, I will show you a picture of that. Bill of exchange is an unconditional order in writing from the drawer who issues the instrument seller requiring the drawee to pay on demand against a transaction. Bill of exchange is negotiable instrument, transferable by endorsement and delivery. Bill of exchange, there are two types of bill of exchange, one is a sight draft. So, sight draft means payable immediately upon the sight of the document.

So, once you present immediately the buyer has to make the payment. Usance draft payable after a fixed duration of time period point of reference and from this point a countdown starts. That means you agreed that the usance is after 60 days, so that 60 days period you can give buyer that 60 days he can enjoy credit. So, there are two bills of exchange. Understand these are negotiable instrument but is not guaranteed by any bank, it is a negotiable document. And this one, you can have two different bill of exchange, one is sight draft.

You prepare the bill of exchange, I will show in the next slide how typically a bill of exchange, and you send the bill of exchange as a seller to the buyer and if it is a sight draft immediately buyer has to make the payment from his bank to your bank in foreign currency as per the agreement in the sales contract. If bill of exchange is usance draft that means you are allowing him a certain credit period, say 30 days or 60 days or 90 days he is a usance, so, after expiry of 90 days he has to make the payment. It is a legal document in the court of law.

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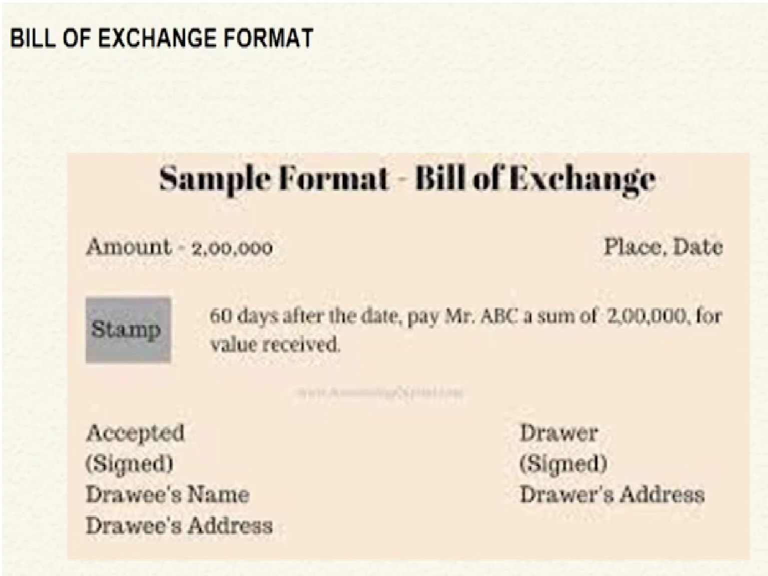

How it looks, is a typical sample format is that amount, stamp, 60 days after the date, pay Mr. ABC a sum of 20 lakhs both signed by drawee and drawer, their address and both of them signs, it is a legal document, both of them signed. This is typical form of a bill of exchange. So, the seller also signs and the buyer also signs and they agree that after 60 days, place where it is signed, date, everything is there. This is a legal document.

And you submit it to the buyer after along with all the documents, your typically your airway bill or bill of lading, insurance, copy of the insurance, packing list, warranty documents, any certification document. All the documents whatever is required along with the bill of exchange you submit to your buyer and your buyer if it is a usance draft, he has to make a payment according to the dates mentioned there, maybe 60 days, 30 days, 90 days whatever the credit both of you agree, buyer and seller agree has supposed to make the payment.

It is a legal document. You can go to the court with a legal document, but there is no guarantor between, you and buyer, so both of you sign this document, you and buyer, both of you, you as a seller and a buyer both of you have sign this document and if the buyer disagrees to make the payment you can take the person to the court, the company can take the court of law in that country. The problem here is the payment is not guaranteed.

The buyer agrees to make the payment and suppose he does not make payment, what you will do? Suppose the buyer is somewhere in some country, somewhere in some African country or somewhere in some Asian country and buyer agrees to, both of you have signed, it is a legal document but he does not make the payment. Legally he is supposed to make the payment. So, what are the courses of action? You only have legal course of action.

You have to go to that court, international court and then pay huge legal fees and all those things and to get the money back. So, this is if the buyer and seller have got full trust, mutual trust amongst each other this mechanism can work. I would suggest, this is purely my view, until unless you know the buyer very well and you do not have a good amount of transaction and trust amongst both the companies, you should not accept this term if it is in international business.

The risk is there, he might sign this document bill of exchange which is a legal document, he is supposed to make the legal payment, but suppose he does not pay, then you have to take the help of the court. There are no intermediaries who come and help you that is the problem. Very often, we have seen that various dealers or the distributors in a foreign country, they do not want to open a letter of credit.

So. what is letter of credit, I will come to that, there is a much more protected payment for you. But this is not very much protected. So when you visit these foreign countries, some of the dealers will say we are a big company, we are here for last 20 years, 25 years, we deal with so many X Y Z multinational companies, we do not go to bank for open letter of credit, why do not you have a simple sight draft or the usance draft?

