



Addis Ababa University

School of Commerce

Masters of Arts in Logistics and Supply Chain Management

Assessment on the Determining Factors of Letters of Credit
Effectiveness: Perception Survey on Trade Services and
International Banking Staffs of Commercial Bank of Ethiopia
(CBE)

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May 26, 2017

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ABSTRACT

Letter of credit has become widely used in international trade as the payment instrument. Letter of credit is the life-blood of international commerce. This study aimed to assess the determining factors of letters of credit effectiveness in the process of import and export practices of CBE. Employing content analysis, this study found that 35% of trade documents contained discrepancies and did not comply with terms and conditions of letter of credit, 53% of documents contained discrepancies and did not comply with the ambiguity of context of the Uniform Customs and Practice 600 and only 12 % of discrepancy of trade finance documents originated from clerical errors. The correlation relation test showed that formation place $r(90) = .680$, $p < .01$, place of payment $r(90) = .667$, $p < .01$, language and currency $r(90) = .728$ $p < .01$ and documentary condition $r(90) = .684$, $p < .01$ had statistically significant relationship with LC effectiveness. To this end, with the support of multivariate analysis, result showed that formation place (0.00010), place of payment (0.00005), language and currency (0.00002), and documentary condition (0.00003) statistically affects LC effectiveness. Banks that facilitate international trade as a major financial institution in goods and service including payment processing for merchandise shipped and services rendered, layouts funds for buyer and seller, and give professional advices to traders specially accurately rendering foreign banking services to facilitate the country's international trade.

Key Words: Commercial Bank, International Trade, Letter of Credit

CANDIDATE'S DECLARATION

I do hereby declare to the senate of Addis Ababa University School of Commerce that the work which is being presented in this thesis entitled "Assessment on The Determining Factors of Letters of Credit Effectiveness: Perception Survey on Trade Services and International Banking Staffs of Commercial Bank of Ethiopia (CBE). It is original work of my own, has not been presented for any other university and that all sources of material used for the thesis have been duly acknowledged.

Bancalem Girma
(Candidate)

Date

This is to certify that the above declaration made by the candidate is correct to the best of my knowledge.

Mengistu Bogale, (PhD)
(Thesis Advisor)

Date

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ABBREVIATION/ACRONYM

CBE	Commercial Bank of Ethiopia
L/C(s)	L/C(s) Letter(s) of Credit
ICC	The International Chamber of Commerce
UCP 500	The Uniform Customs and Practice for Documentary Credits 500
UCP 600	The Uniform Customs and Practice for Documentary Credits 600
UCC	Uniform Commercial Code
SLC	Stand by letter of Credit
CLC	Commercial Letter of credit

List of Table

Table 4.1. Frequency of Participants Based on their Age	21
Table 4.2 Distribution of Participants by Sex	22
Table 4.3. Frequency of Participants Based on their work experience	22
Table 4.4 The Normality Test	24
Table 4.5 Reliability Test by Dimension	24
Table 4.6 Percentages of Characteristics of Discrepancies	25
Table 4.7 Most Repeatedly Occurrence of Discrepancies of Documents	27
Table 4.8 Average Occurrence of Discrepancies	27
Table 4.9 Rarely Occurrence of Discrepancies	27
Table 4.10 Row Percentage Distribution of Formation Place Question Responses	30
Table 4.11 Row Percentage Distribution of Place of the Payment Question Responses	31
Table 4.12 Row Percentage Distribution of Language and currency Question Responses	32
Table 4.13 Row Percentage Distribution of documentary documentation Question Responses	33
Table 4.14 Row Percentage Distribution of LC Effectiveness Question Responses	34
Table 4.15 Summary of Question Responses	35
Table 4.16 Correlation analysis	37
Table 4.17 Correlation analysis based on quality, time and price	38
Table 4.18 Multiple Regression Test Results	39
Table 4.19 Multiple Regression Test Results of LC Effectiveness of Quality, Time and Price	41
Table 4.20 Summary of Research Questions Results	43

List of Figures

Figure 2.1 Conceptual framework adapted from Sakchutchawan study (2009)	16
Figure 4.1: Participants Working Experience Graphical View	23
Figure 4.2: Summary of Question Responses	36

Table of Contents

Abstract.....	I
Candidate's Declaration.....	V
Acknowledgment.....	VI
Abbreviation/Acronym.....	VII
List Of Table.....	VIII
List Of Figures.....	IX
Table Of Contents.....	X
Chapter One - Introduction.....	1
1.1 Background Of The Study.....	1
1.2 Statement Of The Problem.....	2
1.3 Research Questions.....	3
1.4 Research Objective.....	3
1.5 Significance Of The Study.....	4
1.6 Limitation Of The Study.....	4
1.7 Organization Of The Study.....	6
1.8 Definitions Of Basic Terms.....	6
Chapter Two - Literature Review.....	7
2.1 Introduction.....	7
2.2 History And Concept Of Letters Of Credit.....	7
2.3 Principles Of Letters Of Credit.....	8
2.4 Operations Of A Letter Of Credit Transaction.....	10
2.5 Empirical Studies Related To Letter Of Credit.....	11
2.6 Conceptual Framework.....	16
Chapter Three - Research Methodology.....	17
3.1 Introduction.....	17
3.2 Research Approach.....	17
3.3 Research Design.....	17

3.5	Population.....	18
3.6	Data Source	18
3.7	Data Type And Measurement	18
3.8	Data Collection Method	18
3.9	Data Analysis	19
3.10	Reliability.....	20
3.11	Validity.....	20
3.12	Ethical Consideration	20
Chapter Four – Analysis And Discussion		21
4.1	Respondents’ Profile And Response Proportions	21
4.1.1	Response Rate.....	21
4.1.2	Demographic Characteristics Of The Participants	21
4.2	Normality Test.....	23
4.3	Reliability Test.....	24
4.4	Discrepancy Documents Analysis.....	25
4.4.1	Excessive Requirements Of Letter Of Credit	26
4.4.2	Uniform Customs And Practice.....	26
4.4.3	Others Discrepancy – Clerical Errors	29
4.5	Descriptive Analysis	29
4.5.1	Formation Place	29
4.5.2	Place Of The Payment	31
4.5.3	Application Of Language And Currency.....	32
4.5.4	Documentary Condition Of The Lc Processing	32
4.5.5	Letter Of Credit Effectiveness In Cbe	33
4.5.6	Summary Responses Of Factors.....	35
4.6	Correlation Analysis.....	36
4.7.1	Model Testing	43
4.8	Qualitative Data Analysis.....	44
4.9	Consistency With Others Studies.....	45
Chapter 5 - Summary, Conclusion And Recommendation.....		48
5.1	Summary	48

5.2	Conclusions.....	49
5.3	Suggestions For Further Research	49
5.4	Recommendation	50
	Reference.....	52
	Appendix A -Regression Test Result Of Each Variable	55
	Appendix B – Questionnaire In English	58

Chapter One - Introduction

1.1 Background of the study

International trade is a key to worldwide prosperity. It can stimulate gross domestic product of any country. The growth of international trade and financing can offer new opportunities for buyers and sellers between two countries or more (Sut Sakchutchawan, 2009). While international trade continues to grow as a part of global economy, more attention and emphasis have been focused on understanding the key aspects of trade finance transactions.

Nowadays, just about all companies-large or small-are affected by global trade and international competition. Moreover, common problems are a failure to present proper trade documents for payment, a failure to produce goods and services offering to the needs of foreign countries, and a failure in collecting payment and financing. Hill (2005) indicated that a typical international trade transaction may involve 30 parties, 60 original documents, and 360 documents copies, all of which have to be checked, transmitted, re-entered into various information systems, processed, and filed by quoted The United Nations report on Trade and Development. The United Nations had calculated that the time involved in preparing documentations, along with the costs of common errors in paperwork, often amounts to 10 percent of the value of goods export (Hill, 2005).

Similarly, as to any developing country, Ethiopian companies have a common problem such as failure to present proper trade documents for payment, a failure to produce goods and services offering to the needs of foreign countries, and a failure in collecting payment and financing. There could be any other major issues on documentary credit, payment facilitation, document handling, voluminous paper work, complex formalities, and many potential delays and errors.

To sum up, trade transaction facilitation and exploring new opportunities through international trade financing are always a burning issue in the assessment of developing countries import and export achievement. More importantly, much work needs to be done with the course of using commercial letters of credit in the country's import and export in the Ethiopian context. It is sensible to study its potential implications and examined changes in both generally accepted accounting principles. Hence, this study assessed the determining factors of Letters of Credit effectiveness by means of the perception survey on trade services and international banking staffs of Commercial Bank of Ethiopia (CBE).

1.2 Statement of the Problem

The major financial institutions that facilitate international trade are insurance companies and banks. Insurance companies give cover to risk of loss or damage to the goods in transit to buyer's premises while banks facilitate payment for merchandise shipped and services rendered, lay out funds for buyer and seller, and give professional advice to traders. One of these banks that involve in rendering foreign banking services to facilitate the country's international trade is CBE. The annual report of the bank in 2016 and a preliminary interview with trade service staff of CBE indicated that the practice of LC process in CBE characterized as late transfer of LC documents and improperly handling and improper filling documents of letters of credit. Most exporters and importers complained the bank on documentary collection, advance and consignment payment processing, and treatment of guarantee and permit in all procedure of international trade. These all imperfection of international trading practices and associated payment faultiness has a clue to unprecedented research opportunities.

Further, import or export firms highly oblige to fill several needless forms typed in old typing machine (Type Writer) and have been forced to offer various documents when importing and exporting in Ethiopia. The preliminary interview assured that all LC documentation has been inaccurately completed and exploited potential delay problems. The main logistics related problem is specified as firms just entering to the international market should not be forced using freight forwarders who specialize in handling importation and exportation documents. Thus, investigating letter of credit effectiveness in trade service process of letter of credit through intensive search of the trade service activity of Commercial Bank of Ethiopia is a must.

On the other hand, due to the importance of letters of credit in international trade law, some investigations have been conducted. For example, Hahn (2007) investigated the governing laws on letters of credit under the UCC to provide the in-depth analysis with respect to how the choice of law matters for disputes arising out of letters of credit. Hao & Xiao (2013) analyzed the two principles of „Independence“ and „Strict Compliance“ related to letters of credit, and studied the risks exist in letter-of-credit transaction. Sut Sakchutchawan (2009) addressed the phenomenon of document discrepancies in international trade financing and assured the problems related to letter of credit have grown in the past thirty years; no research has been undertaken to address these problems. This can be an extreme source of frustration to the variables of factors using LC and its effectiveness in finding solutions for payment and finance process in international trade.

In general, the issue of finance is an integral one in the supply chain context; given that supply chains embody flows of information, capital, goods, and labor. The supply chain concept has traditionally tended to emphasize the tangible/material dimensions of the chain. Previously, the subject had been largely addressed in the context of operations research and economic development. As a result, the financial dimension had been relatively neglected in the literature. This changed with the 2008-2009 global financial crises. As both a potential aggravator and victim of the crisis, trade finance and supply chains became the subject of a new and rapidly growing body of literature (Hurtrez and Salvadori 2010). Thus, this study focuses on the concept of the financial dimension of supply chain and payments using letter of credit and other related concepts. This study reviewed findings from all research areas in the literature and observes significant merit in the financial and international trade concept of supply chain flows. Actually, this problem gap is growing in the field of logistics and supply chain management and seems to be unstoppable researchable area in commercial trade.

Therefore, this paper assessed the determining factors of Letters of Credit effectiveness that arranged international trade transactions payment and financing. To this effect, various factors such as formation place, place of payment, language and currency, documentary condition were independent variables and letter of credit effectiveness was treated as dependent variable.

1.3 Research Questions

- What are the factors that determine letters of credit effectiveness in the process of import and export practices of CBE?
- Which dimensions have strong relationship to letters of credit effectiveness in the process of import and export practices of CBE?
- What is the gap area that is not yet filed by the commercial bank of Ethiopia in using letters of credit in the process of import and export practices success?

1.4 Research Objective

- To investigate the factors that determines letters of credit effectiveness in the process of import and export practices of CBE.
- To explore the dimensions that has strong relationship to letters of credit effectiveness in the process of import and export practices of CBE.
- To assess the gap area that is not yet filed by the commercial bank of Ethiopia in using letters of credit in the process of import and export practices success.

1.5 Significance of the Study

Since currently CBE provides low quality international payment process and special delayed and incomplete documentation and allied banking services, this kind of research outcomes will be made to serve its esteemed and valuable customers of the Bank by contain the information most useful to letters of credit effectiveness decisions. Also, it helps the bank to take corrective actions on the basis of suggested recommendations and the study will provide a starting ground to other researchers in order to undertake intensive study on the influential factors of letters of credit effectiveness. In general, the result of the study is hoped to contribute for policy makers, bank's executives and for those who need to make further studies in more details towards:

- examining the implementation of operative international trade transaction and payment system in Ethiopian business environment
- Providing feedback to banks, private and public organizations, policy makers, experts in commercial environment because results of the study can explain the documents, payments and trade transactions quality or effectiveness.
- Gaining a better understanding of the need for a closer relationship among, letter of credit, trade facilitation, documentation, business as far as achievement tests practiced in commercial banks are concerned.

