Anna-Maria Laihonen

REDUCING RISKS IN THE LETTER OF CREDIT PROCESS
-CASE ROLLS-ROYCE OY AB

Degree Programme in International Business
and Marketing Logistics
2016

Satakunnan ammattikorkeakoulu
Satakunta University of Applied Sciences

RISKIEN VÄHENTÄMINEN REMBURSSIPROSESSISSA
– CASE ROLLS-ROYCE OY AB

Laihonen, Anna-Maria
Satakunnan ammattikorkeakoulu
International Business and Marketing Logistics -koulutusohjelma
Toukokuu 2016
Ohjaaja: Tanhua, Daniela
Sivumäärä: 77
Liitteitä: 6

Asiasanat: remburssi, riski, myyntisopimus, vientikauppa

Tämän opinnäytetyön tarkoitus oli lisätä kohdeyrityksen tietoutta ongelmista joita on ilmennyt kun remburssia on käytetty maksutapana, sekä tietoutta näiden ongelmien laajuudesta. Tässä opinnäytetyössä keskityttiin erityisesti ongelmiin jotka johtuivat huonoista sopimusehdoista.

Tämä opinnäytetyö oli rajattu kohdeyrityksen projekteihin, jossa remburssia oli käytetty maksutapana vuosien 2014 ja 2015 aikana. Tutkimuksen perustaksi kerättiin teoriaa viennistä, myyntisopimuksen roolista vientiprosessissa sekä remburssiprosessista. Teoriaan tutustuminen aiheesta oli edellytys ongelmien ymmärtämiseksi tutkimukseen valituissa projekteissa.

Kerättyä teoriaa käytettiin viitekehyksenä tutkimusosiossa. Tutkimusosio koostui haastatteluista, sekä selvityksestä siitä kuinka monessa kohdeyrityksen projektissa mahdollisia ongelmia havaittiin. Tutkimusosiossa määriteltiin myös minkä tyyppisiä ongelmia tutkituissa projekteissa havaittiin ja etsittiin lisäksi syitä löydetyille ongelmille. Ongelmien tunnistamisen jälkeen kyseiset ongelmat käytiin kohdeyrityksen Trade finance tiimin kanssa läpi, jotta saataisiin selville mitkä kyseisistä ongelmista johtuivat sopimuksesta ja mitkä muista syistä. Sopimusehdot jotka olivat aiheuttaneet ongelmia etsittiin valikoitujen tapausten sopimuksista analyysin perusteella. Lisäksi myös syyt muille (ei sopimuksesta johtuville ongelmille) selvitettiin.

Tutkimuksen tavoitteet saavutettiin. Tutkimus tarjosi lisää tietoutta siitä, minkä tyyppisiä ongelmia on aiheutunut kun remburssia on käytetty maksutapana ja lisäksi tietoutta näiden ongelmien laajuudesta. Tutkimuksen perusteella saatiin selville, että vain osa ongelmista rembursseissa johtui huonoista ehdoista myyntisopimuksessa. Tämän lisäksi tutkimus sisälsi myös tapauksia, jossa myyntisopimus ei sisältänyt huonoja sopimusehtoja remburssiprosessissa havaituista onglemista huolimatta. Sen sijaan näissä tapauksissa havaitut ongelmat olivat muiden tekijöiden seurausta.

Tutkimuksen perusteella kohdeyritykselle tehtiin kehitysehdotuksia. Kehitysideat keskittyivät pääosin kommunikaation, koulutuksen sekä ohjeistuksen tarjoamiseen kohdeyrityksen sisällä sekä asiakkaille.

REDUCING RISKS IN THE LETTER OF CREDIT PROCESS
– CASE ROLLS-ROYCE OY AB

Laihonen, Anna-Maria
Satakunnan ammattikorkeakoulu, Satakunta University of Applied Sciences
Degree Programme in International Business and Marketing Logistics
May 2016
Supervisor: Tanhua, Daniela
Number of pages: 77
Appendices: 6

Keywords: Letter of Credit, risk, sales contract, export

The purpose of this thesis was to increase the case company's information about the type of problems causing issues while Letter of Credit has been used as a payment method and the magnitude of the identified issues. This thesis focused especially on the problems created by bad conditions and terms in the sales contract.

The scope of this thesis was limited to case company's projects where Letter of Credit had been used as a payment method between the years 2014 and 2015. In order to be able to properly complete the investigation information about exporting of goods, the role of the sales contract in the export process and about the Letter of Credit process was collected. By that it was possible to properly understand the issues involved in the selected Letter of Credit cases.

The collected theory was used as a framework for the research part of the thesis. The research part involved interviews and information about in how many cases issues were identified, the type of identified issues and the root causes for these issues. Based on the issues identified in the investigation it was determined with the help of the Trade Finance team of the company which of the issues were caused by the sales contract and which by other problems. Based on this the terms and conditions that created issues in the Letter of Credit process were searched from the contracts of the selected cases. The root causes for the other identified issues were also investigated.

The objectives of this thesis were met. The research provided increased knowledge about the type of problems causing issues while Letter of Credit has been used as a payment method and the magnitude of these issues. Based on the research it was realised that while in fact there were issues caused by the bad contract terms and conditions there were also a number of cases where the sales contract did not include bad contract terms and conditions but the issues in the Letter of Credits were caused by other factors.

Based on the research suggestions for improvement were made for the case company. The proposed improvement actions are all around communicating, training and providing guidance within the case company and towards customers.

CONTENTS

1 INTRODUCTION 7
2 PURPOSE, OBJECTIVES AND CONCEPTUAL FRAMEWORK 8
2.1 The purpose and objectives of the thesis 8
2.2 Research questions 9
2.3 Conceptual framework 10
2.4 Boundaries and limitations 12
3 EXPORTING OF GOODS 13
3.1 Definition of exporting goods 13
3.2 The reasons for exporting goods 14
3.3 Risks and risk handling methods for the exporter 15
3.3.1 Product, production and transport risks 16
3.3.2 Commercial risks 18
3.3.3 Political or country risks 19
3.3.4 Adverse business risk 20
3.3.5 Currency risks 21
3.3.6 Financial risks 22
4 SALES CONTRACT IN THE EXPORT PROCESS 23
4.1 Definition of a sales contract 24
4.2 Content of the sales contract 24
4.2.1 Selling and purchasing entities 25
4.2.2 Quantity, pricing, currency fluctuations 26
4.2.3 Payment methods and potential export financing 26
4.2.4 Passage of title, delivery, and risk of loss 27
4.2.5 Warranties and product defects 28
4.2.6 Pre-shipment inspections 28
4.2.7 Export licenses, import licences and foreign government filings 29
4.2.8 Governing law 29
4.2.9 Dispute resolution and termination 30
4.3 Relationship between the sales contract and a Letter of Credit as a payment method 31
5 LETTER OF CREDIT 32
5.1 Definition of a Letter of Credit 32
5.2 Types of Letter of Credits 33
5.3 The Uniform Customs and Practice (UCP) for Documentary Credits 34

5.4 Reasons for using Letter of Credits ... 35
5.5 Letter of Credit process ... 36
5.5.1 Issuance of the Letter of Credit ... 36
5.5.2 Utilization of the Letter of Credit ... 37
5.5.3 Confirmed Letter of Credit ... 39
5.6 Disputes ... 39
5.7 Costs of using Letter of Credits ... 40
5.8 Typical problems and risks with Letter of Credits ... 40
6 CASE COMPANY ... 41
6.1 Rolls-Royce Oy Ab ... 41
6.2 Export process ... 42
6.3 Letter of Credit process ... 42
7 RESEARCH METHODOLOGY ... 44
7.1 Research background ... 44
7.2 Research strategy and design ... 45
7.2.1 Case study ... 45
7.3 Research methods ... 46
7.3.1 Qualitative methods ... 46
7.3.2 Quantitative methods ... 47
7.4 Research strategy and methodology of the thesis ... 48
7.5 The collection and analysis of the data ... 49
7.6 Evaluation of validity and reliability of the research ... 50
7.7 Research plan ... 51
8 RESEARCH ... 53
8.1 Interviews ... 53
8.1.1 Conduction of the interviews ... 53
8.1.2 Interview results ... 54
8.2 Case study ... 56
8.2.1 Case selection for the case study ... 56
8.2.2 Letter of Credit related payment posts ... 57
8.2.3 Analysis ... 58
8.2.4 Findings from the analysis ... 59
8.2.5 Potential issues caused by bad contracts ... 61
8.2.6 Summary of results from the sales contract investigation ... 66
8.3 Conclusion based on the research ... 66
9 RISK MITIGATION BY THE USE OF LETTER OF CREDIT ... 67
9.1 Product, production and transport risks ... 67
9.2 Commercial risks ... 68

9.3 Political or country risks 68
9.4 Adverse business risk 69
9.5 Currency risks 69
9.6 Financial risks 69
9.7 Summary 70
10 SUGGESTIONS FOR IMPROVEMENT 70
11 SUMMARY AND CONCLUSIONS 72
12 FINAL WORDS 74
REFERENCES 75
APPENDICES

1 INTRODUCTION

The purpose of this thesis is to reduce risks in the Letter of Credit process for the case company Rolls-Royce Oy Ab. This thesis is done in order to increase the case company's information about the type of problems causing issues with Letter of Credits, and their magnitude. This includes information about how often various issues occur, their root causes and proposal for ways to avoid these issues in the future. The aim is also to increase case organisation's understanding of link between contract conditions (or other identified issues) and Letter of Credits.

The thesis is made with an emphasis to the role of the exporter in the Letter of Credit process, so that the thesis would meet the needs of the case company as well as possible. This thesis includes only cases where Letter of Credits have been used as a payment method.

The author has done her two practical trainings at the case company in trade finance working with Letter of Credits, so this thesis is an opportunity for her to deepen her knowledge in the field.

In the first part of the thesis the purpose, objectives and the conceptual framework of the thesis will be discussed. The theory part of the thesis will focus on exporting of goods, the role of the sales contract in the export process and to the Letter of Credit process.

The research methodology part of the thesis discusses the chosen research methods and strategy, the validity and reliability of the research and the different phases of conducting the research.

The research results part of this thesis focuses on analysing the results of the research. The suggestions for improvements are made based on these results. The last part of the thesis summarizes briefly the things that have been discussed in the thesis and evaluates how successful the research has been.

2 PURPOSE, OBJECTIVES AND CONCEPTUAL FRAMEWORK

2.1 The purpose and objectives of the thesis

This project is done in order to increase the case company's, Rolls-Royce Oy Ab's, information about the type of problems causing issues when Letter of Credit is used as a payment method, and the magnitude of the identified issues. This includes information about how often various issues occur, their root causes and proposal for ways to avoid these issues in the future. The aim is also to increase organization's understanding of the link between contract conditions (or other identified issues) and Letter of Credits. The case company will benefit from this research by increased fact based information about issues and their magnitude, and by proposed ways to avoid these problems.

This research will provide basic information about Letter of Credits - what they are, when and how they are used and what needs to be taken into consideration while payment is handled using a Letter of Credit. So, this research can also be used to gain basic information about the topic.

Since we did not familiarize ourselves thoroughly with Letter of Credits during our studies, this topic will increase my, my fellow students' and potentially also teachers' understanding of Letter of Credits. The author’s view is that also other individuals interested in the topic, including other companies not familiar with Letter of Credits as a way to secure payments, could benefit from this research.

The author has worked two summers in the case company, and through that the author has some knowledge about the Letter of Credits and the case company. This subject provides the author an opportunity to increase her understanding and knowledge of Letter of Credits and the whole process from contracting to delivery of equipment. This topic fits well with the author’s International Business and Marketing Logistic studies and could help her with her future career.

The object of this research is to provide fact base information about the issues the case company faces with Letter of Credits. This will be done by going through and analysing actual cases within selected time period, and by that providing facts about the magnitude of various issues identified - how often they occur, root causes and impact of these issues. This includes looking into risks the case company faces as a result of identified issues. The aim is also to provide clear proposal to the case organization how to avoid these issues in the future.