See, legally it is okay, you can accept that. But there is no third party who assures the payment. If the buyer does not make the payment to you, you have no other way but to pursue and pursue and pursue and finally the buyer does not make payment you have to go to the court of law for getting the justice which is a very costly proposition, maybe ten times the cost of the order or maybe 20 times or 100 times of the cost of the order depending on the value of the order.

So, you should take these of payment terms only when you know the buyer very well and you know the buyer's creditworthiness, you know buyer is a large organization and has a huge credibility in the market, you can accept this clause, but otherwise be careful do not accept this clause because this is not a really a very good clause in international protecting your payment.

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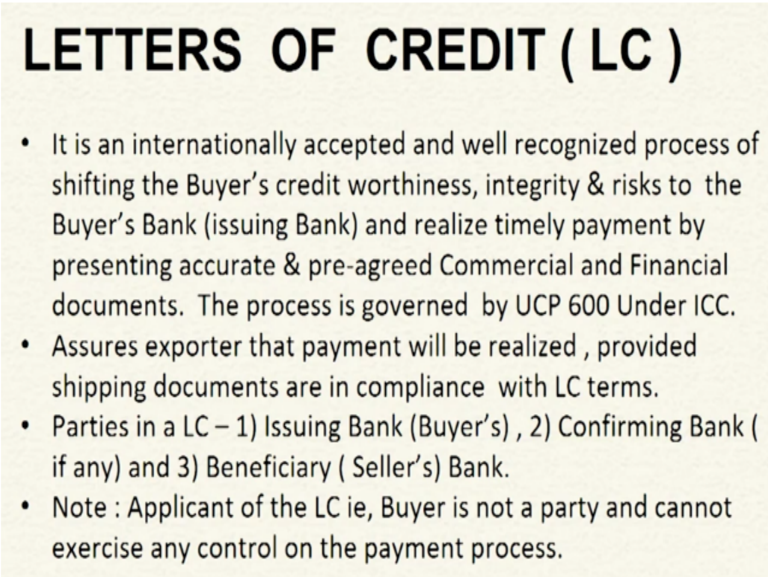

Then the comes later of credit, this is an internationally accepted well recognize process of shifting buyer's credit worthiness, integrity and risks to the buyer's bank and realize timely payments presenting accurate and pre-agreed commercial and financial documents. This process is governed by Uniform Customs practices which is UCP 600. Assures exporter that payment will be realized provided the shipping documents are in compliance.

Here, the bank guarantees that I will make the payment to the seller provided you give me the documents, document 1, document 2, documentary 3, document 5, whatever the documents are listed there if you submit the document all on time before the shipment date and before the expiry date if you submit it to the buyer's bank or your bank and then your bank sends to the opening bank, your payment is guaranteed by the bank.

So, between you and buyer, the third person the bank is coming into the picture. Your bank and one bank is opening bank in buyer's country and the other bank your bank where the letter of credit is coming and they are giving you the information that such and such customer in Malaysia or in Philippines has opened a letter of credit in your favour and that is in your advising bank and then you get the letter of credit.

In the letter of credit, the customer your buyer from Singapore has said that the order value is CIF 100 dollars, the invoice value 100 dollars, I will make 100 dollars payment to you provided you give me 5 documents. Number 1 the airway bill, number 2 the invoice, number 3 packing list, number 4 the quality control checks, inspection test report, warranty certificate, packing list say this type of 5-6 documents. So, what you do?

In this process, you go to your bank, the advising bank. You go with all these documents to your bank and submit it before the last date of expiry of the letter of credit. So, there will be two important dates, one is the last date of shipment, another is last date of expiry of the letter of credit. So before the shipment date, you have to ensure that you ship the consent, then you have an airway bill or bill of lading from the shipper with you so that you give it along with the documents.

And then this you send it to your bank, issuing bank and the beneficiary, your beneficiary is your seller's bank, and then issuing bank is the buyer's bank and confirming bank is the in between if there is a confirming. Why confirming bank, I will come to that little later. So, there are three different types of mechanisms. If you submit the document to your bank, your bank will in turn send the documents to the issuing bank.

Issuing bank will receive the documents and they will immediately make the payment through your bank to you. So based on the documents, they will see the 5 documents correct, they will make the payment, it is protected by the bank, safest mechanism in international business. So, most of the companies prefer to open the letter of credit, buyers and seller agree for letter of credit, but there is a cost involved because banks will charge for their fees for doing the service.