Further, the bank will revise its operational strategy through the foremost recommendations that is to be action by the commercial bank of Ethiopia on the drawbacks of using letters of credit in the process of import and export practices. In related to central focusing on using letters of credit, this paper helps to improve the country's most important instrument in international trade. The finding of research will smooth flow of document process and minimize the risk of importers and exporters as well as the involving parties in international trade such as banks, insurance.

1.6 Limitation of the Study

This study was basically bounded to examining factors of letters of credit effectiveness in the process of import and export practices success. This study emphasized on the country's biggest government owned financial institution and other private banks were overlooked due to time and money restrictions. It is targeted on the strongest financial institutions in the country that plays vital role on the economy as whole and so does in import and export business. However, it does not include the humanitarian goods and service transactions and its international logistics of CBE practices. All the commercial banks of the country were not taken as the subject of the study. It

overlooked roles and duties of trade support of regional offices of CBE and other branches found in Addis Ababa. It only targets the trade support and international banking division office found in head quarter of CBE. Not only this but also, the fact that the study is only conducted in letter of credit other mode of payments like TT transfer and CAD do not include which limits the generalization of the research findings.

Moreover, the study may not search other African countries banking experience and other international trade payment methods as comparison due to financial and time constraint. Thus, there might be a limited extent impact up on the generalization of this study across the country import export practices. A comparative study should have been involved as country level analysis or many participants as possible to further support the concepts in this study. However, considering the time, budget, access to data, expected rate of return for research instruments and convenience, this research concentrated on the case of international payment terms on letters of credit effectiveness.

In short, studies need to be conducted using more variables such as letter of credit efficiency and success factors that seem to be pertinent to the study. The studies should be conducted to investigate the interaction of other variables that influence the LC effectiveness on commercial banking business. Other factors that affect the whole international trade practices may also be given an in-depth analysis through a similar study. A replication of the study needs to be done using a larger sample so as to give more insight on commercial and development banking business in Ethiopia. In regard to risk analysis of Letter of Credit, possible risks and frauds of different parties (exporter, importer, and banks) should have not been shown in this study. Unfortunately, the paper discarded various risks that affect in letter-of-credit transaction even if it is the safest method of payment nowadays in international trade. Those risks may happen on each party, which is not only the exporter, but also the importers and banks.

On the other hand, conflict between clauses of credit and related laws were not included in this study. It was not checked whether or not the clauses of credit are in accordance with the law of related country. In the real practice of international trade, some clauses in the credit are advantage to the exporter on the appearance. The noticeable point is that if the clauses are allowed according to the law of importer's country. This limitation would be more capital for further research. The other point may not consider here, the personnel involved in documentary preparation and documentary examination as they must be trained and certified to ensure they

have enough skills to handle the import and export documents properly; so, in the future research they should be studied in-depth.

1.7 Organization of the study

This study was chiefly organized in five chapters. The first chapter consists of introduction and it includes the study background, statement of the problem, and objective of the study, significance of the study, scope and limitation. The second chapter deals with the review of the related literature the third chapter deals regarding research method chapter four treats data analysis presentation and findings. Chapter five presents conclusion and recommendations

1.8 Definitions of Basic Terms

- Letters of credit often described as the payment method that developed to facilitate international trade. They are especially preferred over other means of payment mostly for one - shot cross - border transactions where traders do not know each other, or in the opening stages of a potential long term relationship, before relational constraints become effective (Krazovska D., 2008).
- International trade is a key to worldwide prosperity. It can stimulate gross domestic product of the country. While international trade continues to grow as a part of global economy, more attention and emphasis have been focused on understanding the key aspects of trade finance transactions. International trade is obviously very important for global economic growth (Sakchutchawan, 2009).
- Trade finance - Broadly defined, trade finance refers to “any financial arrangement connected to inter-firm commercial transactions”. It is often used in the context of international trade (import/export), in which it refers more specifically to “the funding of individual international commercial transactions by financial intermediaries” (Ellingsen and Vlachose 2009).

CHAPTER TWO - LITERATURE REVIEW

2.1 Introduction

This chapter is based on the introduction given lately and the research problem presented in the introduction and the previous studies that have been done within these constructs. It provides the reader with a literature review concerning the research area. Large number of studies has been conducted in the field of letter of credit and international trade (import export transaction). There are useful contributions expressed by so many authors about the payment method that developed to facilitate international trade with payment language and currency, documentary issues, formation place and Place of payment as important factors of effective factors on using letter of credit.

2.2 History and Concept of Letters of Credit

The term „letter of credit“ is derived from the French word „accrédit if“, which means „a power to do something“, which in turn derives from the Latin word „accreditivus“, which means „trust“. The letter of credit is also referred to as documentary credit (Koudriachov SA, 2001). Koudriachov designated that some academics believe that the sources of letters of credit can be traced back to early Egypt and Babylon, which already had a sufficient banking structure. Rufus Trimble e.g. refers to a clay promissory note of Babylon dating from 3000 B.C., which provided for the payment of an amount and the interest on an explicit date. It is confirmed that banks in ancient Greece prepared letters of credit „on correspondents with the view to obviating the actual transport of specie on payment of accounts.

As numerous disciplines of social science, there are no universal one but rather multiple definitions of the letter of credit, depending on the set of rules applicable to the letter of credit transaction. Nevertheless, a letter of credit is a written instrument employed in the event that someone („applicant“) undertakes to pay another person („beneficiary“) under a given contract („underlying contract“), provided the terms expressly specified in the letter of credit are met (Gao X & Buckley RP., 2003).

Regardless of its long mercantile history, the letter of credit has a much shorter legal history. Pillans and Rose v Van Mierop and Hopkins is one of the first lawsuits involving a letter of credit and a landmark case in the UK“s letter of credit law. Cases such as Orr & Barber v. Union

Bank of Scotland¹³, the British Linen Company Bank v. The Caledonian Insurance Company and Re Agra & Masterman Bank v. Ex Parte Asiatic Banking Corporation demonstrate that it is only since the second half of the 19th century when transactions similar to the modern commercial credit began to appear and that banks became properly involved in the utilization of the credit arrangement (Bollen R., 2007). Bollen showed that the law of letters of credit has developed largely through customs of international trade, which mostly the International Chamber of Commerce has codified in the Uniform Customs and Practice, the Uniform Rules for Demand Guarantees, the Uniform Rules for Contract Guarantees and the International Standby Practice.

Bergami R. (2003) exhibited that letters of credit deal with these issues efficiently because, for international parties, they are issued in a transparent way, can be examined by the receiving party and lead to a reliable payment by the bank. Lord Wright described the letter of credit as a „bridge between the period of the shipment and the time of obtaining payment against documents“. The letter of credit permits the beneficiary to rely on the banks instead of the importer's creditworthiness. Additionally, it gives a payment guarantee, provided the exporter produces the required documentation. Regardless of its costs and complex formal requirements the letter of credit plays a leading role in international sales transactions.

2.3 Principles of Letters of Credit

Letters of credit are based on two principles: autonomy, and doctrine of strict compliance. First is the Autonomy of the Letter of Credit. According to this principle, the L/C is disassociated from the actual sales and other contracts and, thus, is not affected by any problems and disputes related to the contracts or dissatisfactions between the exporter and buyer. The main and only agreement that is arranged between the exporter and the bank is the letter of credit. The buyer's protest about the export cannot suspend payment of the L/C. The only case where a bank may refuse payment is in case of fraud or forgery in the transaction, referred to as "fraud exception". (Articles 3 and 4 of UCP 500) (Atefe et al., 2016).

Article 4 UCP 600 defines the autonomy principle as follows a credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honor, to negotiate or to fulfill any other

obligation under the credit is not subject to claims or defenses by the applicant resulting from its relationships with the issuing bank or the beneficiary (Leon, 2012).

The second important principle is the Doctrine of Strict Compliance. According to this principle, the exporter must respect the written terms “to the letter” of the L/C. If any discrepancy or inconstancy occurs between the documents presented by the exporter and what is actually specified in the L/C, the bank can refuse payment. Therefore, with a L/C, the buyer has the protection of the bank strictly controlling the documents, and the seller has the protection of getting paid if all documents comply with the letter of credit. In regard to connecting Factors in Letters of Credit, the most common and relevant connecting factors are as following (Hahn, 2007).

- Formation place: Generally, a contract is concluded where acceptance of an offer becomes effective, but since national laws have different approaches to determine such a place, different places can be nominated as the place of formation of the contract depending on the rules of the applicable national law.
- Place of payment: the place of the payment is deemed to have a strong connection in determining the governing law of the contract. In a L/C, payments are made differently in the course of the transaction, e.g. by correspondent bank or the issuing bank.
- Language and currency: the language and currency used in the contract are important factors which indicate the choice of law in certain situations.

Atefe et al., (2016) described the Commercial and Standby Letters of Credit as CLCs have been used for centuries to facilitate payment in international trade. It is a contractual agreement between banks, known as the issuing bank, on behalf of one of its customers, authorizing another bank, known as the advising or confirming bank, to make payment to the beneficiary. The issuing bank, on the request of its customer, opens the letter of credit. The issuing bank makes a commitment to honor drawings made under the credit. The beneficiary is normally the provider of goods and/or services. Essentially, the issuing bank replaces the bank's customer as the payer. Majority of CLCs are issued subject to Uniform Customs and Practice for Documentary Credits (UCP). SLC has a different function than the CLC. A bank will issue a SLC on behalf of a customer to provide assurances of his ability to perform under the terms of a contract between the beneficiaries.

2.4 Operations of a Letter of Credit Transaction

According to the „Uniform Customs and Practice for Documentary Credits“ („UCP“), which are the most acknowledged set of rules and adopted in virtually every letter of credit. It fundamentally operates on at least three parties: the seller, who is also referred to as the exporter or beneficiary; the buyer, who is also referred to as the importer or applicant; and the issuing bank, which issues the letter of credit either at the request of the applicant or on its own behalf. Further the letter of credit consists of at least three different autonomous contracts: First, the underlying contract (e.g., the purchase contract) under which the seller agrees to sell the goods to the buyer and the buyer agrees to pay the seller the purchase price. Secondly, a contract between the buyer and the issuing bank under which the issuing bank agrees to issue the letter of credit for the benefit of the seller and the buyer agrees to reimburse the issuing bank for the payment made under the letter of credit plus a commission. Thirdly, the issuing banks undertaking towards the beneficiary under whom the issuing bank agrees to honor the beneficiary’s draft provided it is accompanied by the required documents specified in the letter of credit (Baker B., 2003).

Baker (2003) properly proposed as in its international trade practice as the beneficiary generally does not deal directly with the issuing bank. The issuing bank regularly arranges for a bank in the beneficiary’s country to advise the credit, i.e., to check the authenticity of the credit and hereafter deliver it to the beneficiary. The issuing bank in addition or alternatively may ask another bank in the beneficiary’s country to make the credit available upon the presentation of complying documents.

Zhou (2002) included as the bank that advises the letter of credit to the beneficiary is referred to as the „advising bank“ and the bank to which the beneficiary is to present the complying documents is referred to as the „nominated bank“. The advising bank acts as an agent of the issuing bank. It advises the credit at the request of the issuing bank without any undertaking to honor the credit. The advising bank signifies that it has satisfied itself as to the apparent authenticity of the credit and that the advice accurately reflects the terms and conditions of the credit“. The advising bank may offer payment to the beneficiary in addition to and independent of its advising obligation towards the issuing bank, to transmit the terms of the letter of credit to the beneficiary. Though, unless the advising bank issues its own confirmation to a letter of credit, it does not become a

party to the letter of credit and is therefore not obligated to honor the promise of payment it includes. The advising bank can also take on the function of the nominated bank.

2.5 Empirical Studies related to Letter of Credit

Atefe et al. (2016) sought to investigate which kind of guarantee (commercial L/C or standby L/C) they prefer to secure the performance of their client's obligations. Studied companies were 20 international trading companies in Tehran, from which 50 experts were participated in our survey study. For measuring the participants and their policy in using letters of credit, a questionnaire in Persian was designed. They formulated their hypotheses as following:

- Hypothesis 1: Being a guaranteed credit can affect the preference of international trading companies in using letters of credit.
- Hypothesis 2: Integration between CLC and SLC has a relationship with the preference of international trading companies in using letters of credit.
- Hypothesis 3: Documentary condition is an effective factor in using letters of credit by international trading companies in Iran
- Hypothesis 4: Being a secondary payment tool affects the preference of International trading companies in Iran

For analyzing data, they used statistical tests (One-sample t-test). Data showed that being a guarantee; integration, documentary conditions, and secondary payment mechanism are four important reasons for international trading companies in Iran to use letters of credit in their contracts. A statistical result showed that “being a guaranteed credit” is the most important factor with a mean of 3.660 ± 1.135 . As well, they found significant relationship between these four factors and the L/C usage policy ($p < 0.01$, and $p < 0.05$). They concluded that they mostly prefer standby letters of credit for securing their transactions.

