

DILEMMAS OF TRADE FINANCE DOCUMENTS: A STUDY OF DISCREPANT DOCUMENTS NEGOTIATED FOR FINANCING

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ABSTRACT

The dilemma of trade finance documents has been a major worldwide issue for decades. This has been a significant problem for sellers, buyers, and banking institutions when banks discover discrepancies on export documents prior to financing. This research illustrates the problems of discrepant trade documents caused by the ambiguous and excessive requirements of the Uniform Customs and Practice and documentary credit. This research recommends exporters advise importers not to include excessive terms and ambiguous conditions in the letter of credit. This research also recommends changing legal language of the Uniform Custom and Practice into a clearer language.

I. INTRODUCTION

International trade is obviously very important for a country. The growth of international trade can offer new opportunities for importers and exporters. It is impossible for a country to produce domestically everything for its citizens need or demand. Without foreign trade, national resources are not put to their best uses. More exporters are looking for foreign markets to sell their products. Export market is normally so much larger than the firm's domestic market. Most notably, companies export to increase their revenues. More importers are also looking for sources of supply to buy products. Companies and distributors seek out products, services, and components produced in foreign countries. However, many exporters have run into various problems. Common problems are a failure to present proper trade documents for financing. For decades, many international trading firms complained that the banks refused to pay them due to documentary discrepancies without justification.

II. STATEMENT OF THE PROBLEM AND HYPOTHESES

During the past thirty years, the banks discover discrepancies on export and import documents prior to financing, resulting unnecessary delays and dispute in the process. The problems still occur consistently while the climbing to find solution to these problems continues.

Hypothesis 1:

H₀: The excessive requirements in the letters of credit are sources of documentary discrepancies

Hypothesis 2:

H₀: The ambiguous contexts of the Uniform Customs and Practice 500 are sources of documentary discrepancies

In this research, if the null hypothesis is rejected, the alternative cannot be rejected. Therefore, the alternatives for the above hypotheses are as follows:

H₁: The excessive requirements in the letters of credit are not sources of documentary discrepancies

H₂: The ambiguous contexts of the Uniform Customs and Practice 500 are not sources of documentary discrepancies

The condition of this research is the null hypothesis is presumed true until a preponderance of the evidence indicates that it is false.

Decision Rule for Hypothesis 1

The null hypothesis (first hypothesis) will be rejected if 45 % or less of the data shows discrepancies of documents do not comply with the excessive terms and conditions of letter of credit.

Decision Rule for Hypothesis 2

The null hypothesis (second hypothesis) will be rejected if 25 % or less of the data shows discrepancies of documents do not comply with the contexts of Uniform Customs and Practice.

III. UNIFORM CUSTOMS AND PRACTICE

The Uniform Customs and Practice 500, entered into effect for letter of credit on January 1, 1994. It is still questionable if the Uniform Customs and Practice is a more flexible set of rules than any national or international legislation (International Chamber of Commerce, 1993, p.63). According to Del Busto, the Uniform Customs and Practice is not binding law, but applies because banks voluntarily incorporate the Uniform Customs and Practice into the contracts upon which the letter of credit is based (Del Busto, 1994, p. 1). Likewise, Jimenez confirmed the legal status of the Uniform Customs and Practice affects the international banking community and importing and exporting community worldwide (Jimenez, 1997, p, 133–134).

The Uniform Customs and Practice has achieved such universal effect that in some countries the Uniform Customs and Practice is recognized as having the force of law or at least that of a trade tradition or custom (DC Insight, 2005, p. 8). Fung commented that it was not easy to understand the context of each article. As a result, the courts were often asked to interpret certain provisions from the banking commission of the International Chamber of Commerce. These interpretations and opinions are collected and published by the International Chamber of Commerce every few years (Fung, 2004, p. 17). Despite these benefits, difficulty in interpretation of contextual meaning of each article in the Uniform Customs and Practice 500 often increases the risk of nonpayment for exporters.