2.2 Research questions

The main research problem of this thesis is: "How to avoid issues related to Letter of Credits which are caused by sales contracts?" Since it is assumed by the author that most of the risk mitigation in the Letter of Credit process is done through the sales contract it is also assumed by the author that the main reason behind the issues are bad contract conditions. The aim of this research question is to get a confirmation to this assumption and also to get more specific information about different types of issues and the magnitude of those. The aim is also to increase organisation's understanding of link between contract conditions (or other identified issues) and Letter of Credits.

The research problem consists of the following sub-problems:

- What is a Letter of Credit
- What is the relationship between Letter of Credit and sales contract?
- What kind of problems are there while working with Letter of Credits?
- What kind of risks company might face when Letter of Credits are used?
- How to handle the risks while using Letter of Credits?

The research will start with the basic information about exporting of goods, sales contracts and Letter of Credits. This includes information about what Letter of Credits are and how they are used. The research will also focus on the relationship between the Letter of Credit and the sales contract in order to find out which parts of the sales contract are linked to and have an impact on the Letter of Credits. This knowledge is required to successfully complete the empirical part, so that the author is able to identify the parts in the sales contract to look at while analysing the data.

The empirical part will consists of cases selected from a specific period of time from the case company. The selected cases will be analysed in order to find the possible issues that have occurred in the cases and to find out how often different issues have occurred.

The next step after the empirical part is to analyse the problems that occur while working with Letter of Credits. The main focus will be on the problems caused by the sales contracts. In addition to that also problems caused by other factors will be taken into consideration.

The possible consequences of the identified problems will be analysed. This covers the risks these problems can create for the case company, including the worst case scenario where the case company ships equipment and is not be able to get the payment from customer without legal actions. The last research question will focus on finding methods to control the identified risks and prevent them.

2.3 Conceptual framework

Figure 1 presents the conceptual framework of the thesis. The purpose of the conceptual framework is to visualize the topics that will be discussed in the theory and in the empirical part of the thesis in order to meet the purpose and the goals of the research. The conceptual framework consists of the export process in general and the steps forming a Letter of Credit process. These process steps need to be taken into consideration while reducing risks in the Letter of Credit process.

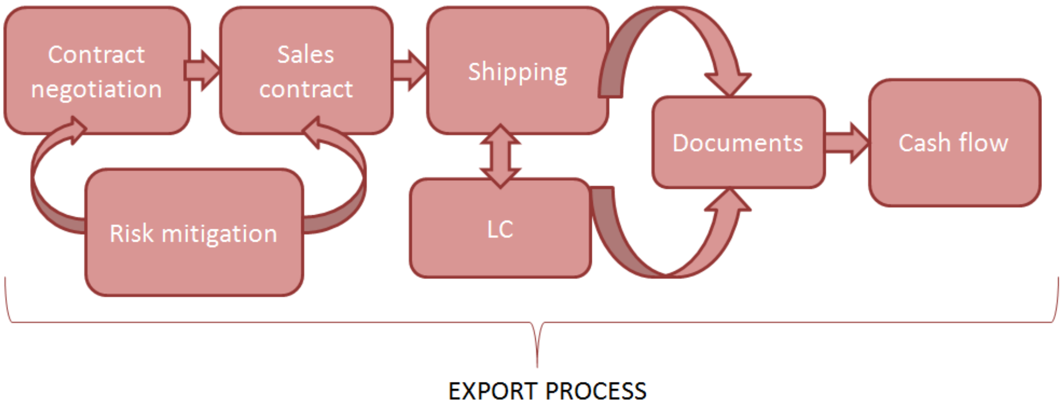


Figure 1. The conceptual framework (Made by the author 2015)

The Letter of Credit process starts when a contract of sale is agreed on by the exporter and importer. (Jimenez 2003, 181.) In the contract negotiation part of the process the purpose is to reduce the risks and future problems for both parties by agreeing to clear contract conditions. The risk mitigation is therefore mostly linked to the contract negotiation and to the sales contract itself. (Shippey 2009, 1.)

When sales contract is signed equipment will be produced and shipped to customer. Before shipment can take place the Letter of Credit needs to be in place. So, the shipment and Letter of Credit are connected and are shown to be happening simultaneously. (Sherlock & Reuvid 2008, 345.)

The documentation needed to get the payment based on the Letter of Credit is completed after the equipment has been given to the carrier. (Jimenez 2003, 181.) In many cases, especially when sea transportation is used, this is happening before the equipment reaches the customer. (Sherlock & Reuvid 2008, 353.) The sales contract is the underlying basis of the Letter of Credit in which the required documents are stipulated. Most of these documents are connected to the shipment or include shipping details. (Todd 2007, 12.) Based on this the conceptual framework has two arrows to documents, one from Letter of Credit and another one from shipping.

The purpose of the Letter of Credit process is to secure the cash flow before equipment is shipped to customer, even if the actual payment is received after the shipment. (Website of the Royal Bank of Scotland 2016.)

All of the parts shown in the conceptual framework will be discussed in both the theoretical and empirical parts of the thesis. The perspective from which these topics will be discussed is from the perspective of the beneficiary (the seller) in the Letter of Credit process. By that the thesis would meet the needs of the case company

2.4 Boundaries and limitations

The thesis consists only of examples and experiences of the Letter of Credit process within the case company and is therefore made from the point of view of the beneficiary (the seller) in the Letter of Credit process, not from a point of view of e.g. a bank involved in the process or the applicant of the Letter of Credit (the buyer/customer).

The case company has three product lines - Azimuth Thrusters, Deck Machinery and Waterjets. Since Letter of Credits are seldom used with Waterjet deliveries handled by factory/office located in Kokkola this product line will be excluded from the scope. So, only Azimuth Thrusters and Deck Machinery handled from Rauma will be included in the scope of the research.

The thesis is made with an emphasis to the role of the sales contract in the Letter of Credit process since it is assumed that the main reason behind the issues with Letter of Credits are bad contract conditions.

The cases for the empirical part are only selected from a certain time frame. Since there is a large amount of material available for the research it is not possible to include all of the cases the case company has had over the years to the research. Thus, a time frame for the research will be selected with the case company and only cases within the selected product lines, Azimuth Thrusters and Deck Machinery, will be analysed within the selected time frame.

3 EXPORTING OF GOODS

3.1 Definition of exporting goods

Sending goods and services out of a country is called exporting. (Website of Taloussanomat) Exporter is the party sending the goods or services, and it is also known as the shipper, supplier or consignor. (Gordon 2000, 2-3.)

The exporting process does not only involve the actual shipment of the goods, it also involves the equivalent documentary exchanges. These documentary exchanges are considered by courts of law to be transactions in the same extent as they are transactions in goods. As a result of this it is as important for the exporter to offer the correct documentations as it is to offer the right physical goods. (Jimenez 2003, 16.)

One of the main ways how exporting differentiates from the domestic sale is that the buyer and the seller are located in different countries. As a result of that they are not subject to the same regulations from the same authorities and the procedures for example for settling disputes differ among the countries. These are not the only things that can differ, for example the currency, the product standards and the commercial standards may also differ between the countries. (Reynolds 2003, 1.)

Many companies have started to export due to the saturation of the domestic market or due to high expected profit margins from foreign markets. Due to the increase of the integration of global markets export has become a vital part of competitive strategy for several companies. In today's world exporting is no longer a way to increase profits but more like a requirement for the company to stay alive. If competitors are exporting the company may need to do it as well in order to avoid having disadvantage over the competitors. (Jimenez 2003, 12.)

The ability to learn fast is an important source of competitive advantage for companies in today's world. The company gets useful experience while being in contact with international customers in addition with foreign distribution and marketing techniques.

This experience can be useful even in the domestic market of the firm. When employees have received training for handling the international trade with one country the knowledge is also applicable to future markets and therefore it is possible to achieve the Economies of Scale. (Jimenez 2003, 12.)

In the last 30 years there have been great changes to the pattern and to the complexity of world trade. Nowadays world trade is an international business of a high profile which is driven by elements like technology, marketing, logistics, politics finance etc. Trade means political power, influence and wealth worldwide and it encourages investments and creates new high professional standards. (Branch 2006, 1.)

Exporting may start randomly through unplanned orders from abroad instead of as a result of formal export strategy. If the export orders start to increase it is likely that the management will start to pay more attention to the export process and will likely set up an export department. Exporting can start in the previously mentioned way or in many other ways as well but it is however reasonable for companies to make investments to export in case they have a reason to believe that it could enhance their competitiveness or maximize the long-term revenues of the company. (Jimenez 2003, 12.)

3.2 The reasons for exporting goods

Although the risks of exporting are larger than in domestic sales the profit can also be higher. Basically for every company located anywhere in the world the potential export market is larger than the domestic one. (Westwood 2012, 4.)

The main reasons why goods are exported are that some countries are not able to produce and provide enough or at all the goods that are needed in the country, or that the country in fact is able to produce the goods but still imports them. The reasons for a country buying goods which it cannot produce are very clear – by exporting the country is able to get these goods. The reason why goods the country is able to produce are imported could be that the exported goods are cheaper, of better quality or with higher brand status. (Sherlock & Reuvid 2008, 3.)

If a company sells its products in more than one country the risk is diversified since it is not completely dependent on sales to a one single market. An exporter could be able to compensate low domestic sales by export. Strong exports are considered to be important for a good economy by many governments and therefore a variety of support services, like low cost loans, are offered by many countries to companies that export. (Jimenez 2003, 12.)

3.3 Risks and risk handling methods for the exporter

Every transaction has its own element of risk. However, in international trade the risk profile has a different magnitude. Although the reward can be higher while comparing exporting of goods to the sales in the domestic market, the risks are also higher. Even if the risks are often evaluated subjectively it is still necessary for both the seller and the buyer to be aware of the type of risks involved in international transactions in order to make a relevant risk assessment. (Grath 2013, 9.)

In order to manage the risks that are included in international transactions a professional approach to exporting and importing is needed. All of the parties involved in the process (e.g. exporter, importer, bankers, carriers, inspectors and insurers) should understand their roles. The reality however is that the understanding of the export process is often rather narrow than widespread. It is obvious that it is not possible for all of the parties to be experts in all of the areas, but it would be helpful if all were familiar with the overall process. That would alert the traders to the areas where they have to consult specialists like lawyers or bank experts. (Jimenez 2003, 13 - 14.)

The figure below shows the main risks that are involved in international business. These risks will influence the buyer's and the seller's preference of the terms of payment. (Grath 2013, 11.)

Figure 2. Different form of risk in international trade (Grath 2013, 11)

Risks in international transactions can be reduced by relying to tested techniques and practices, especially a mastery of relevant documents and contracts is required. It is important that those who are involved in international trade have an understanding of how an effective and complete sales contract is conducted since it will determine the other documents needed, e.g. transport documents, payment related documents and the insurance policy. (Jimenez 2003, 11.)

3.3.1 Product, production and transport risks

Product risks are something that the seller has to accept as part of their commitment. It includes the product itself, delivery, specified performance and agreed maintenance or service obligations. The product risk could also include some elements of the manufacturing process, e.g. when the product is tailor made or has unique specifications. In addition to the product, the physical movement of the goods from seller to the buyer needs to be looked at. This includes aspects like the nature of the product, size of the delivery, the buyer and their country and the transportation route.
(Grath 2013, 15.)

The physical movement of goods in international trade includes higher risks than in the domestic trade. In international trade the distances are usually long, and the carrier may change during the process. The goods may also be stored during the transition process. (Jimenez 2012, 14.) The most likely reasons for loss or damage to the goods during an international trade are poor handling and stowage of the goods, physical damage during the transportation in the conveyance and theft or pilferage. (Sherlock & Reuvid 2008, 293.)

Almost all deliveries in international trade are usually covered by cargo insurance, which provides a cover against the physical damage or loss to the goods while the goods are transported by sea, air or land or by a combination of these. (Grath 2013, 17.)

One of the main issues in international trade is the question about who is responsible in case the goods are damaged or lost during the transport. Therefore it is important to clearly define the point where the risk moves from the seller to the buyer. These issues are defined in the trade terms. (Sherlock & Reuvid 2008, 190.) The international trade terms, usually referred to as the Incoterms, are standard trade terms developed by the International Chamber of Commerce (ICC). The terms define certain essential aspects between the seller and the buyer, e.g. allocation of transport costs, customs clearance and payment duties, insurance responsibilities and responsibilities in case the goods are damaged or lost. (Jimenez 2012, 43.)