Basically, 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. Sometimes called —trade credit, 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 (Zodl, 2001). As indicated by Zodl, letters of credit are the most important instrument in international trade. It is the preferred form of payment because it protects both seller and buyer while they are engaged in the import and export business. In this transaction, the bank acts as a

middleman to enforce the rules of the Uniform Customs and Practice 500 to both the exporter and the importer. Both must operate their business according to the 49 articles of the Uniform Customs and Practice. 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).

According to Zodl, the buyer will reject the payment if there is any discrepancy in the documents (Zodl, 2002, p. 62). Czinkota stated a firm must deal with numerous forms and documents when exporting to ensure that all goods meet local and foreign laws and regulations. He recommended that to ensure that all documentation required is accurately completed and to minimize potential problems, firms just entering the international market should consider using freight forwarders who specialize in handling exportation documents (Czinkota, 2004). On other hand, Daniel J. and Radebaugh, (2004) 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. Based on the Uniform Customs and Practice 400. Daniels and Ruggiero (2004) stated discrepancies in bills of exchange (draft), commercial invoices, insurance documents, and transport documents that caused problems in collection of payments for exporters. Practically, the exporter must present the documents required by the terms and conditions of the letter of credit without any discrepancies, otherwise the exporter will not get paid. Guillermo Jimenez of the International Chamber of Commerce, an expert on international commercial practices, confirmed that the bank issues a documentary credit in favor of the exporter under which the bank agrees to pay the beneficiary, provided that the beneficiary presents documents that conform to the terms and conditions of the credit. Practically, the exporter must present the documents required by the terms and conditions of the letter of credit without any discrepancies, otherwise the exporter will not get paid. Discrepancies are documents or parts of documents that do not exactly conform to terms and conditions of letters of credit.

Moon conducted a research and found that the international institutions designed to facilitate trade. His research confirmed international trade is likely to be very successful without national trade policy (Moon, 2000). Weiss found that there are a lot of restrictions on the international trade rules in exporting to foreign country (Weiss, 2002). Nelson also suggested exporters should

check if their products are complying with the government rules and regulations, otherwise, the exporters will face major problems (Nelson, 2000).

DC Insight cited Del Busto and stated that 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. His study confirmed the legal status of the Uniform Customs and Practice affects the international banking community and importing and exporting community worldwide. 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).

Fung remarked 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). 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. When exporters sell their goods, they expect payments. It is very important for exporters to select the proper payment in international trade.

Sut Sakchutchawan (2009) addressed the phenomenon of document discrepancies in international trade financing as a significant worldwide issue resulting in unnecessary delays, refused payments, and financial loss when banks discover discrepancies in required trade finance documents presented under the International Chamber of Commerce trade rules known as Uniform Customs and Practice. While this problem has grown in the past thirty years, no research has been undertaken to address this problem. Drawing on e-research, documentary survey, and descriptive research methodologies, the findings reveal that the unusual requirements of documentary credit and the ambiguity of the Uniform Customs and Practice 500 caused discrepancies when the required documents examined by the banks. To solve these problems, this article recommended changes include elimination of unusual requirements of documentary credit and concise articulation of the context of each article to facilitate easy understanding of contractual terms. Additionally, the personnel involved in the process must be trained to ensure they have the required skills to properly manage relevant documents for international trade financing. More companies are also looking for sources of supply to buy products. They do this

to reduce their cost. International trade or business comprises a large and growing portion of the world's total business. Today, almost all companies-large or small-are affected by global trade and international competition. Additionally, many exporters have run into various problems. Common problems are a failure to present proper trade documents for payment, a failure to produce goods and services offering to the needs of foreign countries, and a failure in collecting payment and financing.

Independent Variables

- Formation place: Generally, a contract is concluded where acceptance of an offer becomes effective, but since national laws have different approaches to determine such a place, different places can be nominated as the place of formation of the contract depending on the rules of the applicable national law.
- Place of payment: the place of the payment is deemed to have a strong connection in determining the governing law of the contract. In a L/C, payments are made differently in the course of the transaction, e.g. by correspondent bank or the issuing bank.
- Language and currency: the language and currency used in the contract are important factors which indicate the choice of law in certain situations.
- Documentary condition - the phenomenon of document free from discrepancies in international trade financing as a significant worldwide issue resulting in unnecessary delays, refused payments, and financial loss when banks discover discrepancies in required trade finance documents presented under the International Chamber of Commerce trade rules known as Uniform Customs and Practice.

Dependent Variables –Letter of Credit Effectiveness

Effectiveness is the ability of an organization to account successfully for its output and operations to its various internal and external constituencies. Effectiveness can also be defined as the achievement of goals and objectives of an activity through the factor measures provided (Ditternhofer, 2001). On other hand, managerial effectiveness as emphasized by many writers like Meharg (2009) and Bhardwaji & Punia (2013), is the achievement of set goal of an organization. Perception is an important aspect of human behavior. Leaders and managers being human beings can significantly be influenced by their perception about leadership and managerial issues such as managerial effectiveness.

Effectiveness also used against the efficiency. Efficiency means the resources that consumed for producing goods or delivering services. Another meaning of efficiency is that associated with performing activities as well as possible or „doing things right“. But sometimes efficiency doesn't result to success. It may be possible that organization present high efficiency but couldn't gain their objectives. Effectiveness can also be concerned with planning and controlling the three key variables associated with projects which are **time, cost, and quality**. They are interrelated; a change in any single variable frequently has a significant impact on the others (Daft, 2003).

Trade finance is considered critical to lowering trade frictions, and 80 to 90 per cent of trade transactions involve some form of trade finance, whether as trade credit, insurance, or guarantees (Auboin 2009). The wide array of financial arrangements and instruments can be divided according to purpose in either securing and facilitated a trade transaction or in using a transaction as collateral to access credit. As securing a trade transaction, when formalizing a purchase order, the buyer and seller utilize a bank or another trade finance entity as a third party in either serving as a basic financial intermediary or as a guarantor of payment. The former refers to an “open account” setup, while the latter refers to an arrangement involving “letters of credit” (L/Cs). Letters of Guarantee serve to cap potential losses in the case of non-performance from either party. Furthermore, credit insurance can be purchased to protect against a variety of transportation, exchange rate, and political risks (Hurtrez and Salvadori 2010). Fundamentally, 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.

- 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
- As instrument in international trade, letters of credit protect both seller and buyer while they are engaged in the import and export business. In this transaction, the bank acts as a middleman to enforce the rules of the Uniform Customs and Practice 500 to both the exporter and the importer.

2.6 Conceptual Framework

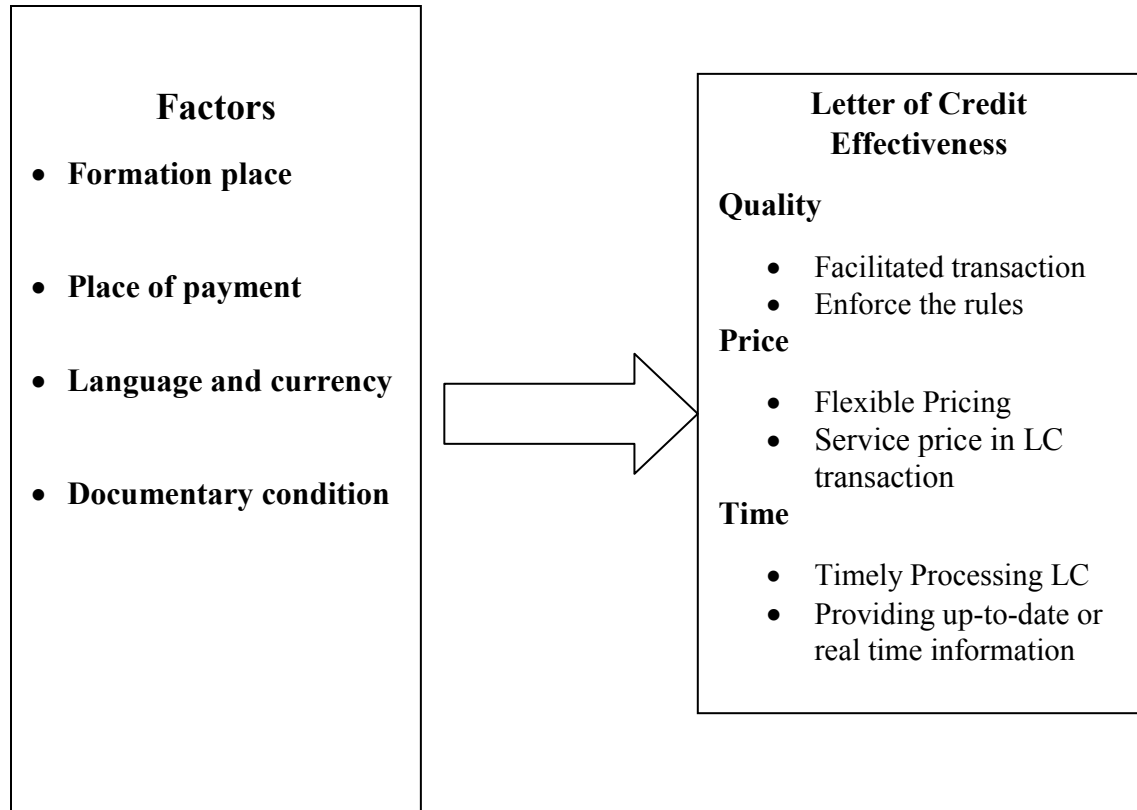


Figure 2.1: Conceptual framework adapted from Sakchutchawan study (2009)

Chapter Three - Research Methodology

3.1 Introduction

This chapter presents details of the research design and methodology of this study. This includes the research design, sample size and sampling technique, data source and collection method questionnaire and validity and reliability test. It also includes the method of data analysis with model formulation.

3.2 Research Approach

Qualitative research is less formalized than quantitative research. Central in qualitative research is to reach a deeper and more complete understanding of the data collected and the problem studied. Several variables are investigated from a few numbers of entities (John, 2007). As qualitative approach, this study tried to examine to gain a deeper understanding and knowledge of letter of credit and its effect on international trade success.

Quantitative research is formalized and structured. It treats the research problem in a broad perspective and aims to make generalizations. The results from quantitative research are assumed to be measurable and presentable in figures. Quantitative research is very much controlled by the researcher and statistical methods have a central role in the analysis of quantitative information. In a quantitative approach, few variables are studied but on a large number of entities (Cresswell, 2009). Thus, as quantitative approach, this study empirically investigated or tested the letter of credit effectiveness by employing statistically test. It also tested the relationship between effective factors that facilitate effect on international trade achievement. In general, this research used both qualitative and quantitative researches and can be said that it will employ mixed research approach.

3.3 Research Design

The purpose of academic research can be exploratory, descriptive, or explanatory. Exploratory studies aim for basic knowledge within the problem area. Descriptive research is appropriate when a problem is clearly structured but the intention is not to conduct research about connections between causes and symptoms. Explanatory research is useful for studying relations between causes and symptoms (Creswell, 2009). Thus, this study properly found out the problem related to formation place, place of payment, language and currency and documentary condition on international trading payment process. As explanatory research, this study examined the

relations between causes and symptoms of letter of credit effectiveness. Accordingly, this study employed descriptive and explanatory research design.

3.5 Population

The target population for this research was trade services and international banking staffs of CBE. The researcher took preliminary survey data about the staff who involve directly in LC processing and import and export trade operation. Accordingly, active participants in the LC management operation were 105 employees. Therefore, due to small size of the target population, a complete numeration of all items in the population or census was used.

3.6 Data Source

In this study, both primary and secondary sources of data were used in the study. Primary data were collected through interview and questionnaire. Accordingly, the basic data sources were trade services and international banking department of CBE and its professional employees and executives. In the same way, other secondary sources of data were collected from LC directives and procedures of national bank, CBE's specific manuals and procedures, import and export transaction files and data base. The operational directive of letter of credit of CBE were referred and checked for more detailed information. This study exhaustively referred international commercial banks practices and International Chamber of Commerce directives.

3.7 Data Type and Measurement

In addition, the two known types of data such as qualitative and quantitative were employed in this study. As qualitative data, numerically non-measurable (interview data) was used. Ordinary data were used in the descriptive analysis of this study and then they were changed to interval data for the correlation and regression analysis. This was done as the respondents were inquired to provide information relating to the subject matter of the study along with comprehensive and understandable questions. As a result, the questionnaire was organized (in ordinary scale) a scale that was prepared (like, 5 = outstanding, 4 = excellent, 3 = good, 2 = average, and 1 = poor) for all the input (factor) variables and then changed to interval data to conduct an analysis to evolve the output variables letter of credit effectiveness.

3.8 Data Collection Method

As John (2007) indicates, there are many research techniques and there are many methods of data collection. In this study, quantitative data were collected by a questionnaire. The

questionnaire was adapted from Sakchutchawan study (2009) and each question was prepared based on the literature review on the research objective then all the question will be tested by logistics and Letter of credit experts of pre-testing technique. The questionnaire had two main parts. The first part of the questionnaire focused on the demographic of the respondents and the second part of the questionnaire emphasized the main parts of the research objective.

In addition, this study used interview to collect qualitative data relevant for the purpose of the study. To effect this, a check list was prepared that will contain informative questions that are focus on the problem that will be associated with letter of credit effectiveness. As qualitative data, it focused on to understand in-depth on the existing international trade and payment practices. In this regard, a face-to-face interview was conducted with ten interviewees. It allowed a mass of information to be collected but as it is very time-consuming and it is assumed to reduce sample sizes tend to be only ten.