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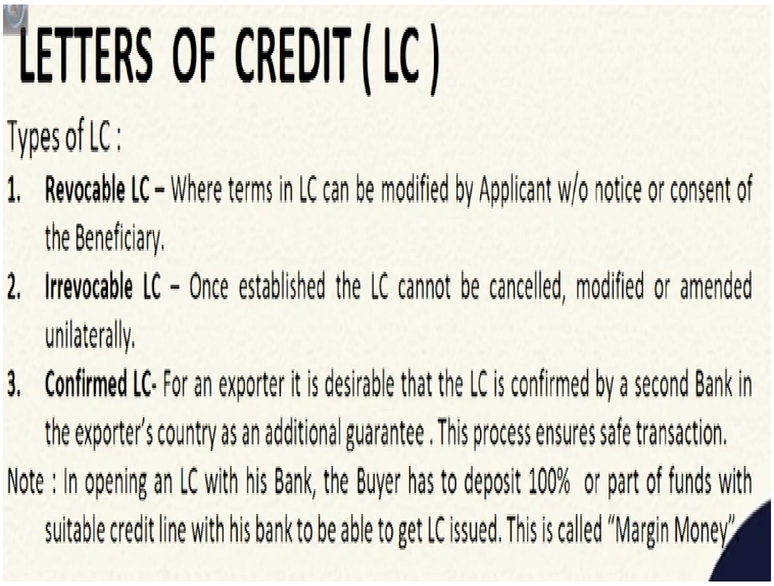

There are three different types of letter of credit. One is revocable letter of credit. Revocable means where the terms of LC is modified by the applicant. without notice and consent of the beneficiary. There are certain in terms, you can revoke that term. So that is known as a revocable letter of credit. Another is known as irrevocable letter of credit. That means one established LC cannot be changed or modified or amended unilaterally, you cannot make the change.

Suppose, I have opened an irrevocable letter of credit one of the sellers in India and I am from Singapore, I have opened an irrevocable letter of credit, I cannot change any terms like the last date of shipment or the whatever the clause, documentation requirement, whatever the various clauses in that LC I cannot change that is known as the irrevocable letter of credit. In revocable, you can change the clause. Third one is a confirmed letter of credit.

When for an exporter it is desirable that LC is confirmed by second bank in an exporter's country as an additional guarantee. In some times, there may be a bank which is very small in a foreign country and that bank is sending opening a letter of credit may not be guaranteed, you might think that this bank maybe a national bank in that country, may not have that international being, so you may ask that seller, a buyer to confirm it through another bank.

Say large international bank say Citibank or any of these large international banks you ask them and you get confirmed through any of these large international banks and then this is known as a confirmed letter of credit. That means on behalf of that local bank in that country, another bank is confirming that I will ensure that the payment will be made. So, another bank when it confirms the letter of credit is known as a confirmed letter of credit.

So, when it is required? When a local bank, when a buyer's bank is very small and maybe a local bank has opened an LC and you do not have that much of trustworthiness on that bank in another country, you may ask another international bank to confirm that letter of credit. So, it is a safest way to do that. So, this process ensures safe transaction. In opening LC with his bank buyer has to deposit 100% or part of the funds suitable credit line with the bank.

So, remember why your buyer's will avoid letter of credit? Because before I buy this consignment, before I receive the goods, I have to make 100% payment of the goods to my bank. So, bank will not take any guarantee, bank will not take any risk, bank will upfront collect 100% from the buyer and keep it. Once they receive the documents from the seller and if the documents are perfectly in order, he will make the payment that is all.

So, typically why your buyers they will avoid this type of letter of credit because they have to make the full deposit there or if the buyer is having a credit line, suppose they have a large credit line bank and use the credit line and to get the LC used. So, this is known as also margin money in a letter of credit. So normally you have to make 100% payment for opening the letter of credit. So to recap, three different letter of credits.

One is a revocable letter of credit. When issuing bank opens a letter of credit where the buyer can change the terms of the letter of credit during the validity of LC letter of credit is known as a revocable letter of credit, he can revoke. Another second part of letter of credit is known as irrevocable letter of credit, that means a buyer has opened from his issuing bank he has opened in the name of beneficiary's bank and the letter of credit cannot be revoked.

Any terms in the letter of credit cannot be revoked is known as irrevocable letter of credit And third one is an additional guarantee by a second bank of this to confirm that the payment will be made. So, this is normally in exporter's bank or maybe an international bank can be also used for this or normally the bank whom you trust you can be confirming bank.

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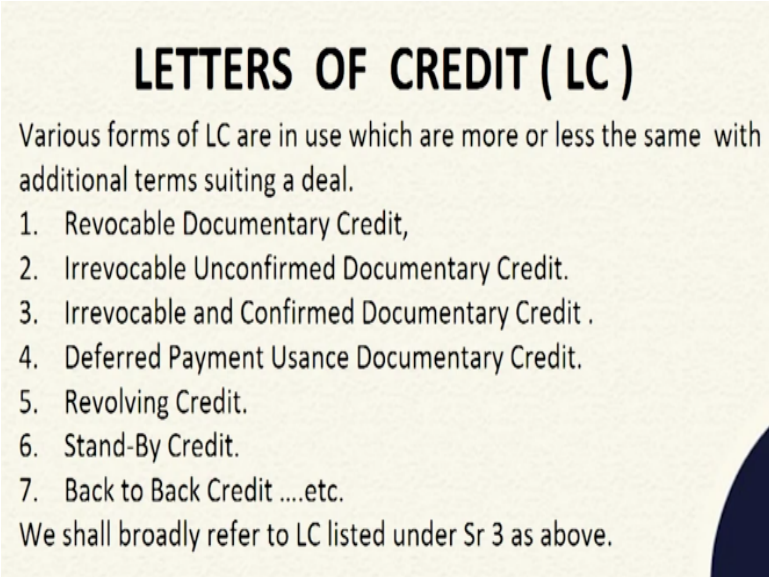