In case the goods are damaged or lost it is important to find out exactly where the damage happened. If the goods have been damaged or lost before the point where the trade term specifies that the risks passes from the seller to the buyer, the seller needs to handle the consequences. If the goods are lost or damaged after that point the contractual obligations of the seller are fulfilled and the buyer bears the risks (Sherlock & Reuvid 2008, 190.)

The seller and the buyer should also understand the legal rights that they have in relation to the carriers. In case the damage to the good has happened because of the carriers neglect the liability of the carrier can depend on the contractual provisions and shipping information in the Bill of Lading. (Jimenez 2012, 14.)

3.3.2 Commercial risks

Commercial risks, also called purchaser risk, includes risk of the buyer going into bankruptcy or being in any other way incapable of fulfilling their contractual obligations. In addition to buyer's payment obligation this covers all other obligations according to contract necessary for the seller to fulfil their obligations. (Grath 2013, 19.)

Verifying the creditworthiness of a foreign buyer can be sometimes challenging for the seller. This creates an additional risk of non-payment, delayed payment or fraud to international transactions. (Jimenez 2012, 14.) In practice a commercial risk means that even if the complete goods are shipped to the seller undamaged, the buyer might still not pay for those goods. (Sherlock & Reuvid 2008, 293.)

The magnitude of the commercial risk is mostly dependent of the value of the contract. If the sales include a large sum of money it is likely that the manufacturing and transportation costs are also high. In case the buyer fails to make the payment on time or completely this can cause a serious financial threat for the seller. (Bishop 2003, 11.)

In case a contractual dispute is taking place between the seller and the buyer, it may be completely legitimate that the buyer is not willing to pay for the goods. The cause for this can be that the goods do not meet the requirements stated in the contract However, in some cases contractual disputes can be a dishonourable effort of the buyer to delay or avoid paying for the goods. (Sherlock & Reuvid 2008, 293.)

Up-to-date credit information about any new potential buyer is needed to understand the customer risk. However, the seller should be aware that the contents and accuracy of the credit information may vary depending on the information available. The received information can also be difficult to evaluate and there might be questions about how it has been produced and how up to date it is, particularly when dealing with customers outside the advanced industrialized countries. When the credit information has limited value and there are other risk factors, such as political risks, terms of payment that reflect the combined risk have to be chosen. (Grath 2013, 21, 25.)

The contract is ultimately the single vehicle by which risks are allocated between the contractual parties. It is important that the parties knows where they stand if risks materialise. (Boyce 2003, 3.)

3.3.3 Political or country risks

Political or country risk is the risk that the commercial transaction is not realized according to contract due to measures emanating from the government or authority of the buyer's own or any other foreign country. Other forms of political or similar risks could be measures taken by authorities in the buyer's home country to put in place trade barriers (e.g. product standards, environmental requirements) to promote important industries within the country. These are often called 'non-tariff barriers' and they could have negative impact on already agreed business transactions since they are often introduced with immediate effect. (Grath 2013, 24, 26.)

Political risks are most often post shipment risks. The cause for political risks is the political action of a foreign country or the political action of the country where the company is located in. Political and governmental policies which can possibly have negative impacts to international transactions are for example tariff and quota restrictions, trade embargoes, restrictive government policies and resale price regulations. (Gordon 2000, 1-41.) Political risks can also be for example terrorism, strikes, wars, riots, currency inconvertibility, currency devaluation or trade disruptions. (Alston, Cook & Raia 2012, 106.)

Political events have an effect to the whole cost structure of the supply chain. For example events such as political instabilities can increase the prices of vital natural resources like oil. This can increase the costs of the whole supply chain process from buying materials to the shipment of finished products. Political risks also often force the companies to take security measures that are likely to create extra costs for the company. For example political instability can make it impossible for a company to use the most convenient routes and methods of transportation. (Alston, Cook & Kelly 2012, 3.)

Certain political risks are often bundled together and referred to as the "country risk". This is a bundle of risks associated with transactions with a buyer or seller within the country. There are multiple external services which help companies in analysing political and economic risks by country, region or a market. These services are provided for example by different organizations and banks. The companies can also evaluate risks themselves by looking at factors like socioeconomic conditions, government stability, corruption, law and order and foreign debt stress. (Gordon 2000, 1-42.)

It is not enough to evaluate the countries which are directly involved in the transaction, but also countries which relate for example to the suppliers or subcontractors of vital components. For example risks such as strikes or lockouts in these countries can cause interruptions to the deliveries of vital components. These delays can make it impossible for the seller to meet the delivery time defined in the sales contract. (Grath 2013, 26, 29.)

There are different types of insurances available for companies with overseas trade and investment activities. Usually the political insurances provide coverage for such risks that are not covered in the normal property insurance policies. The coverage is available in the form of a civil commotion, terrorism policy and a war risk. (Alston, Cook & Raia 2012, 106.)

3.3.4 Adverse business risk

Adverse business risks include business practices of negative nature, which are common in some parts of the world. This could have impact on individual transactions, general business and financial standing of the seller and their moral reputation. This includes for example bribery, money laundering and facilitation payments.
(Grath 2013, 21.)

Companies do business in countries where international law permits and the commercial risk is acceptable. However, companies may choose not to do business in nations that poses significant reputational and integrity risk. An early warning process can start by identifying “watch-list nations” based on an annual governmental lists of nations implicated in state-sponsored terrorism, develop weapons of mass destruction, money laundering, drugs and denial of human rights. (Heineman 2008, 64.)

3.3.5 Currency risks

A currency risk will arise when the payment is going to be made in another currency than in which the seller incurs their costs. In many cases the main costs for the seller are incurred in their own local currency, meaning that currency risk is created when invoicing is done in another currency. (Grath 2013, 27-28.)

The currency risk can be divided to exchange risk and transfer risk. Exchange risk means that the seller may receive less or more money due to fluctuations in exchange rates. Transfer risks means situations where the buyer is incapable of transferring certain currency to the seller due to a regulation or a law. Due to this the buyer is not capable of paying for the seller. (Gordon 2000, 1-40.)

When the buyer and seller have different accounting currencies, the currency selected for the sales contract will automatically benefit either the seller or the buyer at the cost of the other party due to the exchange rate fluctuations between the currencies. However, the parties do not know in advance which one is the party that will benefit from this. (Jimenez 2012, 14.)

There is no direct exchange risk for the seller if the seller is able to negotiate the terms of the contract so that the sales price is defined in seller’s own currency. However, if the buyer uses a different currency it may be possible that due to exchange rate fluctuations the currency costs for the buyer are so high that the buyer or its bank fail make the payment. (Gordon 2000, 1-40.)

If it is not possible to set the price on the seller's currency the risk can be managed by using currency options or forward exchange contracts. The purpose of using these is to get a fixed exchange rate in which the settlement will be eventually made. The sellers try to fix the price for future date rather than to profit from the currency fluctuations. Usually clever buyers and sellers use some of these options to be able to evaluate accurately their future receivables or liabilities. (Bishop 2003, 12.)

By keeping foreign currency on a separate foreign currency account the seller is able to remove the exchange risk. The seller can have for example separate accounts for US dollars and Euros. The main benefits of having separate accounts for different currencies however apply to companies which are not only selling but also buying in a foreign currency. In the best case scenario the purchases and the sales of the company in the foreign currency would be in balance with each other. (Sherlock & Reuvid 2008, 314.)

One option is also to intentionally do nothing and be prepared to accept that the exchange rate fluctuations can have a negative or positive impact to the sum of payment that is received. The seller may face a positive surprise once they payment is received, however the seller could also end up losing significant revenues. Especially when the amounts are large and the profit margins low the company may even face losses. (Sherlock & Reuvid 2008, 314.)

3.3.6 Financial risks

All international trade transactions contain an element of financial risk. Processes like purchasing, production and shipment place a financial burden on the transaction and forces the seller to determine how alternative terms of payment would impact on its liquidity and how this should be financed. (Grath, 2013, 29.)

The additional element of financial risk in international trade is caused by variety of factors. For example the payment period is usually longer in international transactions than in the domestic ones. The period is usually 30 days in the domestic market while in international transactions it can be for example 90 days, or in some cases even number of years. This longer period can create serious cash flow problems, especially for smaller companies, and hinder their liquidity. (Branch 2006, 39.)

The element of financial risk is magnified in international transactions due to additional investments required by the export program. Starting an export effort requires resource commitment. Even strong and stable companies can suffer in case they over-optimistically invest a lot of money to export operations that fail. (Jimenez 2012, 14.)

Most of the companies that trade internationally make profit or at least are trying to do so. For this purpose the receipt of payment is essential. The purpose of the exporter is to operate in the way that maximizes and guarantees the possibility that the payment will be received completely and on time as well. (Sherlock & Reuvid 2008, 335.)

The financial risk can be managed with suitable payment method. Some methods involve greater risks than others. The safest type of payment method is one that involves a guarantee from an independent third party, like Letter of Credit which guarantees the financial aspects of the sale. (Alston, Cook & Raia 2012, 105.) There is a difference between the terms and the method of payment. Terms of payment mean the time that is allowed for the payment to be made. (Sherlock & Reuvid 2008, 335.)

4 SALES CONTRACT IN THE EXPORT PROCESS

Most contracts involve parties, a buyer and a seller, with common and adverse or opposed interests. The common interest is that both parties want to make the trade, but adverse interests are e.g. that the buyer wants to buy at the lowest price, and the seller wants to sell at the highest price. It is common that two parties attempting to reach agreement do not succeed instantaneously. Both parties want to give as little and get as much as possible. (Holtz 1997, 21.)

In the sales process the seller will always try to get terms that will maximize the outcome and minimize the risk. However, the seller must also be prepared to accommodate reasonable demands from the buyer in order to be competitive and reach a deal that is acceptable to both parties. The risk of not accommodating reasonable demands from the buyer is that the deal is lost. (Grath 2013, 9.)

4.1 Definition of a sales contract

A contract is an agreement that defines a relationship between one or more parties, and a commercial contract is an agreement made by two or more parties for the purpose of transacting business. The commercial contract may be oral or written. When a company enters into a commercial contract with an unfamiliar party across a country border, a contract takes on added significance. The creation of an international contract is a complex process since the parties have different societal values, practices and the laws. Since these factors can lead to misunderstandings the contracting parties should define their mutual understanding in contractual, and preferably written, terms. (Shippey 2009, 1.)

Under most legal systems a contract is created by the conjunction of offer and acceptance. In international trade this may be manifested in different ways, like by the exchange of pro forma invoice (offer) and purchase order (acceptance). A good sales contract will cover all the principal elements of the sales transaction to avoid surprises and uncertainties. The parties' respective duties will all be clearly detailed in the contract. (Jimenez 2003, 78 - 82.)

A contract is not valid and cannot be enforced if the content of what it covers is illegal, e.g. an agreement to cooperate in smuggling drugs is an agreement to do something criminal and so invalidates the agreement as a contract. In addition, no contract can overrule or prevail over the laws and powers of the governments. (Holtz 1997, 14.)

4.2 Content of the sales contract

It is important to recognize that it is not possible to cover every gap and fill all the loopholes by the contract provisions since they are not known. Even if it is not possible to create the perfect contract the contract provisions should be drafted as clearly as possible. By that there will be fewer disputes. If terms are left out of the contract or if they are open to interpretation, the gaps will be filled in by application of the law. In cross-border contracts, the implied terms will vary based on which country's law is applied. (Shippey 2009, 85.)

There are number of terms and conditions in an international sales agreement that require special consideration, like (Johnson & Babe 2010, 301-312.)

- selling and purchasing entities
- quantity
- pricing
- currency fluctuations
- payment methods
- export financing
- passage of title, delivery, and risk of loss
- warranties and product defects
- pre-shipment inspections
- export licenses
- import licenses and foreign government filings
- governing law
- dispute resolution
- termination

Since it is usually necessary to know when a contract was entered into, a contract must be dated. If there is no special dating of contract signatures, it is assumed that the contract was signed by all parties on the same date that appears as the contract date. (Holtz 1997, 17.)