IV. LETTER OF CREDIT AND DOCUMENTARY DISCREPANCY

Letters of credit are the instrument of both export and import business in that one party may request a letter of credit for a transaction involving goods or services when the other party is on the other side of the world (Tuller, 1994, p. 148). According to Axtell, the key facilitation of the export and import transaction is that the seller must ship the goods and present the documents to the bank as required by the rules and regulations of letters of credit, guaranteeing that the seller will get paid (Axtell, 1994, p. 104). Neipert suggested that the letter of credit is popular because international trade transactions are complicated by the seller's trepidations regarding the difficulty of collecting funds from a foreign buyer (Neipert, 2000, p. 79) while Nelson presented the

typical format of letter of credit for use (Nelson, 2000, p. 94). Venedikian recommended a letter of credit should be issued after signing the sales contract but before shipment (Venedikian, 1996, p. 349). Hill indicated, it is the choice of the importer to select options and ask the issuing bank to issue letter of credit to meet an objective of the firm (Hill, 2005, p. 544).

Daniels explored the problem of exporting in terms of documentary discrepancy. It was indicated that exporters often become discouraged or frustrated with the exporting process because they encounter problems, delays, and pitfalls (Daniels, 2007, p.4 58). Documentary discrepancy refers to a document or any part of a document that does not exactly conform to the requirements of a letter of credit. Exporters must present document to the banks as required by terms of letter of credit, otherwise it would be documentary discrepancy (Zodl, 2002, p.143). Likewise, Czinkota indicated a firm must deal with numerous forms and documents when exporting to ensure that all goods meet local and foreign laws and regulations, otherwise the exporter will not get paid or get financed (Czinkota, 2004, p. 552). Based on the Uniform Customs and Practice 400, Ruggiero mentioned documentary discrepancy caused problems in collection of payments for exporters (Ruggiero, 1991, p. 52).

V. METHODS AND DATA COLLECTION

The research employed in this study is e-research in nature. In the 21st century, business research has been strongly influenced by two major trends in business: increased globalization and rapid growth of the internet and other information technologies. These trends will continue, and likely accelerate, as the 21st century progresses (Zikmund, 2003, p. 16–17). This research was conducted during the months of May 2006 through June of 2007. 500 web sites of banks, financial institutions, and related institutions worldwide were reviewed to collect data about discrepancies posted online. Any sources that related to discrepancies of export and import documents were examined and analyzed. This was to make sure the data are truly representative of the population.

The checklist method was also employed as described by Leedy and Ormrod (Leedy & Ormrod, 2001, p. 197–198) that is, a list of characteristics, behaviors, or entities that a researcher is looking for. A researcher would simply check whether each item on the list is presented and true. The characteristics of each discrepancy found online were recorded, because these data were needed to analyze the cause of discrepancies in import and export letter of credit documents. Books and documents were also surveyed at libraries to ensure the validity and accuracy of the research. From e-research, 59 characteristics of discrepancies in the export and import letters of credit were found. These characteristics of discrepancies could happen because of several reasons. The data identify the problem directly involved with import and export documents; the data show the character, nature, and behavior of discrepancies that the research was looking for. These data display on Table 1: Percentages of Characteristics of Documentary Discrepancies as follows:

TABLE 1: PERCENTAGES OF CHARACTERISTICS OF DOCUMENTARY DISCREPANCIES

| TYPE OF DISCREPANCIES | CHARACTERISTICS | PERCENTAGES |
|--|--|-------------|
| EXCESSIVE REQUIREMENTS OF LETTER OF CREDIT | Merchandise description differs, Invoice omits certain condition, Packing list requires too much information, Consignee and notify parties differ, Beneficiary certificate differs, Special addendum, Special conditions on partial shipment, Extra documents required, etc. | 49 |
| UNIFORM CUSTOMS & PRACTICE 500 | Transport documents differs, Late presentation, Insurance certificate differs, Condition of insurance differs, Name of carrier omitted, Capacity of signer omitted, Under insured, Shipping term & Freight condition differ, etc. | 29 |
| OTHERS | Clerical errors of exporters | 22 |
| TOTAL DISCREPANCIES | | 100 |

VI. RESULT OF DATA ANALYSIS AND HYPOTHESES

Table 1 shows 49% of discrepant export and import documents do not comply with excessive requirement of letter of credit. Therefore, the decision rule is:

DR: Hypothesis 1 is not rejected.