So, various forms of letter of credit which are more or less the same with additional terms suiting a deal. Number one is a revocable documentary credit which I said any time the buyer or the opener, who are the buying company the buyer can change the clauses. Irrevocable unconfirmed which is another, you cannot revoke but it is unconfirmed. Irrevocable and confirmed letter of credit, so that means it is irrevocable and confirmed.

The third one is confirmed by another bank, second bank is known as an irrevocable and confirmed letter of credit. Deferred payment usance documentary credit, when you continuously import, say you are importing coal, you are importing some mining machineries or regularly you are importing some ores or some crude oils, so it can be a deferred payment and usance sales.

You can get some 30 days credit or some item you may not get any credit but is a documentary credit for getting it a term, but it is through a bank, bank guarantees the payment. Another is a revolving credit. Typically for consumable items, this item is more suited for a regular import like the oils or the crude oils or maybe regular import of certain chemicals, regular import of some food grains or whatever is that regular import so that you have a revolving credit.

So, you reach a credit limit, immediately you ship it, after that again that letter of credit is operational is known as a revolving letter of credit. So, standby credit, back-to-back credit, these are not very important, mostly broadly we use the irrevocable confirmed letter of credit mostly you, so rest of the process is applicable only when you import, there are three types of letter of credit will be useful for you.

Most of the time to protect your payment try for the irrevocable and confirmed documentary credit. It is the most costly one because buyer has to pay the charges for opening the letter of credit, buyer has to upfront deposit the money, buyer has to also pay the charges for conforming; all these charges buyer may not agree. So, here comes your negotiation points, you start negotiating. Buyer will always ask typically for the bill of exchange.

You will say bill of exchange, no, open letter of credit. Then you will start with this letter of credit, irrevocable letter of credit, confirmed letter of credit, then may be you agree another one which is also safe irrevocable unconfirmed letter of credit which equally safe, you can also accept that. So, be careful students this payment mechanism is very crucial in international business.

I am repeating number of times ensure that if you do not know the other party or who is you are transacting very recently or very temporarily for last 6 months or 1 year, do not accept any order except the letter of credit until and unless the company is a huge large company internationally, you can accept that, there is no other option. But from the smaller companies do not accept that. I have seen some situation where the seller has continuously accepted for say last 3 to 4 years, they have accepted the confirmed letter of credit.

The buyer has regularly paid money and regularly imported using the confirmed letter of credit and established a very good relation for 2 to 3 years, a trustworthy relation. Then the customer, then your buyer says look we are working with you for last 3 years, we are continuously importing from your country from your company for last 3 years and every time we open LC, we have so much of cost for opening LC, time consumption, managerial cost, finance people's costs for opening LC, all those costs are there.

So why do not you avoid, we have now enough trust we have built between buyer and seller. So let us now move to bill of exchange without banks involvement. I have seen in some cases it works fine, in some cases after working for a couple of bill of exchange you submit, they are not making the payment on time. There is a delay for 2 months, there is a delay for 3 months payment because no one is protecting your payment.

So, to ensure to protect your payment irrevocable and confirmed letter of credit is the best option. If this does not suit, the second choice is irrevocable unconfirmed documentary credit. These two you can accept it as good terms of payment where banks come into the picture.

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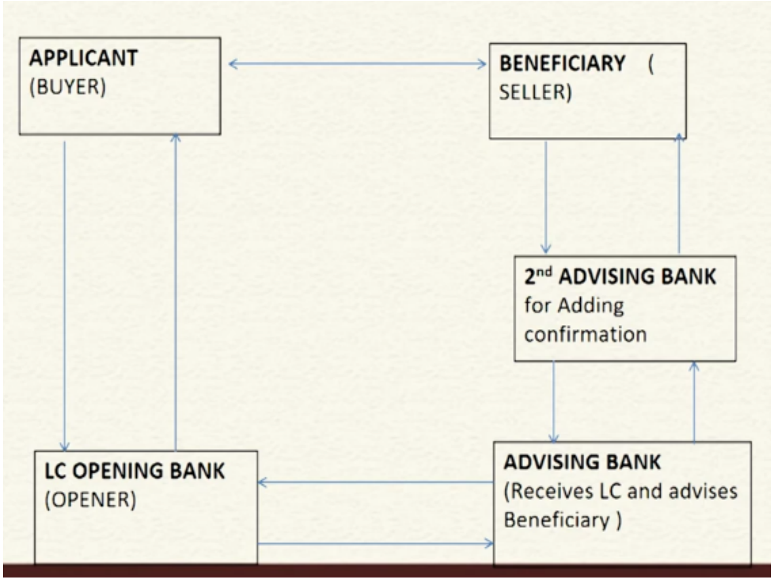

So here the applicant the buyer, beneficiary, then the advising bank, then the arrows LC opening bank. So, this is typically the circle which I have explained to you. The applicant goes to the LC opening bank, LC opening bank goes to the advising bank, advising bank goes to the confirming bank second advising bank, second advising bank goes to the beneficiary the seller. Then seller is giving this. This is the way how this whole mechanism works.