4.2.1 Selling and purchasing entities

The contract must specify clearly who the contracting parties are. To qualify as a contract, the parties must be legally competent, e.g. qualified to enter into contract. If that is not the case, the contract is null and void, and cannot be enforced legally. However, as a result of that the parties might get involved in lawsuits, especially if money has changed hands. (Holtz 1997, 14.)

4.2.2 Quantity, pricing, currency fluctuations

The parties should always be certain to come to a definite understanding on the goods sold (quantity, type, and quality) and the price. (Shippey 2009, 31.) The price may be a price per unit or a total price, but preferable both. The price should also state the currency of the transaction and whether shipping to a particular destination, insurance, taxes, customs duties, and other costs are included. The quality must be stated objectively using applicable industry standard designations (Hinkelman 2008, 21.) Vague terms should be avoided. (Holtz 1997, 6.)

When the duration of the contract is long, or when inflation or currency fluctuations make it sensible, exporters should consider including price escalation or adaptation clauses. The price could be made firm for a given period of time, and beyond that time to peg it to publicly available indexes. This leaves some uncertainty in the price, but the mechanism for fixing the price later should be clear. (Jimenez 2003, 88.)

4.2.3 Payment methods and potential export financing

The parties should always be certain to come to a definite understanding on the time and means of payment. (Shippey 2009, 32.) The payment methods in international trade are similar than in domestic business, but include higher risks due to complexities involved in cross-border transactions. The terms of payment used will depend on things like the relationship between the parties, industry norms, potential for currency fluctuation, and political and economic stability. (Hinkelman 2008, 10.)

In international trade it is more common to utilize payment methods that are designed to give the seller a greater level of protection. The reason for this is that if the buyer fails to pay, it is much more difficult for a seller to go to a foreign country, institute a lawsuit, attempt to attach the buyer's assets, or otherwise obtain payment. (Johnson & Babe 2010, 305.)

The four basic terms of payment used in international trade are: cash in advance, documentary credit, documentary collection and open account. Cash in advance provides greatest security for the seller since payment is received prior to shipment while the open account provides greatest risk since the seller is reliant on the buyer’s ability and willingness to pay after the shipment is made. Documentary credit (Letter of Credit) and documentary collections provide almost equal security and risk for both parties. When documentary credit is used bank is committed to pay the seller a specified sum on behalf of the buyer under precisely defined conditions and the seller is assured that payment will be received after the goods are shipped as long as the conditions are met. When documentary collection is used the seller ships the goods and sends the documents, including bill of landing (title document), through banks with instructions to release them to buyer only upon payment. (Hinkelman 2008, 11.)

If export financing provided by government agencies is going to be utilized, it should be discussed in the international sales agreement. By that the buyer will be aware that the seller intends to use such financing. The sales agreement should specify the documentation that the buyer needs to provide in order for the seller to obtain such financing, and the seller's obligation to sell and make shipment at specific dates. (Johnson & Babe 2010, 307.)

4.2.4 Passage of title, delivery, and risk of loss

The transfer of legal title of goods in international transactions is covered by national law. The parties are free to specify how the title passes, but they need to verify that the method they chose is permitted by the applicable national law. The retention of title clause provides that the seller retains legal ownership of the goods until the purchase price is fully paid. If the contract does not include retention of title clause the title passes to the buyer independently of the payment of the purchase price. In some countries the title will pass at the moment of the physical delivery of the goods, in some others it passes according to the agreement between parties. (Jimenez 2003, 87 - 88.)

Delivery can be either specified by a ship date or by a date of receipt. When ship date is used, the buyer should have some degree of control over the method of shipping, and when receipt date is used the seller should be in some control of the method of shipping. (Hinkelman 2008, 21.)

In international contracts delivery, transport and insurance are best covered by reference to Incoterms (trade terms defined by ICC). Incoterms cover allocation of international transport costs, transfer of risk, responsibility for customs clearance and duties, and responsibility for obtaining insurance coverage. However, Incoterms are fairly general terms, and parties may make additional specifications e.g. with respect to exact manner of delivery, the amount and duration of insurance, and limitations on suitable transportation. (Jimenez 2003, 87.)

4.2.5 Warranties and product defects

The warranty may take several forms, such as warranty of performance, warranty against defects or warranty against patent or copyright infringement. There is also the period of warranty and the remedy offered in the event of a defect covered by warranty. (Holtz 1997, 165.)

From the seller's point of view one of the most important provisions in an international sales contract is the one that specifies the warranty terms. Under the laws of most countries, unless the seller limits its warranty expressly in writing in its agreement, the seller will be responsible and liable for foreseeable consequential damages that result to the buyer from defective products. Such consequential damages can far exceed the profits that the seller has made on such sales. The sales agreement should specify exactly what warranty the seller is giving for the products. (Johnson & Babe 2010, 308.)

4.2.6 Pre-shipment inspections

There are two types of inspections – commercial and statutory. Commercial inspections will relate to the terms of a contract between the parties. The scope of the inspection is determined either by the actual terms of the contract or by established trade practices. The inspector will usually verify that the goods are in line with the specifications described in the order and that the quantity ordered is complete and adequately packed for shipment. It is also possible to verify manufacturing quality or performance standards by further checks or tests. Statutory inspections will be governed by the regulations or standards for particular products, irrespective of the terms of sale. They will have to verify that the goods conform to the precise requirements of national or international standards. (Reuvid 2004, 346.)

The terms and conditions of pre-shipment instruction should be specified in the international sales agreement, including the type of pre-shipment inspection, its scope, its terms, and the consequences if the inspection is unfavourable. (Johnson & Babe 2010, 308-309.)

4.2.7 Export licenses, import licences and foreign government filings

When an export license is required in an international sales agreement, the exporter should state in the sales contract that it is required and should require the buyer to provide the necessary documentation to apply for the license. In case the buyer fails to provide needed documentation, the seller would be excused from making the export sale and could claim damages. The sales contract should also specify that the buyer is responsible for obtaining all necessary import licenses and making any foreign government filings. The contract should state that the buyer will obtain such licenses sufficiently in advance. (Johnson & Bade 2010, 309.)

4.2.8 Governing law

Although references are frequently made to the ‘global marketplace’, there is no such thing as a ‘global’ legal system containing laws of universal application. Different systems exist in the world today, and it should hardly be surprising to find disparity in the laws of countries that have had fundamentally different historical, cultural and political development. (Nayler 2006, 7) Due to the lack of uniform rules for agreements the parties are forced to rely on national laws which do not take into account the specific needs of international trade and differ substantially from one country to another. (Bortolotti, Ferrier, Lando, Matray, Meyer Swantee & Roberts 1993, 1.)

In international sales agreements the rights and obligations of the parties will be governed by either the law of the country of the seller or the law of the country of the buyer. The laws of most countries permit the seller and buyer to specifically agree on which law will apply, and that choice will be binding upon both parties. If the governing law is not agreed by the parties, it will be extremely difficult to determine with any confidence which law governs the sales agreement when a dispute arises. (Johnson & Bade 2010, 309-311.)

In recognition of the difficulties faced in contracting across country boundaries, the international community has begun to adopt systems of laws and rules to be applied instead of local laws in transactions between parties located in different countries. The intent behind this is to ensure that all parties are subject to the same set of rules. If parties to an international sales contract are nationals of countries that have acceded to an international treaty or pact, like the United Nations Convention on the International Sale of Goods (CISG), they may rely on international law to determine at least some of their rights and obligations. (Shippey 2009, 10.)

The Convention on Contracts for the International Sale of Goods permits parties located in countries that are parties to the Convention to exclude the application of the Convention and to choose the law of either party. However, for companies located in any of the countries that are parties to the convention, if the seller and buyer do not agree on which law will apply, the provisions of the Convention will automatically apply. (Johnson & Bade 2010, 104-105.)

4.2.9 Dispute resolution and termination

One method to resolve disputes that may arise between the parties is litigation in the courts, and another one is arbitration. (Johnson & Babe 2010, 105-106.) It is not uncommon to include a special clause in the sales contract that provides for arbitration in the event a dispute arises. The clause normally defines what matters are to be arbitrated, if the findings are binding and by whom and where the arbitration is to be conducted. (Holtz 1997, 167.)

Arbitration clause is included in the contract when both parties agree to arbitration rather than legal action to resolve a dispute. When it is used there are advantages and disadvantages for both the buyer and the seller, and as a result of that it should not be agreed to without a thought. (Hinkelman 2008, 22.) Arbitration is unlikely to save much in expenses and may not involve a significantly shorter time period to resolve the dispute. (Johnson & Babe 2010, 311-312.)

The right to cancel or terminate a contract may often not be exercised but will be important if the occasion arises. Express cancellation rights should be included in every contract, even if the parties do not anticipate the need. In international contracts, the termination clause takes on added significance since the parties are dealing with increased number of factors that are beyond their control than in domestic contracts. This includes factors like long distance transport, customs clearance, different markets and customs, and distinct economic and political forces. In case termination is not expressly covered by the sales contract, courts are likely to assume that the parties intended termination based on a reasonable justification only. (Shippey 2009, 106-107.)

4.3 Relationship between the sales contract and a Letter of Credit as a payment method

The purpose of the Letter of Credit is to provide a sense of security in terms of payment to the seller and credit to the buyer. The concept revolves around using the bank as a mediator between the seller and the buyer in order to effect payment. The Letter of Credit is utilized if it is the agreed method of payment in the sale contract. When the credit is opened, the bank becomes a party to a new separate contract with its own duties and obligations. This means that there are two distinct contracts in operation, one relating to the Letter of Credit and the other representing the underlying sale contract, working independently of each other. (Website of the Law Teacher 2016.)

Every Letter of Credit transaction arises from an agreement between a buyer and a seller. (Gordon 2000, 3-1.) Under most legal systems a contract is created by the conjunction of offer and acceptance. (Jimenez 2003, 78 - 82.) Since quotation is an offer to sell and acts as one-half of a contract it should include all information needed by the buyer to make a purchase decision. In every quotation the exporter should include the terms of payment and state how the exporter is to be paid. If instructions are required, as with Letter of Credit, instructions should be included or referred to. (Gordon 2000, 3-6 – 3-7.)

The intention of Letter of Credit instructions is to result in receipt of Letter of Credit that will be acceptable without requiring amendment. The Letter of Credit instructions addresses a number of important issues, like (Gordon 2000, 3-9 – 3-12.)

- identifies the beneficiary
- stipulates the documents the exporter expects to provide
- stipulates how the Letter of Credit is to be issued and available
- stipulates when shipment will occur in relation to the Letter of Credit
- any other requirements the seller may have

The seller (beneficiary) is responsible for preparing and presenting documents in accordance with the terms of the sales contract. If the documents are incorrect or inconsistent there is a risk that they will be refused, and time and money is wasted. The buyer (applicant) is initially responsible for listing and clearly communicating to the seller the documents that are required. (Hinkelman 2008, 149.)

5 LETTER OF CREDIT

5.1 Definition of a Letter of Credit

The Letter of Credit, also known as a Documentary Credit or a Banker’s Commercial Credit, is a method of payment that gives a sense of security to the seller who does not know buyer’s credit history, and also protects buyer who may be doubtful about the seller’s intentions or abilities to supply the goods. The use of Letter of Credit may have started more than 150 years ago, but throughout the 20th century they have carved a niche in modern day cross-border trade, becoming a widely accepted means of payment in commerce. (Website of the Law Teacher 2016.)

Letter of Credit is one of the most common payment methods used in international transactions since it offers high degree of protection for both of the parties. The buyer has the chance to determine and specify the exact documentation needed from the seller before the payment is made, while the seller gets a guarantee that the payment is made after the goods are shipped in case the seller is able to present the required documentation for the bank. (Hinkelman 2008, 13.)

Letter of Credit is the buyer’s bank's (issuing bank’s) written agreement that it will pay the sum of money specified in the Letter of Credit to the seller according to the instructions it has received. The payment will happen once the seller (beneficiary) has presented the documents stipulated in the Letter of Credit for the issuing bank. (Eloniemi 2011, 17.) Letter of Credit is not a guarantee, it is a conditional promise from a bank in which the condition is that the conditions of the Letter of Credit are fulfilled. (Gordon 2000, 2-1.)