3.9 Data Analysis

The data which were collected from questionnaire were coded on Statistical Package Social science (SPSS) program. Frequency, percentage, mean, standard deviation and graphic representation were applied on descriptive data analysis part. Furthermore, by using correlation analysis the interdependence between the independent and dependent variables were tested. Finally, hypothesis tests were performed using regression analysis.

Model specification

The statistical regression model of the study was based on the theoretical regression model as indicated follows

$$Y = a + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4 + e$$

Where:

- Y= Letter of Credit Effectiveness
- a= the y intercept.
- x_1 = Formation place
- b_1 = the regression coefficient of Formation place
- x_2 = Place of payment.
- b_2 = the regression coefficient of Place of payment.
- x_3 = Language and currency

- b_3 = the regression coefficient of Language and currency
- x_4 = Documentary condition
- b_4 = the regression coefficient of Documentary condition
- e = error term.

3.10 Reliability

This study used Chronbach's alpha to assess the internal consistency of variables in the research instrument. Chronbach's alpha is a coefficient of reliability used to measure the internal consistency of the scale. According to ZikmundEtl (2010), scale with coefficient alpha between 0.6 and 0.7 indicate fair reliability so for this study a Chronbach's alpha score of 0.70 or higher is consider adequate to determine reliability.

3.11 Validity

Validity is the extent to which difference found with measuring instrument reflecting true differences among those being tested. In order to ensure the quality of the research design content and construct validity of the research was checked. Construct validity establishing correct operational measures for the concepts being studied (John, 2007). The literature review will be conducted and thoroughly examined to make sure that the content of measuring is relevant to the study. Experts' opinions were taken.

3.12 Ethical Consideration

In this study, approval for this study was formally obtained from Addis Ababa University School of commerce. And formal consent was obtained from each participant/sampling unit before data collection was commenced. The researcher protected the rights of the respondent's by ensuring that none of the respondent not named during the research or subsequent thesis. In addition, respondents were selected to participate without obligation. Further, all respondents were properly informed of the reason and purpose of the research; and informed consent was sought from the management of the selected organizations before the commencement of this research initiative.

Chapter Four – Analysis and Discussion

4.1 Respondents’ Profile and Response Proportions

Every research study should include demographic data to provide information about the sample. One of the first crucial decisions made in social science research is who the study references. Using descriptive statistics, a study should include items such as gender, age, social economic status, ethnicity, employment status, income, religion, or some other category or identifier. Accordingly, this part mainly dealt with the findings of the study and its analysis. To investigate the factor of LC effectiveness, the respondents’ profile and associated data of the participants presented in this section.

4.1.1 Response rate

Accordingly, the target population for this research was trade services and international banking staffs and active participants in the LC management operation of CBE. During the survey a total of 105 questionnaires that prepared English language were distributed to trade services and international banking staffs and 90 of the distributed questionnaires were returned. So, the analysis was made based on 90 responded questionnaires (response rate was 85.70%). On the other hand, as the first part of the questionnaire consisted of the demographic information of research participants, the following variables about the respondents were summarized and described in the subsequent table and diagram. These variables include age, sex, education level and working experience.

4.1.2 Demographic Characteristics of the Participants

Respondents were requested to indicate their age (in years), sex in terms of male and female, education level as diploma, degree, masters and above holders, working experience in their company (CBE) in years and working experience with LC or International trade in bank system in years. Accordingly, the following information is gathered and presented on the table below.

Table 4.1. Frequency of Participants Based on their Age

Respondent age– Count and Percentage						
		Respondents’ age				Total
		22 -35	35 -45	40 -60	> 60	
Count and Percentage	Count	23	37	26	14	90
	%	26%	41%	29%	4%	100 %

Source: Own survey, 2017

Table 4.1 portrays that among the total number of respondents 23 (26 %) were aged between 22 and 35 and 26 (29%) of the total respondents were between 40 and 60 years old. The majority of the respondents were aged between 35 and 45 years that consisted to 41 % of the total participants of this study. In addition, the ages of the majority participants were ranged from 22 (minimum age) to 60 (maximum age) years with largest age group of 37. Hence, it can be said that most of the participants were active and in proper working age.

Table 4.2 Distribution of Participants by Sex

Sex	N	Percent
Male	54	60%
Female	36	40%
Total	90	100%

Source: Own survey, 2017

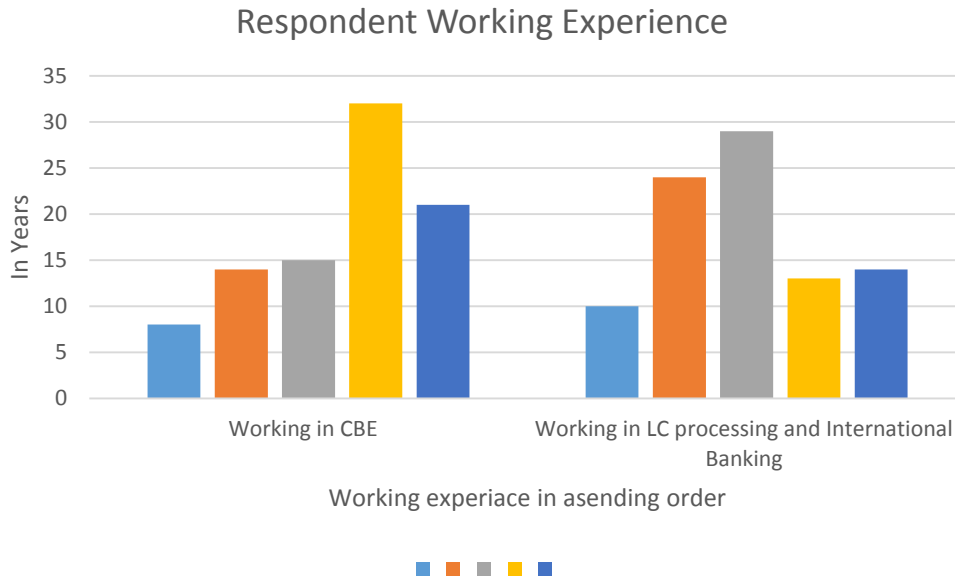
The above table displays the frequency of participants based on their sex. Accordingly, the majority (60%) of the participants of this study was males and the others around 40% are female. In addition, the collected data showed that participants' composition was good but not as expected.

As discussed in method part of the study, the researcher used various variables to know more about the participants based their sex, age and working experience. In order to gain sufficient data pertaining to this study, the targeted employees were requested their working experience working in CBE as a whole and in LC processing section in specific. The following table presents a pertinent data about the respondents' experience in banking sector and the subject matter.

Table 4.3. Frequency of Participants Based on their work experience

Respondent Working Experience – Count and Percentage							
		In Years					Total
		Below 5	5-10	11-15	15- 20	> 20	
Working in CBE	Count	8	14	15	32	21	90
	%	9%	16%	17%	36%	23%	100%
Working in LC processing and International Banking	Count	10	24	29	13	14	90
	%	11%	27%	32%	14%	16%	100%

Source: Own survey, 2017



Source: Own survey, 2017

Figure 4.1: Participants Working Experience Graphical View

Accordingly, most of the participants, 32 (36%), have worked 15 to 20 years in the CBE and the second majority category 21(23%) is found in age more than 20. The fewer respondents 8(9%) indicated they have worked in CBE below five years. The majority of the participants 29(32 %) of this study indicated that they have worked 11 to 15 years in LC processing and international banking. As the data indicate, most participants (73%) having worked in the LC processing for 5 to 20 years and less respondents below 5 years. In regard to this, the targeted employees have pertinent and capacitated employees to include in this study.

4.2 Normality Test

In social science study, numerous business statistics authors indicate that Kurtosis with higher kurtosis means more of the variance is due to infrequent extreme deviations, as opposed to frequent modestly-sized deviations. Similarly, Skewness with its type of distribution like positive skew as the right tail is longer; the mass of the distribution is concentrated on the left of the figure. The distribution is said to be right-skewed. Negative skew as the left tail is longer; the mass of the distribution is concentrated on the right of the figure. The distribution is said to be left-skewed.

Table 4.4 The Normality Test

Dimensions	Skewness		Kurtosis	
	Statistic	Std. Error	Statistic	Std. Error
Formation place	-0.238	0.134	0.091	0.268
Place of payment	-0.047	0.134	0.466	0.268
Language and currency	-0.193	0.134	0.261	0.268
Documentary condition	0.224	0.134	0.264	0.268
LC Effectiveness	0.203	0.134	0.2608	0.268
Valid N (list wise)				

Source: Own survey, 2017

As the above table presented the descriptive statistic, Kurtosis and Skewness statics calculation demonstrates that the distribution is normal because Kurtosis and Skewness are in between -2 and +2, thus data is normally distributed and had a reasonable variance to use subsequent analysis (John, 2007). The detailed descriptive statistics about each variable will be discussed in the next paragraphs.

4.3 Reliability Test

Chronbach's alpha is mostly used and it is a coefficient of reliability used to measure the internal consistency of the scale in reliability test. This study selected this known statistical test to assess the internal consistency of variables. According to Zikmund Etlá (2010), scale with coefficient alpha between 0.6 and 0.7 indicate fair reliability so for this study a Chronbach's alpha score of 0.70 or higher is consider adequate to determine reliability.

Table 4.5 Reliability Test by Dimension

Dimensions	Cronbach's Alpha	N of Items
Formation place	.878	4
Place of payment	.951	4
Language and currency	.766	3
Documentary condition	.861	3
LC Effectiveness	.842	7
Overall test	.751	21

Source: Own survey, 2017

Table 4.5 presented the result of the reliability scale test of this study. This table showed the reliability test based on each dimension and the overall reliability test. In this study, it was found that each dimension scale had a coefficient alpha more than 0.75. It shows a strong reliability and considered as adequate to determine reliability. Based on this the researcher conducted a test to measure the internal consistency and make modification based on the test and the result showed Cronbach's alpha for 21 items is 0.751 that is excellent and the items are internally consistent.

4.4 Discrepancy Documents Analysis

This research was conducted during the months July through December of, 2016 annual report .The discrepancy documents analysis was conducted by visiting various import and export documents and related transaction payment documents to collect data about discrepancies LC documents. Any sources that related to discrepancies of export and import documents were examined and analyzed. LC procedures and related international payment documents were also surveyed at trade services and international banking to ensure the validity and accuracy of the research. From this research, 50 documents that contained discrepancies in the export and import letters of credit were found. These documents were selected based on the discrepancies and do not comply with terms and conditions of letter of credit, do not comply with the ambiguity of context of the Uniform Customs and Practice and discrepancy of trade finance documents originated from clerical errors.

Table 4.6: Percentages of Characteristics of Discrepancies

Types 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, etc.	35
Uniform Customs and Practice	Transport documents differ, late presentation, Insurance certificate differs, Condition of insurance differs, Name of carrier omitted, etc.	53
Others	Clerical errors	12

Source: Own survey, 2017

The data identified the problem directly involved with import and export documents; the data show the character, nature, and behavior of discrepancies that the study was looking for. These data were analyzed to determine what caused the discrepancies that were posted in Table 4.6. After recognizing a problem or identifying a problem, it is absolutely important to provide a diagnostic solution to remedy the situation. Thus, Table 4.6 was composed by three main criteria to show the characteristics of discrepancies. The three types of discrepancies were consolidated into the above table as excessive requirements of LC, Uniform Customs practice and other clerical errors. It was created in order to be able to understand and identify the results data collected as the secondary data analysis. This table displays 35% of trade documents (export and import documents) contain discrepancies and do not comply with terms and conditions of letter of credit. This Table also displays 53% of documents (export and import documents) contain discrepancies and do not comply with the ambiguity of context of the Uniform Customs and Practice 600. Lastly, it displays only 12 % of discrepancy of trade finance documents originated from clerical errors. The details of the three type of document discrepancy were further analyzed as follows.

4.4.1 Excessive Requirements of Letter of Credit

This is the first type of LC document discrepancy. It also shows the frequency of occurrence of each discrepancy. There was recurrently occurrence of discrepancy on that the customers failed to provide the merchandise description exactly as required by the terms and conditions of the letter of credit. Consignee and notify party are the parts with the greatest discrepancy from the requirement of the letter of credit, occurring in most instances. Only some instances of the copy certificate of free trade were not presented for payment.

4.4.2 Uniform Customs and Practice

This is the main discrepancy creator and it shows various reasons such as Letter of credit expired or failed, late presentation, letter of credit overdrawn, L/C transferred without authorization, invoice not signed and others of the discrepancies found and represent 53% of total data collected. From my analysis, the required documents were presented for payment; however, they were not complied with Uniform Customs and Practice 600. Specifically, the table shows that exporters could not prepare the required documents in compliance with articles 16 of the Uniform Customs and Practice 600.