So that is the way and then the seller provides; there is a sale transaction between applicant and the buyer, buyer and seller there is a transaction on the top line and how the document movement and the money movement. Document movement is that the applicant open a letter of credit to the opener bank. Opening bank sends to the advising bank, look at the arrow. Advising banks look at the right side of the arrow, second advising. Second advising bank goes to the beneficiary, informs the beneficiary letter of credit has come from the applicant.

Then seller provides all the documents to the confirmation to the advising bank. Advising bank sends to the second advising bank, so the confirmed bank, the bank who has confirmed the letter of credit sends to the advising bank. Advising bank sends to the LC opening bank. LC opening bank sends to the applicant buyer the documents for clearance to the customs after making the payment. So, this is the documentation flow which is very important which can be shown here.

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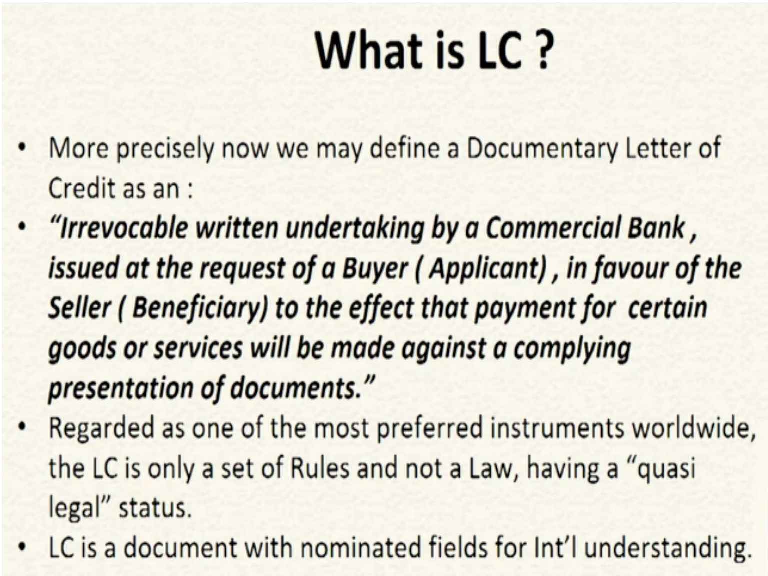

So LC, irrevocable written undertaking by a commercial bank issued at the request of a buyer in favour of the seller beneficiary, so buyer is the applicant, seller is the beneficiary, to the effect that the payment of certain goods and services should be made against complying presentation of documents. That means if I provide a set of documents to the bank, bank agrees to make the payment provided I submit the documents.

So here document moves, so that is very important, I made it red colour in one of the slides. Regardless of one of the most preferred instruments worldwide, the LC is only a set of rules, not a law having a quasilegal status. LC document without nominated field for international understanding with nominated field.

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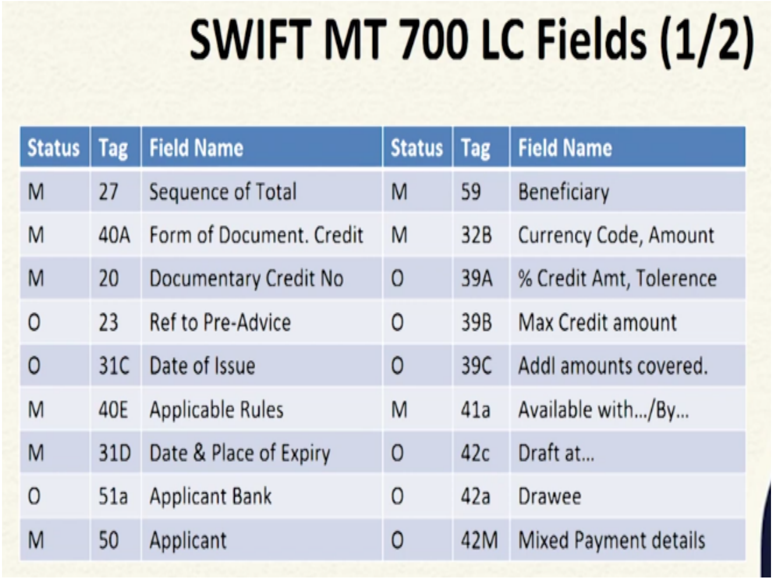

SWIFT MT 700 LC Fields (1/2)