The main value in a Letter of Credit to the seller (beneficiary) is that there is a payment commitment made buy a third party, which is a bank. In many countries banks are considered to be reliable and responsible organizations which are believed to comply with ethical business practices and to handle their commercial dealings with caution. (Gordon 2000, 2-1 – 2-2.)

5.2 Types of Letter of Credits

The type of Letter of Credit can be **revocable** or **irrevocable**, **confirmed** or **unconfirmed**, or **clean** or **documentary**. A revocable Letter of Credit is not a definite undertaking by the issuing (buyer’s) bank while an irrecoverable Letter of Credit is a definite undertaking of the issuing bank provided that the terms and conditions of the Letter of Credit are complied with. When unconfirmed Letter of Credit is used the issuing bank has a binding obligation to pay if all the terms and conditions of the Letter of Credit have been met, while in case of the confirmed Letter of Credit a second bank makes an independent undertaking to pay against documents presented in line with the terms and conditions of Letter of Credit. A documentary Letter of Credit is payable against the presentation of shipping or delivery documents while the clean Letter of

Credit calls for payment against presentation of a demand for payment. (Gordon 2000, 4-1 – 4-5.)

The primary function of a **standby** Letter of Credit is to serve as a security rather than a payment mechanism. The beneficiary (seller) can claim payment in the event the contract partner (buyer) has failed to fulfil certain obligations. (Jimenez 2012, 129.)

When “**at sight**” documentary credit is used the seller will be paid after having presented the documents conforming to the terms and conditions of the Letter of Credit. When a **deferred payment** documentary credit is used the seller grants the buyer a term of payment, and the seller will be paid when the term of payment has elapsed. (Website of Nordea.)

5.3 The Uniform Customs and Practice (UCP) for Documentary Credits

Since the 1920s banks have started to create, modify and amend the rules they are using to handle Letter of Credits. These rules are *the Uniform Customs and Practices for Documentary Credits* (UCP). (Gordon 2000, 2-1.) These are set up by the International Chamber of Commerce (ICC), (Website of the Law Teacher) and accepted by most of the banks in the world as a standard for handling Letter of Credit. (Gordon 2000, 2-1.) These rules are used by all the banks operating in Finland. (Eloniemi 2011, 17.)

The sales contract may stipulate the use of the UCP rules governing the credit transaction. These rules only serve as a governing statute if the underlying contracts expressly stipulate its use. (Website of the Law Teacher 2016.) The UCP rules state that the bank’s task is to deal only with the documents, not with the goods, performance or services to which the documents may be related to. (Jimenez 2012, 121.)

The UCP rules define comprehensively the use of Letter of Credits and govern for example different documents, definitions, interpretations, obligations and the roles of the banks. (Eloniemi 2011, 17.) The rules are more flexible than international or national laws as it is a codification of an actual trade practices which are based on the experiences of trade bankers, importers and exporters. The rules can also be more easily updated than an international law or a treaty. (Jimenez 2012, 125.)

Although various translations of the UCP have been made to many different languages, the official one is still the English version. The translated versions are there to help the correct usage of the rules in daily work, but in case there is a contradiction between the versions the English one will overrule the translated one. (Eloniemi 2011, 17.)

5.4 Reasons for using Letter of Credits

The purpose of the Letter of Credit is to provide a sense of security in terms of payment to the seller and credit to the buyer. The concept revolves around using the bank as a mediator between the seller and the buyer in order to effect payment. (Website of the Law Teacher 2016.)

When a Letter of Credit is being used the exporter has the guarantee of a payment from the issuing bank as long as it obeys the terms of the Letter of Credit, meaning that the payment does not depend on the buyers will or capability to pay for the goods. In addition to that the payment date is also specified when Letter of Credit is used. (Website of Nordea.)

Letter of Credit and cash in advance are the two payment methods that convert sales into cash in a relatively risk free and timely manner. For some exporters, especially those in weak financial condition or heavy demands for cash flows, these two methods may be the only acceptable options. The value of Letter of Credit to the exporter is that the payment commitment is made by a third party, a bank which in most countries is a reliable organisation. The other reasons why an exporter might demand a Letter of Credit could be for example a company policy requiring use of cash in advance or Letter of Credit, or the use Letter of Credit as collateral to the exporter’s bank in support of loans. (Gordon 2000, 1-33 – 2-2.)

Letter of Credit offers also security for the buyer since the bank will not make the payment if the documents do not assure that the buyer's terms are fully obeyed. The buyer will also get the guarantee that the delivery of the goods will take place in accordance with the requirements of the Letter of Credit. (Website of Nordea.)

5.5 Letter of Credit process

5.5.1 Issuance of the Letter of Credit

At first an agreement (sales contract) between the buyer and the seller is made where payment by Letter of Credit is agreed. The next step is that the buyer (applicant) will instruct their bank (issuing bank) to raise the Letter of Credit. It will then be passed to the beneficiary (seller) through the issuing bank's correspondent bank (advising bank) in the exporter's country. (Sherlock & Reuvid 2011, 345.)

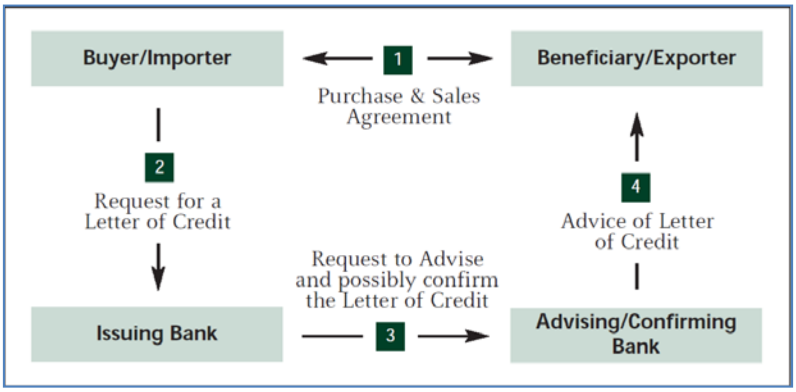


Figure 3. Issuance of Letter of Credit (Website of the Trade Development Network 2010)

The four basic parties in Letter of Credit transactions are as follows (Hinkelman 2008, 39.)

- The **buyer (applicant)** is the party applying to his bank to open the Letter of Credit naming the seller as beneficiary
- The **issuing (buyer's) bank** is the bank issuing the Letter of Credit naming the seller as beneficiary, and sends it to the advising bank
- The **advising/confirming (seller's) bank** is the bank advising the seller of the credit, which is typically the seller's regular business bank located in the seller's country

- The **seller (beneficiary)** is the party that receives notification (advice) of the credit from the advising bank, complies with the terms and conditions of the Letter of Credit, and gets paid

The seller must ensure that all details included in the L/C can be complied with when the documents are to be prepared for presentation at the bank. If not accurately amended, when the Letter of Credit is first received, it may be difficult to get corrections later. (Grath 2013, 63, 66.)

5.5.2 Utilization of the Letter of Credit

If the terms and conditions in the Letter of Credit are as planned and no amendments are needed, the exporter's task is to prepare the goods for shipment and to advice the forwarder to prepare the required transport documents, e.g. Bill of Lading (title document). (Jimenez 2003, 26,181). After the shipment has started and the seller has all the necessary documents it presents them to the bank that is nominated in the credit to effect payment. (Arvonen & Sievi-Korte 2013.)

One of the main documents in the Letter of Credit process is the Bill of Lading (title document), which allows the buyer to take the goods from the harbour or from the place where the goods are shipped to. (Hinkelman 2008, 13.)

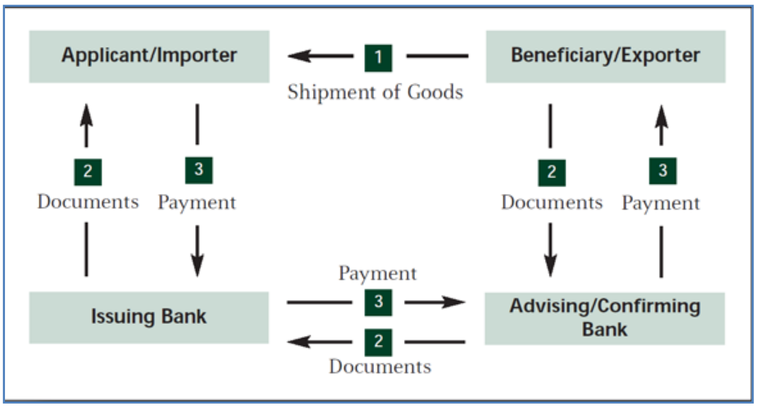


Figure 4. Payment under Letter of Credit (Website of the Trade Development Network 2010)

Once the bank receives the documentation it examines it in order to make sure that they comply with the terms of the Letter of Credit. (Jimenez 2003, 26 & 181). It is highly important that the documents are accurate and consistent with the terms of the Letter of Credit. In case there are discrepancies the issuing bank and buyer have the right to refuse to make the payment. In many cases the documents presented to the bank contain some errors which can cause delay or prevent the fulfilment of the credit. (Hinkelman 2008, 13.)

In case it is determined that there are discrepancies in the documents, the bank should contact the seller for instructions. The best option is to correct the discrepancies and represent the corrected documents within the validity of the credit. If that is not possible the seller can try to get the payment authorised despite the discrepancies or get the bank to send the documents at the seller’s risk. (Gordon 2000, 3-42 – 3-44.)

If the discrepancies cannot be corrected the security of the Letter of Credit is lost. The bank may contact the buyer, via the issuing bank, and inform them of the discrepancies. The buyer then has the right to accept or reject the documents. The problem for the seller is that the goods are on their way, or arrived at, the destination. The worst case scenario is if that the goods are not cleared into the importing country or returned to the exporting country they will be auctioned off. (Sherlock & Reuvid 2008, 353.)

Once the documents are examined by the seller’s bank, it arranges the payment to the seller and transmits the documents to the issuing bank. In case the documents are in line with the terms and conditions of the Letter of Credit the issuing bank reimburses the nominated bank and gives the documents to the applicant (buyer), who can present them to the shipping company and take over the goods. (Arvonen & Sievi-Korte 2013.)

The way that the exporter gets paid depends on the type of the Letter of Credit. The exporter can get paid immediately ("sight” credit), or later ("deferred payment" credit). A draft that is payable in the future can also be discounted to a partial, immediate payment. (Jimenez 2003, 26.)

5.5.3 Confirmed Letter of Credit

In case the beneficiary (seller) has asked for the Letter of Credit to be *confirmed,* it requires that the buyer attains a confirmation of the Letter of Credit from another bank, usually from one that is located in the same country than the seller. (Jimenez 2003, 25). When the Letter of Credit is confirmed the **confirming bank** should be treated as it was the issuing bank. Usually the issuing bank asks the confirming bank to add its confirmation so that the confirming bank becomes the one who has the primary liability on the Letter of Credit. (Gordon 2000, 2-3.)

Confirmed Letters of Credit is commitment to pay from both the issuing and the advising banks. The advising bank’s commitment to pay is independent of that of the issuing bank. This means that when documents conforming to the requirements of confirmed Letter of Credit are presented in a timely manner, the payment from the advising bank to the seller is final in all respects. (Hinkelman 2002, 182.)

Exporters also have the possibility to ask their own banks add a "documentary purchase agreement", which is a silent confirmation from the exporter's bank. (Gordon 2000, 2-3.)

5.6 Disputes

If the seller is able to present conforming documents, the bank must normally pay against the documents. The only exception is when manifested fraud is involved. However, payment under a Letter of Credit might not be the end of the story. The buyer may take legal actions even if the payment is received under the Letter of Credit. The availability of potential remedy is subject to applicable law, which in turn depends on provisions in the sales contract. (Jimenez 2003, 26 - 27)

In case interpretation of the provisions of the ICC rules on documentary credits (UCP) are involved in the dispute, the dispute may be also settled by a DOCDEX decision process, which is a less expensive than arbitration or court action. However, the drawback is that the decision is not binding unless the parties agree to make it so. (Jimenez 2003, 27)

5.7 Costs of using Letter of Credits

It is important that the seller knows all the Letter of Credit charges when the selling price is defined and factors them into the selling price. Generally the fee splitting arrangement is for the buyer to absorb most of the costs incurred in setting-up the Letter of Credit while the costs in the seller's country are usually the responsibility of the seller (beneficiary). However, the seller and buyer can arrange to split the fees differently. The fees for the seller normally include the following:

- advising
- payment
- potential discrepancy related payments
- communication charges to buyer's bank
- courier and postage
- reimbursement bank charge and bank-to-bank reimbursement

(Website of the Credit Management World 2016.)