Table 4.7b Most Rated Repeatedly Occurrence of Discrepancies

Discrepancies of Documents	Always	Sometimes	Rarely	Never	No Response
Transport document omits name of the carrier	68%	19%	7%	5%	1%
Transport document omits capacity of signer	70%	16%	12%	1%	1%
Transport document omit on board date/flight date	72%	9%	16%	3%	0%

Source: Own survey, 2017

Table 4.8b Average Occurrence of Discrepancies

Discrepancies of Documents	Always	Sometimes	Rarely	Never	No Response
Letter of credit expired	49%	25%	12%	11%	3%
Late presentation documents	51%	23%	12%	4%	10%
Letter of credit overdrawn	48%	12%	20%	10%	10%
L/C transferred without authorization Partial shipment	47%	5%	19%	15%	14%

Source: Own survey, 2017

Table 4.9 Rarely Occurrence of Discrepancies

Discrepancies of Documents	Always	Sometimes	Rarely	Never	No Response
Invoice not signed	12%	15%	40%	14%	19%
Charter party bill of lading	8%	12%	42%	36%	2%
Goods shipped on deck	25%	15%	47%	11%	2%
Insurance risk not covered as specified	18%	30%	39%	12%	1%
Under-insured	8%	12%	21%	35%	24%
Documents inconsistent with each other	5%	10%	34%	35%	16%
Freight prepaid omits on bill of lading on CFR condition	11%	22%	45%	13%	9%
Insurance dated after the shipment date	28%	14%	45%	11%	2%
Copy insurance certificate presented instead of an original one	26%	7%	50%	16%	1%
Insurance certificate had different currency	7%	13%	35%	21%	24%
Multi-modal transport	10%	15%	49%	5%	21%

Source: Own survey, 2017

The above three tables showed the occurrence of discrepancy and the data were organized by employees' responses. The respondents were requested to rate the occurrence of discrepancies of documents that do not comply with uniform customs and practice document in terms of the various factors. This is because there are major issues on the strict Uniform Customs and Practice and Terms and conditions of documentary credit. Traders specifically importers and exporter often face voluminous paper work, complex formalities, and many possible delays and errors.

Table 4.7, 4.8 and 4.9 showed 19 characteristics of the discrepancies found and represent the employees' perception in case of CBE's LC processing. From this analysis, the required documents were presented for payment; however, they were not complied with Uniform Customs and Practice in most cases. Specifically, table 4.7 shows that customers could not prepare the required documents in compliance with the Uniform Customs and Practice. The table indicates that there is repeatedly occurrence of discrepancies such as transport documents omits name of the carrier, transport documents omit capacity of signer, and transport documents omits on board date or flight date.

Table 4.8 also shows the average frequency of occurrence of discrepancy that involved on LC expired, late presentation of LC, overdrawn LC and transferred without authorization of partial shipment of LCs. According to this study, the customers did not present the documents for payment on time that result has impact on the letter of credit to expire. This is a serious situation for the customers because the customers especially exporter will not get paid until the buyer agrees to accept the discrepant documents. Another serious situation was the transport document-omitting name of the carrier and the transport document omitting the capacity of the signer. Further, Table 4.9 presents rarely occurrence of discrepancies. These are invoice not signed, charter party bill of lading, goods shipped on deck. Insurance risk not covered as specified, under-insured, documents inconsistent with each other, freight prepaid omits on bill of lading on CFR condition, insurance dated after the shipment date, copy insurance certificate presented instead of an original one and insurance certificate had different currency.

According to the literature review, United Nations had calculated that the time involved in preparing documentations, along with the costs of common errors in paperwork, often amounts to 10 percent of the value of goods export (Hill, 2005). This can be an extreme source of frustration to both sellers and buyers in finding solutions for payment and finance process. It is

not easy to provide a persuasive explanation of that problem. This problem is growing and seems to be unstoppable in commercial trade.

It is a remind that 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). 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). 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).

4.4.3 Others Discrepancy – Clerical Errors

It represents 12% of total data collected as of Table 4.6 that showed percentages of characteristics of discrepancies. They are clerical errors of exporter and importers in preparation documents for payment or for letter of credit. The discrepancies occurred because of human oversight and human carelessness. The typist can type incorrectly if the person is not detail oriented. Some documentary preparers might not be skilled enough to handle import and export documents because of the specific requirement of the letter of credit. Lastly, the person who handles the import and export documents may lack knowledge of shipping terms, pricing, etc. The common mistakes made by the importers and the exporters were spelling and typing errors.

4.5 Descriptive Analysis

In this part of the study, it is tried to analyze primary data that was collected from 90 participants. Descriptive statistics is the branch of statistics which gathers all techniques used to describe and summarize quantitative and qualitative data.

4.5.1 Formation place

Respondents were asked to rate the formation place as LC effective factor by applying national law on the process of LC when a contract is concluded where acceptance of an offer becomes effective. They also rated as an offer in CBE's letters of credit in general, takes the form of an instruction properly, with respect to an acceptance, in CBE practice, the offeree often communicates to the offeror to give notice of acceptance and the practice of CBE causes legal

complexity in contract formation context even under the rule which views a contract as concluded at the place where an acceptance is dispatched.

Table 4.10 Row Percentage Distribution of Formation Place Question Responses

Items	Level of Your Agreement					Mean	St Dev
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree		
Applying national law on the process of LC.	28.9%	46.7%	12.2%	12.2%	0.0%	1.905	.951
Taking the form of an instruction properly	28.9%	45.6%	15.6%	8.9%	1.1%	1.905	.951
Communication	25.6%	48.9%	12.2%	12.2%	1.1%	1.965	.978
Legal complexity in contract formation	27.8%	47.8%	8.9%	12.2%	3.3%	1.985	1.070
Formation Place	Grand Mean 1.94						

Source: Own survey, 2017

Thus, Table 4.10 portrays row percentage distribution of formation place variable indicative responses. In regard to the national law of LC process, the above table indicates that 46.7% of respondents preferred the category of disagree and 28.9% respondents preferred the category of strongly disagree. With the factor of formation placement instruction, 28.9% of the respondents rated the category of strongly disagree and 45.6% rated the category of disagree. In addition, most respondents (48.9%) preferred the category of disagree and 25.6% respondents preferred the category of strongly disagree as they assured that the offeree often communicates to the offeror by telex, facsimile or other expedient means to give notice of acceptance. Further, this study found that most respondents (47.8%) chosen the category of disagree and 27.8% respondents preferred the category of strongly disagree as ensured how the legal complexity in contract formation in LC process.

The grand mean for this factor was rated as fair as it has 1.94 mean score. It is interpreted as a contract is concluded where acceptance of an offer becomes effective, but since national laws have different approaches to determine such a place, different places can be nominated as the place of formation of the contract depending on the rules of the applicable national law. It shows they agreed as in LC processing the application of national law is very complex. The interpretation was made based on the following measurement scale intervals or range. Mean scores 4.51-5.00 excellent or very good, 3.51-4.50 good, 2.51-3.50 average or moderate, 1.51-2.50 fair and 1.00-1.50 is poor (Francisco M. Ebio, 2016).

4.5.2 Place of the Payment

Respondents of this study were requested to rate the place of the payment that is deemed to have a strong connection in determining the governing law of the contract.

Table 4.11 Row Percentage Distribution of Place of the Payment Question Responses

Items	Level of Your Agreement					Mean in level	St Dev
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree		
Payments properly transacted	28.9%	46.7%	12.2%	12.2%	0.0%	1.905	.460
Making reimbursement effectively	28.9%	45.6%	15.6%	8.9%	1.1%	1.835	.732
Effectively processing reimbursement of the issuing bank by the applicant	25.6%	48.9%	12.2%	12.2%	1.1%	1.835	.816
Providing secure payment method to as the essence of instruments	27.8%	47.8%	8.9%	12.2%	3.3%	1.985	.535
Place of Payment	Grand Mean 1.89						

Source: Own survey, 2017

The above table indicates that most respondents (46.7%) preferred the category of disagree and 28.9% respondents preferred the category of strongly disagree as payments not properly transacted as expected. In the next factor, the study found that 28.9% of the respondents strongly disagreed and 45.6% disagreed as making reimbursement ineffectively. In addition, most respondents (48.9%) preferred the category of disagree and 25.6% respondents preferred the category of strongly disagree and indicated that ineffectively processing reimbursement of the issuing bank by the applicant. Further, this study found that most respondents (47.8%) chosen the category of disagree and 27.8% respondents preferred the category of strongly disagree as provided unsecured payment method to as the essence of instruments.

The grand mean was rated as reasonable as it has 1.89 mean score for place of payment factor. The place of the payment is deemed to have a strong connection in determining the governing law of the contract. In a L/C, payments are made differently in the course of the transaction, e.g. by correspondent bank or the issuing bank. It is difficult to consider that effectively processing reimbursement of the issuing bank by the applicant can exist in CBE LC processing. In passing, the interpretation was made based on the following measurement scale intervals or range of Francisco M. Ebio (2016).

4.5.3 Application of Language and currency

Respondents of this study were requested to rate the application of Language and currency. The language and currency used in the contract are important factors which indicate the choice of law in certain situations.

Table 4.12 Row Percentage Distribution of Language and currency Question Responses

Items	Level of Your Agreement					Mean in level	St Dev
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree		
Considering language and currency as significant factors	3.3%	10.0%	13.3%	43.3%	30.0%	3.87	1.062
Terms and conditions of credits and guarantees	4.4%	11.1%	22.2%	42.2%	20.0%	3.62	1.066
Payable in an internationally accepted language	1.1%	11.1%	28.9%	34.4%	24.4%	3.70	.999
Application of Language and currency	Grand Mean 3.73						

Source: Own survey, 2017

The above table portrays that most respondents (43.3%) preferred the category of agree and 30.0% respondents preferred the category of strongly agree considered language and currency as significant factors. In the next factor, the study found that 20.0% of the respondents strongly agreed and 42.2.0% selected the category of agree. They assured that terms and conditions of credits and guarantees to be drafted in English for formal communication and transaction to LC processing. In addition, most respondents (28.9%) preferred the category of neutral and 34.4% respondents preferred the category of agree. It is showed that it is not usually to use payable in U.S. dollars as English is an internationally accepted language and U.S. dollars are commonly used in international trade.

The grand mean was rated as very good as it has 3.73 mean score for the variable of langue related issues. The interpretation was made based on the following measurement scale intervals or range of Francisco M. Ebio (2016). Overall, the language and currency used in the contract are important factors which indicate the choice of law in certain situations.

4.5.4 Documentary Condition of the LC processing

Respondents of this study were requested to rate documentary condition of the LC processing in CBE in terms of the following factors.

Table 4.13 Row Percentage Distribution of documentary documentation Question Responses

Items	Level of Your Agreement					Mean in level	St Dev
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree		
Using excessive requirements of terms and conditions	7.8%	13.3%	11.1%	47.8%	20.0%	1.99	1.179
Ambiguity of the Uniform Customs and Practice 600	4.4%	13.3%	11.1%	50.0%	21.1%	1.86	1.086
Executing properly to manage the supply chain and quality management	6.7%	12.2%	13.3%	43.3%	24.5%	1.79	1.171
Documentary Documentation	Grand Mean 1.88						

Source: Own survey, 2017

Table 4.13 portrays that most respondents (47.8%) preferred the category of agree and 20.0% respondents preferred the category of strongly agree as indicated that CBE used excessive requirements of terms and conditions. It is found that 50.0% of the respondents agreed and 21.1% selected the category of strongly agree for the next factor. The result assured that there is ambiguity of the Uniform Customs and Practice 600 on CBE processing LC. In addition, most respondents (43.3%) preferred the category of agree and 24.5% respondents preferred the category of strongly agree for the last factor. It is showed that the bank properly manages the supply chain and quality management.

The grand mean was rated as fair as it has 1.88 mean score for this factor. The interpretation was made based on the following measurement scale intervals or range of Francisco M. Ebio (2016). In general, the condition of documentary matters is the very necessary issue in LC processing. The phenomenon of document free from discrepancies in international trade financing as a significant worldwide issue resulting in unnecessary delays, refused payments, and financial loss when banks discover discrepancies in required trade finance documents presented under the International Chamber of Commerce trade rules known as Uniform Customs and Practice.

4.5.5 Letter of credit Effectiveness in CBE

In the part of dependable variable, this variable was composed of three dimensions of quality, time and price. Accordingly, the participants were asked to rate their opinion based on LC effectiveness in terms of quality, price and time.