Status	Tag	Field Name	Status	Tag	Field Name
M	27	Sequence of Total	M	59	Beneficiary
M	40A	Form of Document. Credit	M	32B	Currency Code, Amount
M	20	Documentary Credit No	O	39A	% Credit Amt, Tolerence
O	23	Ref to Pre-Advice	O	39B	Max Credit amount
O	31C	Date of Issue	O	39C	Addl amounts covered.
M	40E	Applicable Rules	M	41a	Available with.../By...
M	31D	Date & Place of Expiry	O	42c	Draft at...
O	51a	Applicant Bank	O	42a	Drawee
M	50	Applicant	O	42M	Mixed Payment details

So, in LC there are various tags. The tag M this is 27, Tag M 27, sequence of the total, form 40 form of the document of the credit. The tag 20 is the documentary credit number. So, these are the tag numbers in the letter of credit. So, whenever you receive a letter of credit from your buyer, you look which, a couple of very important things which are 42a drawee, look at the credit amount 39 B. And this is internationally every bank follows the same one.

Look at 51 A who is the applicant bank, date and place of expiry 31 D in that LC you see because LC will come only with these tags to you. A document will come with all the tag, 31 D will say date and place of expiry, when this letter of credit will expire. And then date of issue 31 C is the date of issue. Then in the letter of credit you go to the 31 C, see that what is the date of issue.

So, remember this chart will be very useful for you. Look at that 59 who is the beneficiary there, 32 B the most important what is the currency code, is it in dollar, is it in Euro, is it in British pound. So, all those are very important in 32 B. And then look at the next slide.

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SWIFT MT 700 LC Fields (2/2)

Status	Tag	Field Name	Status	Tag	Field Name
O	42P	Deferred Payment Details	O	46A	Documents Required
O	43P	Partial Shipments	O	47A	Addl Conditions
O	43T	Transhipments	O	71B	Charges
O	44A	Place of taking Charge	O	48	Period of presentation
O	44E	Port of Loading/Airport	M	49	Confirmation Instructions
O	44F	Port of Discharge/Destination	O	53a	Reimbursing Bank
O	44B	Place of final Delivery	O	78	Instr to paying/Nego Bank
O	44C	Latest Date of Shipment	O	57a	Advise thru Bank
O	44D	Shipment Period	O	72	Sender to Receiver Information.
O	45A	Description of Gds / Servic			O=Optional ; M= Mandatory

The 42 P, is there any deferred payment clause, look at that 42 P. Transhipment allowed or not? So 43 P is very crucial because whether it allows a transhipment? That means can you send a consignment from Kolkata to US without any transhipments in between in Frankfurt or Bombay to JFK or Bombay to San Francisco without any transhipment either in Narita Airport in Japan or Frankfurt in Germany.

So, transhipment allowed or not allowed, will look into that 43 T. And port of discharge 44 F, you look into that and then look at 53 a who is the reimbursing bank and instrument paying negotiation bank all these clauses are very important the tag fields and this is uniform throughout the world. So, any letter of credit whether it is from Japan to India or US to Japan or any country in the world, the letter of credit the SWIFT codes, the tags are uniform.

So, look at these before you get the letter. Once you get the letter of credit, look at this tag and the most important tag is 44 C, which is the last date of shipment. So, if you look at any letter of credit, you go through that letter of credit you will see any sample letter of credit in the website, any internet search you can get it, look at the 44 C what is the last date of shipment, which is very important for you to understand.

So, go through the sample letter of credits. I wish I could have shown a sample letter of credit here, but nevertheless you can get any letter of credit in the internet search, any of these letters of credits you can see typically how letter of credit looks and look at these clauses.

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RISK MATRIX – (As per Int'l Workbook , Chicago)

Method	Payment	Receipt of Goods by Buyer	Risk/Cost to Exporter (Seller)	Risk/Cost to Importer (Buyer)
Cash in Advance	Before Shipment	After Payment	None/None	High/High
LC	On shipment with compliant documents	After Payment	None / Min	Relies on Seller or 3P inspection / High
Sight Draft Docs	On presentation	After Payment	Moderate/ Moderate	Low/Moderate
Time Draft Docs	On Maturity of Draft	Before Payment	High / Low	Low/Low
Open Account	As agreed	Before Payment	High/Low	None/None

Risk matrix, as I said cash in advance before shipment. If you look the risk proportion, this slide I have prepared, this can be kept for you as a reference as per the international workbook of Chicago receipt of goods by the buyer, risk by exporter, risk by the importer. So, I have clause put it like cash in advance, there is no risk for the exporter, but the importer risk is very high.

He has paid 100% money, but he might not get the equipment, risk is very high. Letter of credit, no risk for the exporter or minimum risk. In buyer's case, in the importer case seller third party inspection the cost is very high and risk is there because the seller might sell a correct equipment, might sell a wrong equipment to you some, second hand equipment, so a risk is there. You your bank will make the payment, but you might get damaged equipment.

You might get an equipment which is non-functional, so that risk is still there. Sight draft is moderate for the exporter, low or moderate risk and cost for the importer. Time draft, on maturity of the draft, before payment, is high and low and open account as I said is high and low and none there for risk.