5.8 Typical problems and risks with Letter of Credits

Common problems associated with the Letter of Credit process are problems with the Letter of Credit, Bill of Lading, insurance and inconsistencies among documents. Faulty and fraudulent documentation are the major risks for parties involved in international trade, leading to refused or delayed payment. (Website of the International Trade Forum Magazine)

If the discrepancies related to Letter of Credit documentation cannot be corrected the security of the Letter of Credit is lost. The bank may contact the buyer, via the issuing bank, and inform them of the discrepancies. The buyer then has the right to accept or reject the documents. The problem for the seller is that the goods are on their way, or arrived at the destination. The worst case scenario is if that the goods are not cleared into the importing country or returned to the exporting country they will be auctioned off. (Sherlock & Reuvid 2008, 353.)

6 CASE COMPANY

6.1 Rolls-Royce Oy Ab

Rolls-Royce Oy Ab is a member of the Rolls-Royce Marine division within Rolls-Royce group. It was established in 1988 through the merger of Rauma-Repola Shipyard's Deck Machinery Works (established in 1940) and Hollming Shipyard's Engineering Works (established in 1965). The company was acquired by Vickers in 1995 and by Rolls-Royce in 1999. (Website of Rolls-Royce Oy Ab Intranet 2016.)

Rolls-Royce Oy Ab has production sites in Rauma and Kokkola and they have 550 employees in Rauma and 78 in Kokkola. The turnover was 468 million euros in 2005. It has three product groups – Azimuth Thrusters, Deck Machinery and Water Jets. 61% of the 2015 turnover came from Azimuth Thrusters, 10% from Deck Machinery, 2% from Waterjets and 27% from Services. Most of the company's turnover (99 %) came from export. (Website of Rolls-Royce Oy Ab Intranet 2016.)

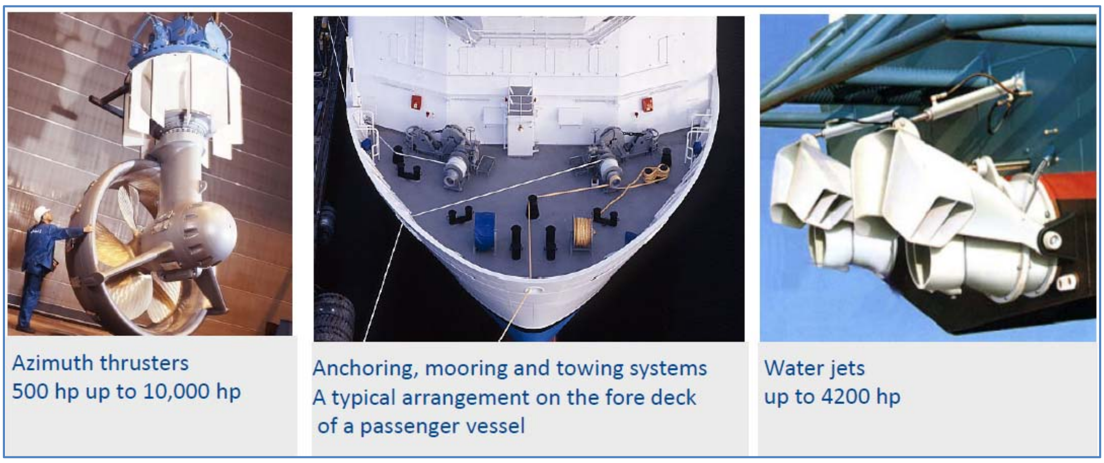


Figure 5. Rolls-Royce Oy Ab's product groups (Website of Rolls-Royce Oy Ab Intranet 2016)

6.2 Export process

When exporting Rolls-Royce Oy Ab must comply with export control legislation. All countries Rolls-Royce do business with control the export of certain technologies, but each country controls different technologies in different ways. Within Rolls-Royce the group (Rolls-Royce plc) concentrates on initiatives at strategic government level, whilst individual businesses are responsible for their own licensing decisions. Rolls-Royce has nominated Export Point of Contacts (EPOCs) to provide a first point of contact within the business for export control matters. EPOCs provide guidance to help process export transactions and alert business to larger issues. Currently Rolls-Royce Oy Ab has 8 individuals in Rauma and 7 in Kokkola acting as EPOC in addition to their daily work. (Website of Rolls-Royce Plc Intranet 2016.)

Once potential export control issues are cleared, the company can export its goods and services. In Rolls-Royce Oy Ab the Azimuth Thruster products are produced and shipped from Finland while the Deck Machinery products are produced and shipped from factories located in Poland, South Korea and China. In addition to the main Deck Machinery deliveries from these three factories, some vital parts are delivered to customers as separate shipments. These vital parts were shipped from Finland until late 2015, and after that from Poland.

When exporting Rolls-Royce Oy Ab needs to take care of export custom clearance. These activities are outsourced, and the used partners vary based on the production location.

6.3 Letter of Credit process

Rolls-Royce Oy Ab’s Letter of Credit process is coordinated by a Trade Finance team located in Rauma. From the Trade Finance team’s point of view the process includes the following steps:

1. Check Letter of Credit related terms from draft contract document

   When needed, the Trade Finance team provides guidance for the Letter of Credit related contractual terms and conditions. This guidance if normally provided for individuals in Sales and Sales Support organisation.

2. Request issuance of Letter of Credit

   Based on project schedules set by Contract Managers the Trade Finance team requests customer to issue the Letter of Credit. This request includes opening instructions.

3. Check conditions of draft Letter of Credit

   The Trade Finance team checks issued draft Letter of Credit (if issued by the customer). This check includes all shipment related conditions and required documents. If needed, the Trade Finance requests amendments until the Letter of Credit can be approved.

4. Approve opened Letter of Credit

   The Trade Finance team approves Letter of Credit document received from the advising bank. When needed, amendments are asked from the customer.

5. Prepare and check Letter of Credit related documents

   The Trade Finance team prepares documents, like invoices, according to Letter of Credit and checks documents, like bill of lading, from third parties. If needed they request changes to documents until they are acceptable.

6. Negotiate documents

   The Trade Finance team negotiates documents with bank according to conditions of Letter of Credit.

7. Follow-up payments

   The Trade Finance team follow-up of Letter of Credit related payments.

The overall Letter of Credit process for both Azimuth Thrusters and Deck Machinery products is the same, but the process for Deck Machinery is more complex since the goods are not shipped from Finland. The local forwarding department and external partners in Poland, South Korea and China are involved in the process by controlling deliveries and helping with the needed documentation. Even if these departments/parties are involved in the process, the overall responsibility of approving the documents sits in the Trade Finance team in Rauma.

7 RESEARCH METHODOLOGY

7.1 Research background

Research means a systematic process by which additional knowledge is gathered from a specific subject. Research can be divided into several types based on the purpose of the research. The aim of the process can be for example to make contributions to the knowledge base of a specific field (pure research), improve a particular practice (applied research), evaluate the value of something (evaluation research) or to identify a particular problem (action research). (Merriam 2009, 4.) The research type of this thesis is applied research.

The aim of a research based development is to solve organization's problems and to develop existing practises and new ideas. New working methods, products or services can be created in companies and organizations with the help of development work. The basis of the development work is systematically and critically evaluating theoretical and practical background information about the phenomena. Various research methods can be used in this type of development work. (Ojasalo, Moilanen & Ritalahti 2009, 12, 18.)

Research based development can start due to various causes. For example the organization may want to improve or change something. Instead of only explaining and describing things, research based development also focuses on solving problems and producing new ideas and practices. The main difference between a scientific research and a research based development is that in addition to producing new theory the aim is also to make practical improvements and solutions. (Ojasalo, Moilanen & Ritalahti 2009, 19). This thesis is a research based development.

7.2 Research strategy and design

Before conducting the research a research strategy needs to be selected. The research strategy is not the same thing than research methodology. The research strategy means the manner of an approach that is taken towards the research rather than the concrete methods. These strategies do not have their own predetermined methodologies since both quantitative and qualitative methods can be utilized in most research strategies. There are six types of research strategies that are especially suitable for research based development. These are case study, action based research, constructive research, producing innovations, forecasting and network analysis. (Ojasalo, Moilanen & Ritalahti 2009, 51; Kananen 2015, 67)

The selection of one research strategy does not exclude all the other available strategies. Features of more than one research strategy can appear in one research in case they are properly justified and described in the reports related to the research work. (Ojasalo, Moilanen & Ritalahti 2009, 51)

7.2.1 Case study

Case studies are typical research strategies especially in business sciences. They are based on already existing theories and to previous studies conducted in the chosen field. Case studies are usually a combination of both qualitative and quantitative methods and they usually offer deep and comprehensive description about the cases that are being researched. (Ojasalo, Moilanen & Ritalahti 2015, 52-53; Kananen 2015, 67)

The first phase of a case study is getting familiar with the available literature and finding the relevant information about the topic on hand. By this the researcher will gain needed information to be able to collect the material for the empirical part. Both quantitative and qualitative methods can be used for case studies by either choosing one or using both of them. Concrete methods that can be used for case studies can be for example interviews, surveys, observations or analysis. By conducting the empirical part the researcher will be able to create the development ideas or models. (Ojasalo, Moilanen & Ritalahti 2015, 54)

7.3 Research methods

Research methods are the concrete methods or ways that are used to solve a research problem. Selecting a research method requires that the author is well familiarized with the problem. Methods that are scientifically approved are used in order to produce reliable information to which the solution can be based on. (Kananen 2015, 65)

There are different research methods. The data collection methods can be divided into qualitative and quantitative methods. These methods are complementary and in some cases it is difficult to clearly classify whether a specific method is qualitative or quantitative. (Hakala 2004, 113; Hirsjärvi, Remes & Sajavaara 2007, 131– 133)

The research problem defines the most suitable methods. In case there is already existing theory and previous studies available about the research problem quantitative methods can be used. Qualitative methods are favoured and in some cases even required, like when people's everyday behaviour or life historie's are being researched. (Silverman 2010, 10; Kananen 2015, 67)

7.3.1 Qualitative methods

Qualitative methods include a wide set of data collection methods which can for example be in depth or conversational interview, participant observation, case study, personal experience, observation and interaction. Qualitative methods produce information that is not based on statistical procedures or any other means of quantification. Subjectivity and the authenticity of human experience is a strong feature in the qualitative research. Things are studied usually in their natural settings in order to interpret or make sense of things. The interpretation of the collected material is subjective due to the meanings people bring to the interpretations of the phenomena. (Kuada 2012, 93; Newman & Benz 1998, 16)

The basic idea behind qualitative research is that there are multiple interpretations and realities of one event instead of a single observable reality. Instead of finding reality researchers construct it. Some of the key characteristics in qualitative research are that the focus is on understanding and meaning of the process, the researcher is the primary instrument in the data collection and analysis, and the end product is largely descriptive. The central activities in qualitative research are analysing, observing and interviewing (Merriam 2009, 2, 14)

7.3.2 Quantitative methods

Quantitative research methods are methods that give a general image about the relationships between measurable variables. They answer for example to questions like how much and how often. Quantitative methods also focus especially on the cause and effect relationships between things. Objectivity is essential in this type of research, which means that the researcher does not have an effect to the research result. Quantitative studies have a limited amount of variables that the researcher will select. Variable can be an attribute, action or a fact concerning for example a person such as an occupation, sex, age or gender. Research instruments providing quantitative information or verbal information turned into quantitative information are used. Survey, interview and observation forms are commonly used research instruments. (Mujis 2004, 7; Vilkka 2007, 13-14)

Quantitative methods are the only accurate methods for studying numerical changes and they are especially suitable for testing existing theories and hypotheses. However, they are not very suitable for developing hypotheses and theories. Therefore a quantitative study requires preliminary knowledge about the research problem. The hypotheses that is tested by using quantitative methods may come for example from existing literature or theory or can be created for example by using qualitative research methods. (Mujis 2004, 7, 9)

7.4 Research strategy and methodology of the thesis

This thesis is a quantitative research based development which aims to reduce the risks in the Letter of Credit process for the case company. This is done by collecting information about issues occurring in the Letter of Credit process and their frequency, and by evaluating potential risks the issues create for the case company. The target is to provide recommendations how to avoid these issues in the future. The research strategy will be a case study since the purpose of a case study is to develop new suggestions and ideas for existing practices. (Ojasalo, Moilanen & Ritalahti 2015, 52-53)

Case study as the chosen research strategy is especially appropriate for this thesis since a comprehensive knowledge is required about the theory and practice of the Letter of Credit process in order for the author to give proper recommendations for the case company.