Table 4.14 Row Percentage Distribution of LC Effectiveness Question Responses

Items	Level of Your Agreement					Mean in level	St Dev
	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree		
Facilitating the export and import transaction by presenting required documents	35.6%	43.3%	14.4%	4.4%	2.2%	1.94	.940
Protecting both seller and buyer	38.9%	41.1%	14.4%	3.3%	2.2%	1.89	.929
Act as a middleman to enforce the rules	43.3%	37.8%	7.8%	10.0%	1.1%	1.88	1.004
Facilitating LC documents and processes timely	40.0%	42.2%	8.9%	7.8%	1.1%	1.88	.946
Providing real time information regarding documents, payments, transaction etc	37.8%	43.3%	11.1%	6.7%	1.1%	1.90	.925
Facilitate the export and import transaction within competitive and flexible price	32.2%	41.1%	14.4%	10.0%	2.2%	2.09	1.035
Requiring a high service price to facilitate the export and import transaction	26.7%	47.8%	13.3%	12.2%	0.0%	2.11	.941
LC Effectiveness	Grand Mean 1.96						

Source: Own survey, 2017

Table 4.14 portrays that 43.3% of the respondents disagreed and 35.6% strongly disagreed the practices of CBE on facilitating the export and import transaction by presenting required documents. With protecting both seller and buyer LC transaction, 41.1% of the respondents selected the category of disagree and 38.9% preferred the category of strongly disagree. In regard to acting as a middleman to enforce the rules, 43.3% of the respondents rated that category of strongly disagree and 37.8% selected the category of disagree. In case of factor called facilitating LC documents and processes timely, 40.0% of the respondents strongly disagreed and 42.2% selected the category of disagree for. Regarding to providing real time information regarding documents, payments, transaction, 37.8% of the respondents strongly disagreed and 43.3% selected the category of disagree. For facilitate the export and import transaction within competitive and flexible price, 32.2% of the respondents strongly disagreed and 41.1% selected the category of disagrees. Finally, 26.7% of the respondents strongly disagreed and 47.8%

selected the category of disagree for requiring a high service price to facilitate the export and import transaction.

The grand mean was rated as fair as it has 1.96 mean score for this factor. The interpretation was made based on the following measurement scale intervals or range of Francisco M. Ebio (2016). In general, 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. But, CBE exerted fewer efforts to facilitation the export and import transaction. That is the sellers is not actively and properly 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. As instrument in international trade, letters of credit protect both seller and buyer while they are engaged in the import and export business. In this transaction, the bank acts as a middleman to enforce the rules of the Uniform Customs and Practice 600 to both the exporter and the importer. In addition, the practice of document transaction is not free from discrepancies in international trade financing. It's resulting in unnecessary delays, refused payments, and financial loss in a majority of LC processing practice. CBE's ability to account successfully for its LC output and operations to its various internal and external traders is less.

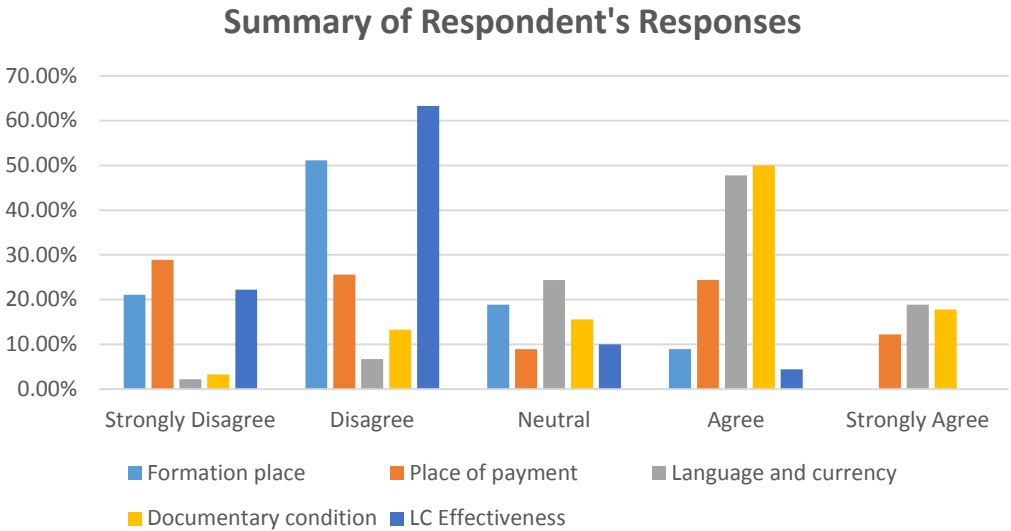
4.5.6 Summary Responses of Factors

This part presents the summary responses of factors as the average responses of four independent variables and one dependent variable as the average of the four dimensions of the LC effectiveness measurement were taken.

Table 4.15 Summary of Question Responses

Average Responses in %	Level of Your Agreement					Mean in level Neutral
	Strongly disagree	Disagree	Neutral	Agree	Strongly Agree	
Formation place	21.1%	51.1%	18.9%	8.9%	0.0%	1.94
Place of payment	28.9%	25.6%	8.9%	24.4%	12.2%	1.89
Language and currency	2.2%	6.7%	24.4%	47.8%	18.9%	1.88
Documentary condition	3.3%	13.3%	15.6%	50.0%	17.8%	1.88
LC Effectiveness	22.2%	63.3%	10.0%	4.4%	0.0%	1.96

Source: Own survey, 2017



Source: Own survey, 2017

Figure 4.2: Summary of Question Responses

From this chart of the averages can be obtained as displayed in Figure 4.2. This part presents the summary responses of factors as the average response of formation place was selected by 51.1% of respondents as disagree. The majority of the respondents (28.9%) preferred as strongly disagree for place of payment. With the factor of documentary condition, almost half of the respondents favored the category of agree. In respect to language and currency, most of the respondents disposed to the group of agree. In regard to LC effectiveness, the summarized data show that the majority of the respondents rated that category of disagree.

4.6 Correlation Analysis

In chapter three, it was indicated as the data which is collect from questionnaire first give code or recording variables on Statistical package social science (SPSS) program and by using correlation analysis the interdependence between the independent and dependent variables would be tested. Accordingly, correlation analysis was used that measures the relationship between two items such as formation place, place of payment, language and currency and documentary condition as independent variables of the component of four factors and LC Effectiveness as dependent variable. The resulting value (called the "correlation coefficient") shows if changes in one item will result in changes in the other item. A pertinent interpretation was given based on this analysis. When comparing the correlation between two items, one item is called the "dependent"

item and the other the "independent" item. The goal is to see if a change in the independent item will result in a change in the dependent item.

Table 4.16 Correlation analysis

		1	2	3	4	5
Formation place (1)	Pearson Correlation	1	.533**	.338**	.497**	.680**
	Sig. (2-tailed)		.000	.001	.000	.000
Place of payment (2)	Pearson Correlation	.533**	1	.274**	.495**	.667**
	Sig. (2-tailed)	.000		.009	.000	.000
Language and currency (3)	Pearson Correlation	.338**	.274**	1	.410**	.728**
	Sig. (2-tailed)	.001	.009		.000	.000
Documentary condition (4)	Pearson Correlation	.497**	.495**	.410**	1	.684**
	Sig. (2-tailed)	.000	.000	.000		.000
LC Effectiveness (5)	Pearson Correlation	.680**	.667**	.728**	.684**	1
	Sig. (2-tailed)	.000	.000	.000	.000	

** . Correlation is significant at the 0.01 level (2-tailed).

Source: own survey, 2017

Table 4.16 shows the result of correlation analysis based on the average value of respondents' response on four independent variables and one dependent variable. According to the above table, the relationship between formation place and LC Effectiveness was statistically significant relationship, $r(90) = .680, p < .01$. As the contract formation is well placed, the likelihood of LC moderately effective in terms of time, quality and price. Similarly, the relationship between place of payment and LC Effectiveness was statistically significant relationship, $r(90) = .667, p < .01$. The descriptive statistics also showed that as the placement of payment is well organized the likelihood of to be LC effectiveness consumption moderately increases. Besides, there was statistically strong relationship between language and currency and LC Effectiveness $r(90) = .728, p < .01$. This indicates that the LC will be effective in terms of time, quality and price with high use of language and currency properly. Finally, the relationship between documentary condition and LC Effectiveness was also tested and there was moderately relationship with statistically significant, $r(90) = .684, p < .01$. This indicates that LC effectiveness will be determined by the appropriately handling documentary conditions.

Table 4.17 Correlation analysis based on quality, time and price

		1	2	3	4	5	6	7
Formation place (1)	Correlation	1	.533**	.338**	.497**	.807**	.575**	.333**
	Sig. @		.000	.001	.000	.000	.000	.001
Place of payment (2)	Correlation	.533**	1	.274**	.495**	.776**	.527**	.377**
	Sig.	.000		.009	.000	.000	.000	.000
Language and currency (3)	Pearson Correlation	.338**	.274**	1	.410**	.717**	.600**	.550**
	Sig.	.001	.009		.000	.000	.000	.000
Documentary condition (4)	Pearson Correlation	.497**	.495**	.410**	1	.609**	.847**	.346**
	Sig.	.000	.000	.000		.000	.000	.001
LC Effectiveness Quality (5)	Pearson Correlation	.807**	.776**	.717**	.609**	1	.742**	.553**
	Sig.	.000	.000	.000	.000		.000	.000
LC Effectiveness Time (6)	Pearson Correlation	.575**	.527**	.600**	.847**	.742**	1	.564**
	Sig.	.000	.000	.000	.000	.000		.000
LC Effectiveness Price (7)	Pearson Correlation	.333**	.377**	.550**	.346**	.553**	.564**	1
	Sig.	.001	.000	.000	.001	.000	.000	

** . Correlation is significant at the 0.01 level (2-tailed) and @Sig. (2-tailed)

Source: Own survey, 2017

Table 4.17 shows the correlation test of the four independent variables analysis with LC effectiveness in terms of quality, time and price. According to the above table, there were a positive relation between relationship between formation place and LC Effectiveness in terms quality, time and price as $r(90) = .807, 0.575$ and 0.333 $p < .01$ respectively. Similarly, the relationship between place of payment and LC Effectiveness in terms quality, time and price were positive and statistically significant relationship as $r(90) = .776, 0.527$ and 0.377 , $p < .01$ respectively. In addition, there were positive and statistically relationship between language and currency and LC Effectiveness in terms quality, time and price as $r(90) = .717, 0.600$ and 0.550 , $p < .01$ respectively. Lastly, the relationship between documentary condition and LC Effectiveness in terms quality, time and price were tested and there were positive and statistically significant relationship as $r(90) = 0.609, 0.847$ and 0.346 $p < .01$ respectively.

The above tables were analyzed based on The Pearson's Product Moment Correlation Coefficient (r) as it is a measure of the degree of association between variables. It takes a value between -1 and 1. A value of r near to 1 indicates strong positive association, where as a value of

r near to -1 indicates a strong negative linear association, when $r = \pm 1$ this indicates that the two variables are perfectly correlated, i.e., all the points are on a straight line (John et al, 2007).

4.7 Regression Analysis

The data which is collect from questionnaire first give code or recording variables on Statistical package social science (SPSS) program. In this study, it is attempted to test that was performed using regression analysis based on model specification. The statistical regression model of the study was based on the theoretical regression model as indicated in chapter three.

Table 4.18 Multiple Regression Test Results

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.928 ^a	.862	.855	.262

a. Predictors: (Constant), formation place, place of payment, language and currency and documentary condition

ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	36.392	4	9.098	132.466	.000 ^b
	Residual	5.838	85	.069		
	Total	42.230	89			

a. Dependent Variable: LC Effectiveness

b. Predictors: (Constant), formation place, place of payment, language and currency and documentary condition

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.275	.079		3.502	.001
	Formation place	.188	.037	.256	5.045	.00010
	Place of payment	.217	.037	.293	5.831	.00005
	Language and currency	.324	.031	.472	10.513	.00002
	Documentary condition	.158	.037	.218	4.274	.00003

a. Dependent Variable: LC Effectiveness

Source: own survey, 2017

$$Y = 0.275 + 0.188x_1 + 0.217x_2 + 0.324x_3 + 0.158x_4 + e$$

Where:

- Y= Letter of Credit Effectiveness
- a= the y intercept.
- x_1 = Formation place
- b_1 = the regression coefficient of Formation place
- x_2 = Place of payment.
- b_2 = the regression coefficient of Place of payment.
- x_3 = Language and currency
- b_3 = the regression coefficient of Language and currency
- x_4 = Documentary condition
- b_4 = the regression coefficient of Documentary condition
- e= error term.

In literature, linear regression estimates the coefficients of the linear equation, involving one or more independent variables that best predict the value of the dependent variable. In this study, the regression analysis was used to four independent variables indicated on the model to measure the LC effectiveness in terms of time, quality and price. The significance level of 0.05 was used with 95% confidence interval. As indicated in the above table the independent variables predict the dependent variable R square = 86.2 % with adjusted R square around 85.5 the remaining less than 14% other extraneous variable that can affect the LC effectiveness. This result also indicates that the four independent variables had an effect on LC effectiveness in terms of time, quality and price.

Table 4.18 the ANOVA test, it is noticed that F value of 132.46 is significant at 0.000 levels. Therefore, from the result, it is concluded that with 86.2% of the variance (R-Square) in the factors of four independent variables are significant effect on the dependent variable and the model adopted appropriately measure the construct. Using the regression result it was showed that formation place (0.00010), place of payment (0.00005), language and currency (0.00002), and documentary condition (0.00003) statistically affects LC effectiveness.

In theoretical principle of the Doctrine of Strict Compliance, the exporter must respect the written terms “to the letter” of the L/C. If any discrepancy or inconstancy occurs between the documents presented by the exporter and what is actually specified in the L/C, the bank can

refuse payment. Therefore, with a L/C, the buyer has the protection of the bank strictly controlling the documents, and the seller has the protection of getting paid if all documents comply with the letter of credit. Hahn (2007) stated that a contract is concluded where acceptance of an offer becomes effective, but since national laws have different approaches to determine such a place, different places can be nominated as the place of formation of the contract depending on the rules of the applicable national law.