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So, role of freight forwarders, they are very important in the international trade these freight forwarders and these freight forwarders are indispensable in handling the paperwork and the documentation. So, they are the people who are routing, scheduling and rates of shipping they are the people, they are the companies who internationally will help you to move your goods from your country to a buyer's country.

Wide range of specialist services not only eliminates cost and very renowned international freight forwarders are there. They will take care of the entire routine and scheduling and shipping and consular licensing, insurance certificates everything will be done by the freight forwarder. So, you can catch hold of the freight forwarder, they can help you and they will obviously charge you the fees for that.

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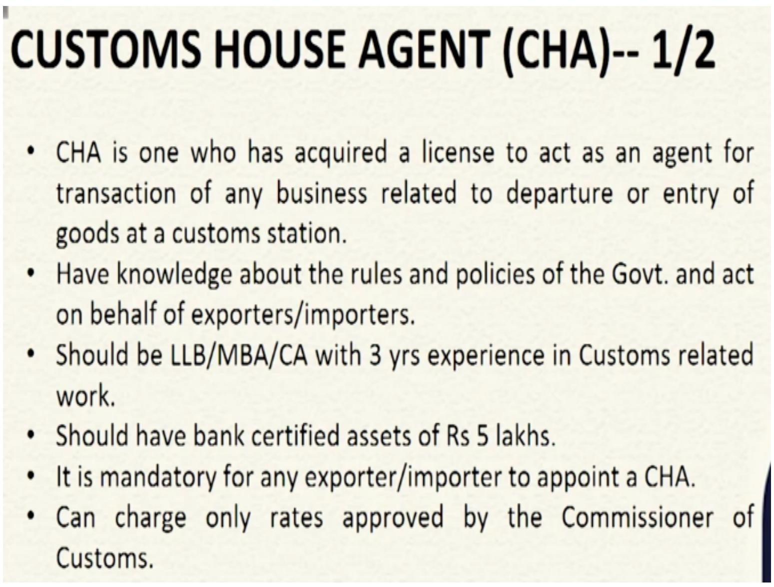

Customs house agent, they are very important. You cannot clear any consignment by going to the customs, you have to approach to the custom house agents who are authorized by customs, who has acquired a license to act as an agent for transaction of any business. So, you have to go and file the bill of entry through the customs house, the agents, the entry of goods and have knowledge about the rules and policies of the government and with typically all the customs clearance they will help you and is mandatory for any exporter importer to appoint a customs house agent. You cannot go to the customs to clear the consignment, you have to take the help through the customs house agent.

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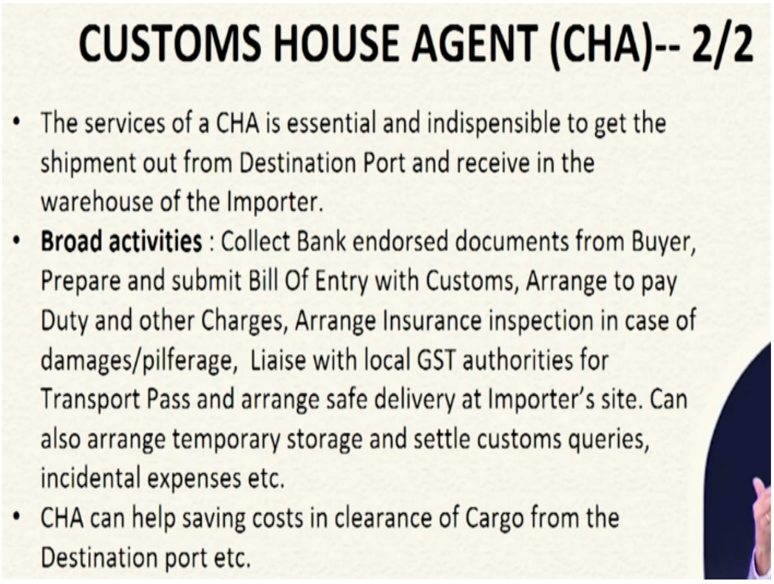

And they have the broad activities of these and they collect the bank endorsed document from the buyer, prepare submit bill of entry with the customs, clearance, arrange every job is done by the customs house agents and customs house agents saving cost in clearance, origin, cargo from destination. They have the expertise in doing that.