This research is mainly a quantitative research, so the main focus will be on quantitative methods. However qualitative methods will also be used. Information about the case organization's Letter of Credit processes will be collected from available documentation and by interviewing relevant individuals. Information about Letter of Credit cases and issues occurred will be collected from the databases used by the case company.

The information about of Letter of Credit cases and identified issues will be available on a numerical form after the author has gone through the selected data set and turned it into statistics. The author has created a hypothesis based on the theory collected from the topic and base on her previous experience at the case organization. The hypothesis is that that most of the issues in the Letter of Credit process are caused by bad contract conditions. Qualitative methods will be used to test the hypothesis.

Other qualitative methods that will be used are for example interviews, which are used to gain in-depth knowledge of the subject. The persons who will be interviewed are Chief - Trade Finance, Area Sales Manager and General Manager - Contract Management and Engineer to Order of the case company. These persons have been involved in the Letter of Credit process of the case company for several years and have knowledge about the problems and risks in they have encountered in their daily jobs.

7.5 The collection and analysis of the data

The main data collection methods that will be used in this thesis are observation and interview. In observation the researcher follows the activity of the target that is being researched. Observation is used for example to find out if people or processes operate in the way that they are expected to. Observation can be divided into several types. The two main types of observation are participant observation and structured observation. These types differ significantly from one another. For example participant observation is a qualitative method which emphasizes the meanings that people place on certain actions while structured observation is a quantitative method which focuses more on frequency of for example specific actions. (Saunders, Lewis & Thornhill 2003, 221; Ojasalo, Moilanen & Ritalahti 2009, 103)

In this research mostly structured observation will be used. However, qualitative observation is also required in order to further evaluate the causes of the problems that have happened in cases where Letter of Credits have been used as a payment method and the possible risks that the problems create to the case company. This analysis is not performed by using numerical data or quantitative information, so qualitative methods need to be used as well.

Besides of observation interviews will be used as a data collection method in this research. Interview can be used to complete or confirm the information that has been collected with observations. Interviews are especially well suited for cases where the aim is to develop something since through interviewing it is possible to quickly collect in depth information about the subject that is being the target of development. (Ojasalo, Moilanen & Ritalahti 2009, 95)

The forms of interview vary from unstructured interview to completely structured interview. In this case a semi-structured theme interview will be used. This means that specific themes will be used as the topics of the conversation. These themes are usually broad and cannot be answered with just one or two sentences. A theme interview requires a face-to-face contact between the interviewer and the interviewee. The things that will be discussed are not narrow predetermined topics. The purpose of this type of interview is that while discussing about the different themes new things or topics will arise for discussion. The benefit of this type of interview for the interviewer is that by examining issues related to the topic the researcher is able to develop his or her understanding of the topic. (Kananen 2015, 143-148)

7.6 Evaluation of validity and reliability of the research

Validity is the level of confidence we can have that the data provide insight into reality. The test design, content, procedures used to collect and statistically analyse data affect the validity of the resulting data. (Sleezer, Russ-Eft & Gupta 2014, 378.)

Reliability is the degree of consistency in the data or the item. In practice the reliability means that when a phenomena or a person is being researched at two separate occasions or by different researchers the research is reliable in case the results are the same. Reliability is used to reflect the level of error in the measurement.(Sleezer, Russ-Eft & Gupta 2014, 376; Hirsjärvi, Remes & Sajavaara 2007, 226.)

Information from the literature review is seen valid based on the high number of reliable sources (e.g. university library and Google books) used with relatively consistent content.

The author has worked in the case company during summers 2014 and 2015 in addition to some short periods during the school semester. Therefore the author has gained some basic knowledge about the topic and it can be assumed that she is based on her previous experience able to conduct a valid research about the topic.

The author decided to start the research by using qualitative methods in form of a semi-structured theme interview. The reason for selecting the interview as a research method was that the author wished to gain an extensive understanding of the topic in order to make a valid research.

The interviewees for this research were selected from three different departments, which each have their own roles in the Letter of Credit process. These departments were trade finance, sales and the contract management departments. The author decided to select one individual from each department with the most experience and knowledge in the field. This selection was made in order to ensure the validity of the research. The interviewees were the chief of the trade finance department and the head of the contract management department. From the sales department the author decided to interview the individual in charge of sales to Asia since based on discussion with the trade finance team that was the area with most challenges with the Letter of Credits in these cases.

Results from the interview can be seen to be valid due to the different roles and perspectives of the individuals in the process in addition to the extensive knowledge and experience these three individuals have.

The author wanted to validate the interview results by conducting a case study to get facts from actual Letter of Credit cases of the case company from two years. With the case study the author could see if there were problems involved in the Letter of Credit process, and the type and magnitude of these problems. By this the author could see if the results from the case study supported the findings from the interviews, and confirm or reject assumptions and validate the results based on the interviews.

The results of the research can be seen to be valid due to the fact based information collected from actual cases which was used to support or reject findings of the interview. It is likely that the results of this research could also be applied to other companies working with Letter of Credits in order to see if they have same type of problems.

7.7 Research plan

The idea for this research was born during the summer 2015 while the author was working in the case company. Based on her experience in the company the author came up with a hypothesis that most of the problems related to Letter of Credits were caused by bad contract conditions. The author thought it would be interesting to test this hypothesis, and in case the hypothesis was not true to see where the problems actually came from and figure out ways to prevent the problems in the future.

After familiarizing herself with the theory and writing the literature review the author decided with the case company about the limitations of the research. It was decided that cases from two years (2014 and 2015) will be selected for the research from two product lines, Rauma Azimuth Thrusters and Rauma Deck Machinery. In total there will be 248 cases. In the Azimuth Thrusters product line there are 127 cases with 46 customers in 11 different countries. In the Deck Machinery product line there are 121 cases with 23 customers in 10 different countries. The company's internal system gives information that Letter of Credit has been used as a payment method in all of these cases. Firstly the author will check if the information in the system is correct, meaning that Letters of Credit has really been used as a payment method in these cases. The next step is to eliminate potential cases from the research that are falsely classified as Letter of Credit Cases in the system.

Based on the literature review the author will investigate the material from the selected cases, such as contracts, Letter of Credits documents and correspondence, in order to see what type of problems there have been and what have been the causes for these problems. Special focus will be on the problems caused by bad contract conditions. Based on the analysis the author will make statistics about number of cases with problems by type of problem. By this the case company will gain fact based information about the most common problems. Based on this the author will make an in-depth investigation to the problems in order to figure out if these problems could have been avoided.

The author will before researching the cases conduct a semi-structured theme interview with the Chief – Trade Finance, Area Sales Manager and General Manager – Contract Management and Engineer to Order of the case company. A semi-structured interview is beneficial in this case since the persons who are interviewed will most likely provide their opinions and information to the topic from different points of views.

After collecting and analysing the data the author will start writing the research results and suggestions for improvement.

8 RESEARCH

8.1 Interviews

8.1.1 Conduction of the interviews

The face-to-face interviews for this thesis were conducted in April 2016. A semi-structured theme interview was selected where the author had predetermined themes to be used as the topics of the conversation. The reason for this was that the author did not want to limit the content of the interviews and wished to achieve a broad understanding of the topic provided by persons who are involved in different parts of the Letter of Credit process, and have different points of view about the topic. Since the interview was conducted face-to-face this allowed new questions to arise for discussion during the interview.

The titles of the three persons who were interviewed were *Chief - Trade Finance, Area Sales Manager* and *General Manager - Contract Management and Engineer to Order*. All three interviews were conducted separately with each individual. There were two main themes for the interview. The first one was issues in the Letter of Credit process, the causes for these issues and how often specific issues occurred. The second theme was the relationship between the sales contracts and Letter of Credits. The focus was on the terms and conditions that have caused problems in the Letter of Credit process, the risks these issues create for the case company and how they could be prevented in the future. The interview themes are available on the Appendix 1.

The author wanted to conduct the interviews before completing the case study so that she could compare the results from these two methods. By completing the case study after the interviews the author could find out if the results from the analysis are in-line with the assumptions of the persons interviewed. In this case the quantitative methods were used in order to validate the data collected.

8.1.2 Interview results

A short conclusion was made based on the answers of the three persons interviewed. The complete answers of each person interviewed are available on the Appendix 2.

All the three persons agreed that there had been issues while Letter of Credit had been used as a payment method. Contract was seen as an important tool for risk handling in the Letter of Credit process, since the payment cannot be secured in case the terms and conditions of the sales contract do not support the Letter of Credit. Almost all the problems in the Letter of Credit process were seen to be somehow, indirectly or directly, linked to the contract.

There, however, might still be problems even though the contract terms and conditions are correct and support the Letter of Credit. Even if the customer is provided with instructions about how to open the Letter of Credit correctly they are not always willing to open based on all of the conditions defined in the contract and opening instruction. In case the customer does not follow the opening instructions, amendments to the Letter of Credit document are usually needed.

One of the most common problems is that the customer opens the Letter of Credit late due to the guarantee requirements from the opening bank. The documentary requirements of the Letter of Credit may also be challenging for the case company to fulfil, as the trigger for a payment may be a document signed and issued by the customer. This means that fulfilling the documentary requirements of the Letter Credit and receiving the payment is dependent of the buyer's willingness to offer the correct document.

Other problems related to Letter of Credits are the delays in the shipment schedules, mistakes in documentation, especially in case the negotiation period for the documents is short, and the possible differences between the opening bank's and the advising bank's interpretation of the Letter of Credit.

Especially unclear contract terms and conditions in the contract leaving room for interpretation can cause problems or delays in payment while executing the Letter of Credit conditions. The contract should also clearly define the opening bank of the Letter of Credit, especially in case there are only a few solid banks in the country of the buyer. In case the contract does not specify that only a first class bank is acceptable the bank can be almost any type of bank which causes risks for the seller.

Ways for risk handling and preventing issues are to accept only contractual terms and conditions that support the Letter of Credit and by not accepting conditions where the payment is dependent on for example of a document issued and signed by the customer. However, the terms and conditions that the case company is able to negotiate to the contract are dependent of the competitive situation and the history the case company has with the client.

In case the case company has a strong market position it can require better contractual terms and conditions. When the position is weak there is a risk that bad conditions need to be accepted to get the contract. In cases when some contract condition has been used previously with the customer the case company has to offer a good reasoning why the same condition could no longer be used.

Usually both the buyer and the seller have their preferred conditions, and the contract is a compromise between these parties. Neither the buyer of the seller is usually able to get the exact terms and conditions they would like to.

Ways to reduce risks related Letter of Credit payments with contracts would be for example getting better contract templates for sales, commercial education and better instructions about the Letter of Credits and related documents. In addition to that risks could be reduced by providing information about acceptable and non-acceptable contractual terms and conditions to Chinese customers in Chinese and English with proper reasoning why some specified terms should not be used.

8.2 Case study

8.2.1 Case selection for the case study

It was decided that data included in the analysis consists of projects (sales contract or part of sales contract including equipment for one ship) with deliverables in 2014 and 2015. The finance department in Rauma generated a report from the ERP system with this information. Based on the report Rolls-Royce Oy Ab had totally 938 projects with deliverables in 2014 and 2015. Based on the report Letter of Credit was used as payment method in 281 of these projects. Since it was decided that Waterjet deliveries from Kokkola are excluded from the analysis the total number of projects included in the analysis was 248. That included 127 Azimuth Thruster projects with 46 different customers in 11 different countries and 121 Deck Machinery projects with 23 different customers in 10 countries.