Thus, formation place is a determinant factor for LC effectiveness. The same is true for place of payment. It is deemed to have a strong connection in determining the governing law of the contract. In a L/C, payments are made differently in the course of the transaction, e.g. by correspondent bank or the issuing bank. Hahn (2007) stated the language and currency used in the contract are important factors which indicate the choice of law in certain situations. Constructive result was found here that documentary condition affected the LC effectiveness. The phenomenon of document free from discrepancies in international trade financing as a significant worldwide issue resulting in unnecessary delays, refused payments, and financial loss when banks discover discrepancies in required trade finance documents presented under the International Chamber of Commerce trade rules known as Uniform Customs and Practice.

Table 4.19 Multiple Regression Test Results of LC Effectiveness of Quality, Time and Price

Independent Variable	Dependent variable and their sig. value			
	LC Effectiveness	Quality	Time	Price
Formation place	.00010	.00003	.031	.639
Place of payment	.00005	.00002	.252	.005
Language and currency	.00002	.00002	.00001	.0001
Documentary condition	.00003	.875	.00001	.818

Source: own survey, 2017

In this study, further regression analysis was used to observe the individual independent variable effect to measure the LC effectiveness in terms of time, quality and price. The significance level of 0.05 was used with 95% confidence interval. The regression test result showed that the

independent variables predict the dependent variable as indicated as LC effectiveness in terms of time, quality and price. This result also indicates that the four independent variables had an effect on LC effectiveness in terms of time, quality and price.

Using the coefficient table of the regression result, formation place (0.00003), place of payment (0.00005), and language and currency (0.00002), statistically affects LC effectiveness in terms of quality but documentary condition (0.00003) insignificantly affects this dependent variable as $P > 0.05$ (.875). In theoretical and legal aspects of LC, the fact that banks are concerned only with documents and not with goods makes it easier for the dishonest to abuse this system. A fraudster can easily fabricate documents required by the letter of credit, discount them in a bank and then vanish. In another scenario, he can ship containerized, valueless goods instead of contract goods, safe in the knowledge that the goods will arrive after he obtains payment. Even after shipping goods different from contractual quality, he/she can make alterations in necessary shipping documents and demand payment from the bank with these documents. Therefore, a letter of credit will be facilitated or enforced the rules by contract formation place, place of payment, and language and currency but documentary condition will not be the determined factor.

Using the same regression test, formation place (0.031) and place of payment (0.252) had insignificant effect of LC effectiveness in terms of time but language and currency (0.00001) and documentary condition (0.00001) significantly affected this dependent variable as $P < 0.05$. Normally, in accordance with the article of the Uniform Customs and Practices for Documentary Credits, a bank will have a reasonable time, not to exceed seven banking days following receipt of the documents, to examine the documents and determine whether to take up or to refuse the documents and inform the party from which it received the documents accordingly. Therefore, a letter of credit will be timely processed or provided up-to-date or real time information by clearly indicated language and currency and proper documentation.

With the analysis of LC effectiveness in terms of price, formation place (0.639) and documentary condition (0.818) had insignificant effect but place of payment (0.005) and language and currency (0.0001) significantly affect the dependent variable as $P < 0.05$. In international sales, as the seller and the buyer are in different countries, there is a common problem of payment due to the difference of time between dispatch and delivery. Obviously, seller would like to receive payment for the goods when delivering them to the carrier and the buyer would prefer to delay

the payment of the price until receipt of the goods. Therefore, a letter of credit solves this problem between the seller and the buyer in terms of place of payment and language and currency.

4.7.1 Model Testing

Multicollinearity refers to a situation in which there is exact (or nearly exact) linear relation among two or more of the input variables (Uma, 2003). The VIF (Variance Inflation Factor) for each term in the model measures the combined effect of dependence among the regression on the variance of that term. One or more large VIF indicate multicollinearity. Practical experience indicates that if any of the VIF results exceeds 5 or 10, it is an indication that the associated regression coefficients are poorly estimated because of multicollinearity (Uma, 2003). Collinearity Statistics shows that the VIF value of all the factors are less than 5 or 10 and no collinearity is observed on this data. The independent variables that contribute to variance of the dependent variable are explained by standardized Beta coefficient. In multiple regressions, it should have independence of observations, which can be easily checked using the Durbin-Watson statistic. It is a simple test to run using SPSS Statistics. In this study the test indicates that the result of the Durbin-Watson statistic is below 2.

Table 4.20 Summary of Research Questions Results

Research Questions	Sig.	Statistically Significant Level	Correlation Result	Relation Indicator
To what extent formation place affects LC effectiveness?	.00010	Significant	.680	Related
To what extent place of payment affects LC effectiveness?	.00005	Significant	.667	Related
To what extent language and currency affects LC effectiveness?	.00002	Significant	.728	Related
To what extent documentary condition affects LC effectiveness?	.00003	Significant	.684	Related

Source: Own survey result, 2016

Moreover, this study summarizes its results on the above table. Accordingly, Table 4.16 indicates the summary of this study's research questions results. The investigation of the study

employed a correlation relation testing and it showed that formation place, place of payment, language and currency, and documentary condition had a significant relation with LC effectiveness. In the same way, the study found that formation place (0.00010), place of payment (0.00005), language and currency (0.00002), and documentary condition (0.00003) statistically affects LC effectiveness using multivariate analysis. It can be supposed that the four independent variables had an effect on LC effectiveness in terms of time, quality and price.

4.8 Qualitative Data Analysis

It is a remind that this study allowed in-depth qualitative analysis for answering the questions of what the main problems are associated with LC processing in terms of quality, time and price and to identify the main gaps in LC processing and requirements. In addition, according to international trade and finance transactions, this study tried to get answers on the main requirements and shortcomings of letters of credit processing as the most engaged instrument in global trade in Ethiopia context. Moreover, it was requested to indicate the main problems and the key facilitation of the export and import transaction as required by the rules and regulations of letters of credit and on guaranteeing that the seller will get paid. Further, it was asked to indicate the mechanisms that CBE applies and the national law that governs to protect both seller and buyer while they are engaged in the import and export business. It was requested to specify the national law that applied in the processing of LC in Ethiopia and considering how CBE was effective in acting as a middleman to enforce the rules of the Uniform Customs and Practice 600 to both the exporter and the importer.

Accordingly, it is found that the main problems that are associated with LC processing in terms of quality, time and price and identified the main gaps in LC processing and requirements are involved on facilitating the export and import transaction by presenting required documents and CBE has showed deficiency on acting as a middleman to enforce the rules. Besides, CBE employed a lesser arrangement to simplify the export and import transaction. Moreover, this study points the best common problems with Letters of Credit. The interview analysis assured that most problems result from the seller's inability to fulfill obligations stated in the letter of credit. The seller may find these terms difficult to fulfill and, either tries to fulfill them and fails, or asks the buyer to amend to the letter of credit. As most letters of credit are irrevocable, amendments may at times be difficult since both the buyer and the seller must agree. This study

also confirmed that sellers have several problems such as un-meet the shipment schedule, providing the stipulations concerning unacceptable freight costs, having too low price due to exchange rates fluctuations, presenting incompatible quantity of products (the quantity ordered is not the expected amount), and offering unrelated documents. Even when sellers accept the terms of a letter of credit, problems often arise late in the process. When this occurs, the buyer's and seller's banks will try to negotiate any differences. In some cases, the seller can correct the documents and present them within the time specified in the letter of credit. If the documents cannot be corrected, the advising bank will ask the issuing bank to accept the documents despite the discrepancies found. It is important to note that, if the documents are not in accordance with the specifications of the letter of credit, the buyer's issuing bank is no longer obligated to pay.

As of international trade and finance transactions, letters of credit are the most engaged instrument in global trade. However, it was found that there are several problems related to doing business agreement in global business practices by Ethiopian traders. Even if Letters of credit are the instrument of both export and import business, a lot of problems are created on requesting of one party for a transaction that involving goods or services when the other party is on the other side of the world. The main challenge is rotated on the key facilitation of the export and import transaction. That is on shipping the goods by seller and presenting the documents to the bank as required by the rules and regulations of letters of credit with guaranteeing that the seller will get paid. As saying letters of credit are the most important instrument in international trade, it cannot fully protect both seller and buyer while they are engaged in the import and export business. In this transaction, the bank expected to act as a middleman to enforce the rules of the Uniform Customs and Practice 600 to both the exporter and the importer. This study assured that international trade transactions are complicated by the seller's fears regarding the difficulty of collecting funds from a foreign buyer. Consequently, the sellers unsuccessfully pushed to facilitate the payment process without properly handover the required documents.

4.9 Consistency with Others Studies

According to the Doctrine of Strict Compliance, the exporter must respect the written terms “to the letter” of the L/C. If any discrepancy or inconstancy occurs between the documents presented by the exporter and what is actually specified in the L/C, the bank can refuse payment. Therefore,

with a L/C, the buyer has the protection of the bank strictly controlling the documents, and the seller has the protection of getting paid if all documents comply with the letter of credit.

In view of that, the results of this study are related with the argument of Hahn (2007) study. According to him, as of formation place, a contract is concluded where acceptance of an offer becomes effective, but since national laws have different approaches to determine such a place, different places can be nominated as the place of formation of the contract depending on the rules of the applicable national law. The same principle applied to place of payment as it is deemed to have a strong connection in determining the governing law of the contract. Also, he indicated the language and currency used in the contract are important factors which indicate the choice of law in certain situations.

This study also assured as specified by Atefe et al., (2016). They described the Commercial and Standby Letters of Credit as CLCs have been used for centuries to facilitate payment in international trade. It is a contractual agreement between banks, known as the issuing bank, on behalf of one of its customers, authorizing another bank, known as the advising or confirming bank, to make payment to the beneficiary.

Baker (2003) properly opposed as in its international trade practice as the beneficiary generally does not deal directly with the issuing bank. The issuing bank regularly arranges for a bank in the beneficiary's country to advise the credit, i.e., to check the authenticity of the credit and hereafter deliver it to the beneficiary. Zhou (2002) included as the bank that advises the letter of credit to the beneficiary is referred to as the „advising bank“ and the bank to which the beneficiary is to present the complying documents is referred to as the „nominated bank“. The advising bank acts as an agent of the issuing bank. Atefe Ghasemi et al., (2016) sought to investigate which kind of guarantee (commercial L/C or standby L/C) they prefer to secure the performance of their client's obligations. Studied companies were 20 international trading companies in Tehran, from which 50 experts were participated in the survey study. Data showed that being a guarantee; integration, documentary conditions, and secondary payment mechanism are four important reasons for international trading companies in Iran to use letters of credit in their contracts. A statistical result showed that “being a guaranteed credit” is the most important factor with a mean of 3.660 ± 1.135 . As well, they found significant relationship between these four factors and the L/C usage policy ($p < 0.01$, and $p < 0.05$). And they concluded that they mostly prefer standby letters of credit for securing their transactions Neipert (2000) 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 Czinkota (2004) recommended that to ensure that all documentation required is accurately completed and to minimize potential problems, firms just entering the international market should consider using freight forwarders who specialize in handling exportation documents. On other hand, Daniel J. and Radebaugh, (2004) 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. Sakchutchawan (2009) addressed the phenomenon of document discrepancies in international trade financing as a significant worldwide issue resulting in unnecessary delays, refused payments, and financial loss when banks discover discrepancies in required trade finance documents presented under the International Chamber of Commerce trade rules known as Uniform Customs and Practice.

CHAPTER 5 - SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

This study aimed to investigate the factors that determine letters of credit effectiveness in the process of import and export practices of CBE. The study distributed questionnaires to 105 respondents and out of the distributed questionnaires, 90 filled in and returned the questionnaires making a response rate of 85.70%. Using correlation analysis, the interdependence between the independent and dependent variables were tested and hypothesis tests were performed using regression analysis. The result indicated that

- Out of the 50-discrepancy document investigation of secondary data analysis, 35% of trade documents (export and import documents) contain discrepancies and do not comply with terms and conditions of letter of credit. 53% of documents (export and import documents) contain discrepancies and do not comply with the ambiguity of context of the Uniform Customs and Practice 600 and only 12 % of discrepancy of trade finance documents originated from clerical errors.
- Using the correlation analysis, it was found that the relationship between formation place and LC Effectiveness was statistically significant relationship, $r(90) = .680, p < .05$. Similarly, the relationship between place of payment and LC Effectiveness was statistically significant relationship, $r(90) = .667, p < .01$. There was statistically strong relationship between language and currency and LC Effectiveness $r(90) = .728$. Finally, the relationship between documentary condition and LC Effectiveness was also tested and there was moderately relationship with statistically insignificant, $r(90) = .684, p > .01$. This indicates that LC effectiveness will be determined by the appropriately handling documentary conditions.
- By means of multivariate analysis, result showed that formation place, place of payment, language and currency, and documentary condition statistically affects LC effectiveness. This result also indicates that the four independent variables had an effect on LC effectiveness in terms of time, quality and price; noticed that F value was high (132.46) and $P < 0.05$. By means of the model testing, no co-linearity is observed on this data since co-linearity Statistics showed that the VIF value of all the factors are less than 5 or 10 and. The independent variables that contribute to variance of the dependent variable are explained by standardized Beta coefficient. In this test, it was checked the result of

the Durbin-Watson statistic was below 2 for the independence of observations, which can be easily checked using the Durbin-Watson statistic.