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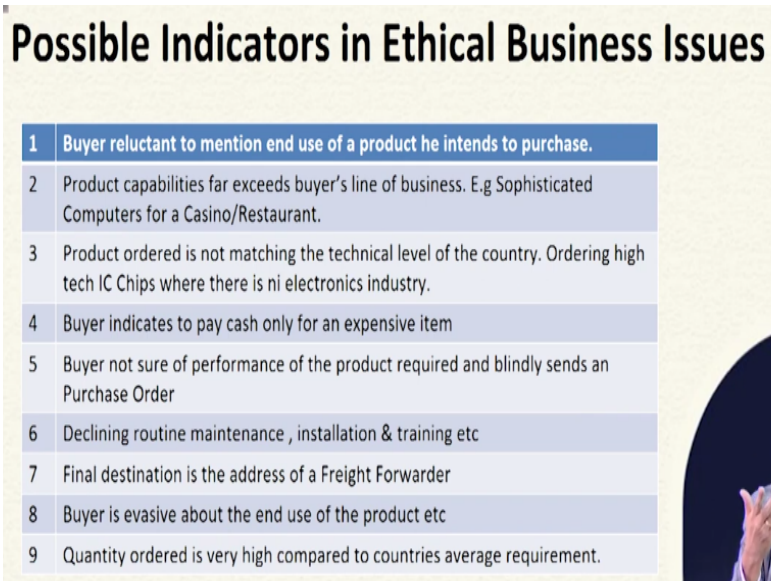
Possible Indicators in Ethical Business Issues

1	Buyer reluctant to mention end use of a product he intends to purchase.
2	Product capabilities far exceeds buyer's line of business. E.g Sophisticated Computers for a Casino/Restaurant.
3	Product ordered is not matching the technical level of the country. Ordering high tech IC Chips where there is ni electronics industry.
4	Buyer indicates to pay cash only for an expensive item
5	Buyer not sure of performance of the product required and blindly sends an Purchase Order
6	Declining routine maintenance , installation & training etc
7	Final destination is the address of a Freight Forwarder
8	Buyer is evasive about the end use of the product etc
9	Quantity ordered is very high compared to countries average requirement.

There is little bit of ethical issues in the business, in international business. So, buyer reluctant to mention the use of product, why he intends to buy. There are certain ethical issues, he may not disclose. But if you are not very sure what purpose he is buying this you should not sell it. So, there are some ethical things which I have mentioned, ethical business issues that the final destination is address of the freight forwarder.

Buyer is evasive about the end use of the product. He is not telling what is the end use of the product. quantity ordered is very high comparative of the average country's requirements. So, these are all very doubtful cases. Buyer not sure about the performance of the product required and blindly sends and purchase order. So, these are the things which I have listed down are typically the possible indicators in the ethical issues.

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And the last one is the special economic zone. Just to give you an heads up on that a special economic zone is an area in a country that is subjected to different economic regulation than other regions within the same country. The economic regulations of special economic zones tend to be conducive to and attractive foreign direct investment. So, what does it mean? They are typically created in order to facilitate a rapid economic growth by leveraging tax incentives to attract foreign investment and spark technological advancement. While many countries have set up special economic zones, China has set up most successful and India we have set up also several special economic zones.

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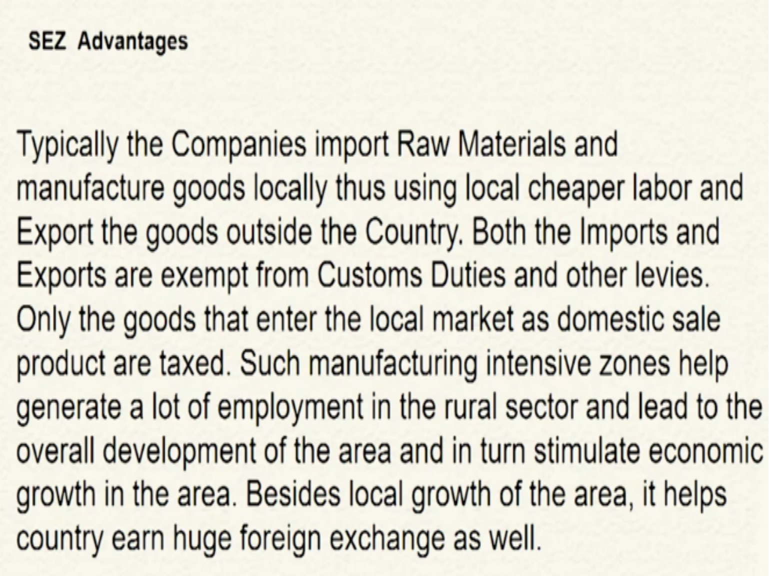

The advantage, the company imports the raw material, manufacture goods locally thus using local cheaper labour and export the goods outside the country. So, both the imports and exports are exempt from the customs duty within that special economic zone and other levies. Only the goods that enter the local market, suppose you are manufacturing a good in special economic zone and then if you are selling it in the domestic country, then locally the product has to be taxed for that, GST.

In case of India GST will be taxed. Such manufacturing intensive zones help to generate lot of employment in rural sector and lead to the overall development in the area, in turn stimulate economic growth in the area. Besides local growth of the area, it helps the country earn huge amount of foreign exchange as well. So, this is a foreign country within this economic zone.

So that operates right just like in foreign country and takes the benefit or takes the advantage of the labour or the technology in that and then sell that product in the international market, part of the product can be sold here. So special economic zones are very upcoming and there are a lot of special economic zones in our country in various parts of our country special economic advantage SEZ zones are there. That is all from my side. Thank you very much.