Table 1 also shows 29% of discrepant of export and import documents do not comply with the ambiguous context of the Uniform Customs and Practice 500. Therefore, the decision rule is:

DR: Hypothesis 2 is not rejected either.

Therefore, it is concluded that the excessive requirements of letters of credit and the ambiguous contexts of the Uniform Customs and Practice are the sources of documentary discrepancies.

VII. CONCLUSION AND RECOMMENDATIONS

Prior to the issuance of the letter of credit, the exporters must be serious in

negotiating with the importers and be sure that excessive requirements and conditions are not included in the letter of credit. During this stage of negotiation, it is easier to work out details in the letter of credit to avoid future discrepancies. The exporters can bring many incentives to the table for negotiation. For instance, the exporter may motivate the importers to make the deal easier by offering an incentive plan on the unit price, quality of merchandise, or cost of transportation. Once the letter of credit is issued, it becomes much more difficult to negotiate. In the case of shipping terms such as free on board (FOB) and Cost and Freight (CFR), the required documents should be an invoice, transport document, and beneficiary's certificate. The insurance certificate is needed in the case of CIF (cost, insurance, and freight) only. If the importers need other documents such as certificate of origin or special addendum, the exporters may send them directly to the importers as requested.

Exporters, importers, and bankers agree that the language of each article of the Uniform Customs and Practice 500 is difficult to understand (International Chamber of Commerce, 2005, p.1). The fact is that each article contains ambiguous language with interpretive phrasing that can be seen from the following example:

Article 31, unless otherwise stipulated in the credit, banks will accept a transport document which does not indicate, in the case of carriage by sea or by more than one means of conveyance including carriage by sea, that the goods are or will be loaded on deck. Nevertheless, banks will accept a transport document which contains a provision that the goods may be carried on deck, provided that it does not specifically state that they are or will be loaded on deck (International Chamber of Commerce, 1993, p. 5).

The language and context about loading or shipping on deck in article 31 is ambiguous. It is very difficult to understand if loading or shipping on deck is acceptable or not. This article should have stated clearly that unless otherwise stipulated in the letter of credit, loading on deck or shipping on deck is not acceptable. It is recommended that the International Chamber of Commerce must use a clearer language on each article. Inappropriate contexts of the Uniform Customs and Practice must be changed. Each article should be written in clear and concise language that can be understood easily for practice. Additionally, the International Chamber of Commerce should provide a practical example for each article so that the personnel who work in export and import businesses would be able to follow the guidelines easily. The implementation of a clearer language should be executed for the next version. This will be the best way to eliminate the discrepancies in presentation of import and export documents for payments and financing.

VIII. LIMITATIONS OF THE STUDY

One of the limitations of this study was that there are only two hypotheses for this research. The limitation of this type of hypothesis is they were focused on terms and conditions of letter of credit rules and regulations of international trade. These hypotheses did not focus personnel involved in preparation of export and import documents. The discrepancy of export and import documents could involve personnel who prepare and present the documents for payment at the bank. It would be interesting to see this type of hypothesis or research question more fully incorporated into future research.

Lastly, the qualitative method was not employed in data collection and data analysis. Qualitative methodology can improve the efficiency of investigation. A qualitative approach is also more sensitive to human factors such as the motivations and opinions of the personnel involved with export and import business. Interviews with knowledgeable people would have been of great value to this research. In addition, comments from experts in this field will facilitate improvements in data analysis and the conceptual model for future investigation.

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