5.2 Conclusions

Employing multivariate analysis, the result of this study revealed that formation place, place of payment, language and currency, and documentary condition statistically affects LC effectiveness. It was found that formation place, place of payment and language and currency statistically will facilitate and enforce the role as they affect LC effectiveness in terms of quality but documentary condition is not a determinant factor in this regard. In addition, formation place and place of payment are not the causes for timely LC dealing out but language and currency and documentary condition are the determinant factor for timely realizing of LC process. With the analysis of LC effectiveness in terms of price, formation place and documentary condition are not creating price flexibility and the achievement of service pricing but place of payment and language and currency are the causes to gain price flexibility and service price of LC to be paid within the LC procedure at low service charge.

Overall, as of the payment instrument, letter of credit has become widely used in international trade. Letter of credit is the life-blood of international commerce. Letter of credit takes care of the interests of both the exporter and importer, so it is considered to be the most effective and safest method to secure the payment in an international trade transaction. As the international convention for the letter-of-credit transaction, UCP 600 holds the most important doctrines for the using of letter of credit of the two principles such as principle of independence and strict compliance. In the real practice, these two principles are the amulet that can secure the payment for both exporter and importer, but also the main source that can cause the risks for a letter-of-credit transaction.

5.3 Suggestions for Further Research

As seen, the determinant factors of letter of credit transactions were briefly summarized and recognized in this study. However, it seems to have some practical problems regarding its operation. It is mostly acknowledged that UCC offers significant importance, as it provides specific rules for letters of credit transactions. However, procedural matters thereof have not been thoroughly dealt with, although UCC clearly provides express rules. Considering its

importance, scholars in international trade should give more weight to this issue. Although this study attempted to provide in-depth analysis on LC effectiveness in order to cure the lack of academic researches, it may not be regarded as the sufficient academic treatment. It is hoped that this article may invite further researches in near future.

5.4 Recommendation

Banks should that facilitate international trade as a major financial institution in goods and service including payment processing for merchandise shipped and services rendered, layouts funds for buyer and seller, and give professional advices to traders specially accurately rendering foreign banking services to facilitate the country's international trade. Altogether, on the basis of the findings of the study, the following recommendations are made:

- The practice of LC process in CBE should be characterized as fast transfer of LC documents and handling filling documents of letters of credit properly. Most exporters and importers should raise any complain about the bank on documentary collection, advance and consignment payment processing, and treatment of guarantee and permit in all procedure of international trade and all imperfection of international banking practices and associated payment faultiness should be corrected accordingly
- Marketers should be forced using freight forwarders who specialize in handling importation and exportation documents. This study recommends changes include elimination of unusual requirements of documentary credit and concise articulation of the context of each article to facilitate easy understanding of contractual terms
- Letter of credit should be issued after signing the sales contract but before shipment. It is to the advantage of the exporter to have the importer arrange for the issuance of a letter of credit as soon as after the signing of the sales contract as possible but before sales contract importers should be communicate the bank and get advice of the contract of sale.
- CBE must ensure that all documentation required is accurately completed and to minimize potential problems, firms just entering the international market should consider using freight forwarders who specialize in handling import/export documents
- Banks specially CBE voluntarily incorporate the Uniform Customs and Practice into the contracts upon which the letter of credit is based and likewise CBE should know that

legal status of the Uniform Customs and Practice affects the international banking community and importing and exporting community worldwide and as 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.

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Appendix A -Regression Test Result of Each Variable

Regression test result of independent factors on LC effectiveness variables of quality, time and price

Legend – Place of Formation (PF), Place of Payment (PP), Application of Language and Currency (ALC) and Documentary Condition (DC)

Letter of Credit Effectiveness in terms of Quality (LEQ)

ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	47.832	4	11.958	84.910	.000 ^b
	Residual	.000	85	.000		
	Total	47.832	89			

a. Dependent Variable: LEQ

b. Predictors: (Constant), DD, ALC, PP, PF

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.000	.000		.000	.115
	PF	.333	.000	.428	.995	.00003
	PP	.333	.000	.423	.947	.00002
	ALC	.333	.000	.456	.504	.00002
	DD	.000	.000	.000	.000	.875

a. Dependent Variable: LEQ

Letter of Credit Effectiveness in terms of Time (LET)

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.903 ^a	.815	.806	.347

a. Predictors: (Constant), DD, ALC, PP, PF

ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	45.126	4	11.282	93.440	.000 ^b
	Residual	10.263	85	.121		
	Total	55.389	89			

a. Dependent Variable: LET

b. Predictors: (Constant), DD, ALC, PP, PF

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.166	.104		1.594	.594
	PF	.108	.049	.129	2.189	.031
	PP	.057	.049	.067	1.153	.252
	ALC	.218	.041	.277	5.332	.00001
	DD	.531	.049	.636	10.794	.00001

a. Dependent Variable: LET

Letter of Credit Effectiveness in terms of Price (LEP)

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.601 ^a	.361	.331	.734

a. Predictors: (Constant), DD, ALC, PP, PF

ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	25.852	4	6.463	12.008	.000 ^b
	Residual	45.748	85	.538		
	Total	71.600	89			

a. Dependent Variable: LEP

b. Predictors: (Constant), DD, ALC, PP, PF

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.797	.220		3.623	.023
	PF	.049	.104	.051	.471	.639
	PP	.202	.104	.210	1.944	.005
	ALC	.416	.086	.465	4.820	.0001
	DD	.024	.104	.025	.231	.818

a. Dependent Variable: LEP

Appendix B – Questionnaire in English



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Subject: Requesting to fill the questionnaire based on LC Process in CBE

I am Banchalem Girma who is a graduating student of MA in Logistics and Supply Chain Management program at Addis Ababa, School of Commerce. This questionnaire is intended to collect data for a study entitled “Assessment of The Determinant Factors of Letters of Credit Effectiveness: Perception Survey on Trade Services and International Banking of Commercial Bank of Ethiopia” in Addis Ababa and will be kept confidential. This study is conducted in partial fulfillment of requirements for award of Masters of Arts in Logistics and Supply Chain Management from Addis Ababa University.

Please note that the information you provide will firmly be used only for academic purpose. In addition, your response in this regard is extremely valued and the researcher thanks you in advance for your time and cooperation. Should you have any enquiry please feel free to contact the researcher at the following addresses: Phone: 0913 257073 Email: banchalemgirma19@gmail.com.

Thank you for your cooperation and cooperative.

With Sincerely

Banchalem Girma

Part One: Respondents - Demographic Profile - Instruction: Please choose the correct information about yourself for the following questions among response categories by putting “√” mark in the box.

1. Age (in years): 22 – 35 35 – 45 40- 60 More than 60
2. Sex: Male Female
3. Education level: Diploma Degree Masters and above
Other (Please specify) _____
4. Working experience in your company (CBE) in years:
5years and below Between 5 and 10 More than 20
Between 11 and 15 Between 15 and 20
5. Working experience with LC or International Trade in bank system in years:
1 years and below Between 1 and 3
Between 3 and 5 More than 5 years

Part Two:For each of the following questions choose the correct answer.

Question 1 - How do you rate **Formation Place of the contract** in the process of LC on import and export goods? Please circle the number with the answer you choose.

Question Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree
1. CBE applies national law on the process of LC as a contract is concluded where acceptance of an offer becomes effective.	1	2	3	4	5
2. An offer in CBE’s letters of credit, in general, takes the form of an instruction properly	1	2	3	4	5
3. With respect to an acceptance, in CBE practice, the offeree often communicates to the offeror by telex, facsimile or other expedient means to give notice of acceptance.	1	2	3	4	5
4. The practice of CBE causes legal					

Question Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree
complexity in contract formation context even under the rule which views a contract as concluded at the place where an acceptance is dispatched	1	2	3	4	5

Question 2 - How do you rate **the place of the payment** that is deemed to have a strong connection in determining the governing law of the contract? Please circle the number with the answer you choose.

Question Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree
1. In a letter of credit of CBE, payments are made in the course of the transaction by the correspondent bank to the beneficiary properly.	1	2	3	4	5
2. CBE is making reimbursement of the correspondent bank by the issuing bank effectively.	1	2	3	4	5
3. CBE is effectively processing reimbursement of the issuing bank by the applicant	1	2	3	4	5
4. CBE provides a secure payment method to the beneficiary; the performance of the payment obligation can be regarded as the essence of these instruments	1	2	3	4	5

Question 3 - How do you rate **the application of Language and currency**: the language and currency used in the contract are important factors which indicate the choice of law in certain situations? Please circle the number with the answer you choose.

Question Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree
1. CBE considers language and currency as significant factors which provide an indication of the choice of law in certain situations.	1	2	3	4	5
2. In processing LC in CBE, it is quite normal for the terms and conditions of credits and guarantees to be drafted in English	1	2	3	4	5
3. The practice of LC in CBE is to be normally payable in U.S. dollars as English is an internationally accepted language and U.S. dollars are commonly used in international trade	1	2	3	4	5

Question 4 - How do you rate documentary documentation of the LC processing in CBE

in terms of the following factors? Please circle the number with the answer you choose

Question Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree
1. CBE uses excessive requirements of terms and conditions on the letters of credit to generate documentary discrepancies in international trade transactions resulting unnecessary delays, refused payments and financial loss.	1	2	3	4	5
2. There is an ambiguity of the Uniform Customs and Practice 600 imposed by the International Chamber of Commerce generates documentary discrepancies in international trade transaction	1	2	3	4	5

Question Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree
resulting unnecessary delays, refused payments and financial loss.					
3. Our company executes properly or manage the Supply chain and Quality management practices in the import/export supply chain	1	2	3	4	5

Letter of credit Effectiveness in CBE

Question 5 - How do you rate LC effectiveness in terms of quality as the following factors? Please circle the number with the answer you choose

Question Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree
1. CBE tries to facilitate the export and import transaction by presenting the documents to the bank as required by the rules and regulations of letters of credit	1	2	3	4	5
2. CBE properly protects both seller and buyer while they are engaged in the import and export business.	1	2	3	4	5
3. In business transaction, CBE effectively acts as a middleman to enforce the rules of the Uniform Customs and Practice 600 to both the exporter and the importer	1	2	3	4	5

Question 6 - How do you rate LC effectiveness in terms of time as the following factors?

Please circle the number with the answer you choose

Question Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree
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Question Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree
1. CBE tries to facilitate LC documents and processes timely	1	2	3	4	5
2. CBE provides real time information for export and importers regarding their LC documents, payments, transaction etc	1	2	3	4	5

Question 7 - How do you rate LC effectiveness in terms of price as the following factors?

Please circle the number with the answer you choose

Question Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree
1. CBE tries to facilitate the export and import transaction within competitive and flexible price	1	2	3	4	5
2. CBE requires a high service price to facilitate the export and import transaction	1	2	3	4	5

Part Three Regarding Document Discrepancy

Question 7 - How do you rate the occurrence of discrepancies of documents that do not comply with uniform customs and practice document in terms of the following factors?

Please circle the number with the answer you choose.

Discrepancies of Documents Do Not Comply with Uniform Customs and Practice	Always	Sometimes	Rarely	Never
1. Letter of credit expired				
2. Late presentation documents				

3. Letter of credit overdrawn				
4. L/C transferred without authorization				
5. Partial shipment				
6. Transport document omits name of the carrier				
7. Transport document omits capacity of signer				
8. Transport document omit on board date/flight date				
9. Invoice not signed				
10. Charter party bill of lading				
11. Goods shipped on deck				
12. Insurance risk not covered as specified				
13. Under-insured				
14. Documents inconsistent with each other				
15. Freight prepaid omits on bill of lading on CFR condition				
16. Insurance dated after the shipment date				
17. Copy insurance certificate presented instead of an original one				
18. Insurance certificate had different currency				
19. Multi-modal transport				

20. Share your opinion about the occurrence of **discrepancies of documents** and other letter of credit processing issues, management and practices of the bank.

21. If there is anything you would like to add regarding the company's strength and Weakness in its letter of credit processing and factors affecting the effectiveness of the LC in terms of time, quality and price:

Thank you for your cooperation!

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Subject: Interview Check List

1. What are the main problems associated with LC processing in terms of quality, time and price? Please identify the main gaps in LC processing and requirements.

2. According to international trade and finance transactions, please indicate the main requirements and shortcomings of letters of credit processing as the most engaged instrument in global trade in Ethiopia context.

3. Please indicate the main problems and the key facilitation of the export and import transaction as required by the rules and regulations of letters of credit and on guaranteeing that the seller will get paid.

4. Please indicate the mechanisms that CBE applies and the national law that governs to protect both seller and buyer while they are engaged in the import and export business. Please indicate the national law that applied in the processing of LC in Ethiopia.

5. Do you think CBE is effective in acting as a middleman to enforce the rules of the Uniform Customs and Practice 600 to both the exporter and the importer? Please include any either issue related to LC processing in terms of quality, price and time.

Thank You Again