Table 1. Rolls-Royce Oy Ab's projects with deliverables in 2014 and 2015. (Made by the author 2016)

	Number of Customers			Number of Projects			Number of Countries			
	With LC	Without LC	Total	With LC	Without LC	Total	With LC	Without LC	Combination	Total
Kokkola	6	62	68	33	234	267	6	21	-2	25
Rauma Thr	46	58	104	127	354	481	11	26	-7	30
DM	23	29	52	121	69	190	10	15	-7	18
Total	**75**	**149**	**224**	**281**	**657**	**938**	**27**	**62**	**-16**	**73**

Based on discussion with the Trade Finance team it was decided that the first part of the analysis is to validate the data in the report. This was done by checking all the 248 projects from excel file used by Trade Finance team to ensure that Letter of Credit was really used as a payment method. Based on the validation it was found out that some of the information was incorrect – Letter of Credit was not used as payment method in some of the projects. The reason for the incorrect data was either the incorrect input in the ERP system when the contract was received or lack of system update when the payment terms were changed at a later point. In addition to this validation it was decided that the cases where the Letter of Credit process was not finalised (e.g. payment not yet received) are left out from the analysis.

After the projects where Letter of Credit was not used as payment method and cases where the Letter of Credit process was not finalised were removed from the report the total number of cases included in the further analysis was 225. This included 112 Azimuth Thruster projects with 45 different customer in 10 different countries and 113 Deck Machinery projects with 21 different customers in 9 different countries.

Table 2. Rolls-Royce Oy Ab’s Azimuth Thruster and Deck Machinery projects included in the analysis. (Made by the author 2016)

	Letter of Credit Cases		
	Projects	Customers	Countries
Rauma Thr	112	45	10
DM	113	21	9
Total	**225**	**66**	**19**

8.2.2 Letter of Credit related payment posts

The next step after the case selection was more detailed investigation of payment posts and deliverables for each of the selected project.

The payment terms used with sales contracts vary from contract to contract, meaning that the terms for investigated projects vary accordingly. One sales contract can include number of different payment posts, like advance payment at the time of the contract signature, progress payments based on progress of the engineering and/or manufacturing process, payments at the time of the delivery and payments after delivery. The payment methods for the different payment posts can vary, even within the same project. The most common payment methods used by the case company are bank transfer and Letter of Credit. Only the payment posts where Letter of Credit was used as the payment method were included in the analysis.

In the case company one project can include one or more deliverables (equipment or part of equipment shipped to customer). Since the Letter of Credit process and the documentation used in the process are in most of the cases linked to deliverables the next step of the investigation was to find out the deliverables linked to each of the payment posts, and to find potential payment posts where Letter of Credit was used without equipment delivery. This information was available in the excel file updated by the Trade Finance team. Based on the file there were 393 Letter of Credit deliverables and 7 Letter of Credit payment posts without physical equipment delivery, meaning that the total number of Letter of Credit documentation to be reviewed was 400 cases.

Table 3. Rolls-Royce Oy Ab's Azimuth Thruster and Deck Machinery projects with Letter of Credit deliverables and Letter of Credit payment posts without equipment deliveries. (Made by the author 2016)

	Letter of Credit						
	Projects	Documents	Equipment deliverables	Without equipment deliverable	Total	Customers	Countries
Rauma Thr	112	116	174	7	181	45	10
DM	113	116	219		219	21	9
Total	**225**	**232**	**393**	**7**	**400**	**66**	**19**

Each Letter of Credit has unique identification number. There is no one-to-one relationship between Letter of Credit identification number and a project since the same Letter of Credit can be used for more than one projects with the same customer and since more than one Letter of Credit can be used for one project. The total number of Letter of Credits included in the investigation was 232 (see table 3 above).

Even if the number of investigated Letter of Credits was 232, the documents for all of the 400 deliverables and payment posts without equipment deliveries needed to be investigated to find out if any of the 400 cases triggered Letter of Credit changes. The 232 Letter of Credits had between one and six deliverables each, and these deliverables belonged to one to three different projects.

8.2.3 Analysis

It was decided that the best way to find out the potential contractual Terms & Conditions causing problems in the Letter of Credit process was to identify Letter of Credit related changes and amendments, and by checking if the need for amendments was linked to contractual Terms & Conditions or other issues.

The cases selected for the analysis were investigated by going through the Letter of Credit related documentation for each of the 400 deliverables and the Letter of Credit related payment posts without deliverables. This was done by checking the relevant documents from the case company’s network drive. In addition to that all the paper documents were checked for 80 deliverables. Based on the experience from these 80 deliverables it was decided that the added value from that work is limited compared to the time it takes to go through all the papers. As a result of that it was decided that the information in the case company’s network drive is good enough for this part of the investigation. The documents looked at were

- Sales contract amendments
- Opening instructions sent to customer (appendix 3)
- Draft Letter of Credit document
- Opened Letter of Credit document (appendix 4)
- Documents listed in Letter of Credit (appendix 5), including transport documents, like Bill of Lading and Airway Bill, commercial invoice, packing list and various certificates, like insurance certificate, certificate of origin and packing material related certificates
- Letter of Credit and document related amendments (appendix 6)
- Correspondence between the local forwarding department and external partners in Poland, South Korea and China
- Correspondence between the case company and the customer
- Correspondence between the case company and the negotiating bank

When the documents were investigated the focus was on Letter of Credit related changes (need for changes, type of changes) and discrepancies when the final Letter of Credit documents were sent to the issuing bank.

8.2.4 Findings from the analysis

Even if the case company provides opening instructions for Letter of Credits to customer and comments to draft Letter of Credit document (if received from customer) there was high number of changes after the opened Letter of Credit was received from the advising bank.

Based on the Letter of Credit draft documents and correspondence before the opening of Letter of Credit the most commonly discussed topics were insurance certificates, transhipments & partial shipments, Letter of Credit related documents and date and place of expiry.

After the Letter of Credit was opened and received from the advising bank more than 50% of the Letter of Credits or related documents were changed based on a request from the case company. The most common changes were related to expiry and latest shipment dates. The table 4 below includes information about the actual changes done based on request from the case company. Please note that there were also cases where changes were requested, but not completed by other parties. The case company has work-arounds for certain changes not done by other parties to secure the payment. For example when the port of loading is not in accordance with Letter of Credit the invoice document can be issued with limited information (without port of loading).

Table 4. Rolls-Royce Oy Ab's Azimuth Thruster and Deck Machinery Letter of Credit changes. (Made by the author 2016)

		LC documents with amendments	Expiry date	Latest shipment date	Change in LC related documents	Delivery terms	LC amount	Description of goods	Partial shipment	Trans-shipment	Forwarding company	Other changes
Azimuth Thrusters	Yes	42	22	24	19	12	1	3	1	6	8	9
	No	74	94	92	97	104	115	113	115	110	108	107
	Total documents	**116**	**116**	**116**	**116**	**116**	**116**	**116**	**116**	**116**	**116**	**116**
	% of amendments	36 %	19 %	21 %	16 %	10 %	1 %	3 %	1 %	5 %	7 %	8 %
Deck Machinery	Yes	81	58	59	24	29	12	11	1	9	4	5
	No	35	58	57	92	87	104	105	115	107	112	111
	Total documents	**116**	**116**	**116**	**116**	**116**	**116**	**116**	**116**	**116**	**116**	**116**
	% of amendments	70 %	50 %	51 %	21 %	25 %	10 %	9 %	1 %	8 %	3 %	4 %
Total Case Company	Yes	123	80	83	43	41	13	14	2	15	12	14
	No	109	152	149	189	191	219	218	230	217	220	218
	Total documents	**232**	**232**	**232**	**232**	**232**	**232**	**232**	**232**	**232**	**232**	**232**
	% of amendments	53 %	34 %	36 %	19 %	18 %	6 %	6 %	1 %	6 %	5 %	6 %

We can see from the table 4 above that Deck Machinery cases generated more changes than Azimuth Thruster cases, and that expiry and latest shipment date needed to be changed in every second Deck Machinery case. Relatively high amount of Deck Machinery changes were also linked to delivery terms and Letter of Credit related documents.

In addition to changes requested by the case company, the advising bank requested changes to negotiated documents. Of the investigated 232 cases 18 (9 Azimuth

Thruster and 9 Deck Machinery cases) were such that bank request changes to documents. These changes were related to typing mistakes, incorrect or missing information and discrepancies between documents.

Totally seven discrepancy cases were identified, one from Deck Machinery and six from Azimuth Thrusters. These discrepancies were caused by shipments not done based on the Letter of Credit or documents not provided in accordance with Letter of Credit.

8.2.5 Potential issues caused by bad contracts

The next step of the case study was to find out which of the issues identified in the analysis are caused by bad contractual Terms & Conditions. This was done by looking at sales contracts for projects with identified issues. When the number of identified issues in a category was low all related sales contracts were checked and when the number of issues was high only randomly selected sales contracts were checked. Input was also asked from the Trade Finance team for each of the categories identified as part of the analysis.

Expiry date & Latest shipment date: based on the Trade Finance team the most common reason for the amendments is delivery delays or unavailability of transportation equipment. Based on results from the contract investigation no bad contractual Terms & Conditions related to the expiry or latest shipment date found.

In addition to expiry date related Letter of Credit changes also Expiry Place related changes were identified (e.g. *place of expiry Rizhao*). The time the case company has to negotiate the Letter of Credit documents reduces in case the Expiry Place in the Letter of Credit is not changed to Finland. Normally the time the company has is 21 days, and in one of the investigated cases the time was reduced to 7 days due to Expiry Place abroad.

Changes in Letter of Credit related documents: based on the Trade Finance team some of the sales contracts include unacceptable documents. Based on results from the contract investigation many of the amendments were caused by a need to change the documents to fit for air transportation. The main reason for this was delivery delays, not bad sales contract. In addition to that many of the amendments were linked to insurance certificate. When the contract documents were checked the text in the contracts was actually correct – *insurance policy or certificate*, but the text used in the Letter of Credit was not in accordance with contract.

There were also cases where *Warranty Bank Guarantee* was removed from the Letter of Credit documents. When the contracts were checked they included Warranty Bank Guarantee, but not as part of Letter of Credit documents. In addition to that there were cases where Letter of Credit documents listed in the contract included Performance Guarantee. Letter of Credit was amended by removing the performance guarantee from Letter of Credit documents since it is not a delivery related document and it is provided by an external party (a bank). If these type of documents are kept in the Letter of Credit documentation the risk that the case company is not able to negotiate the documents by the expiry date increases.

The buyer shall establish an irrevocable 80% of the contract value L/C at sight in favour of the Sellers 60 days prior to the date of shipment, and will be paid against presentation of the shipping documents stipulated in clause 10 hereof. … The Sellers shall send the following documents to any bank for negotiation. … ***Performance guarantee*** *(see clause 17). … Clause 17: Performance Guarantee. The Seller shall furnish the Buyer a "Performance and Warranty Guarantee" in the amount of ten percent of the total contract value in the currency of the contract, issued by First Class Bank. The Performance Guarantee shall remain valid in full force for a period of 24 months counting from the date of B/L or 12 months counting from the date on which the new-built ship be delivered to ship owner, whichever comes earlier.*

There were cases where the contract defined that the packing list includes detailed information on an item level. The Letter of Credit document was amended to have the detailed information on a package level. *80% of the contract value, payable against irrevocable Letter of Credit (LC) issued by first class international bank in favour of the Seller 45 days before 1st shipment in accordance with this contract clause 6., LC is payable on shipments of commodities against documents under contract section 12* *paragraphs 1-6. … 12. Documents. … 5. Packing List in duplicate with indication of both gross and net weights, measurements and quantity of* ***each item packed****.*

There were cases where the Letter of Credit was not linked to a physical delivery and the Letter of Credit related documentation included inspection report signed by external parties. The risk related to this type of term was minimised by including contractual terms to ensure that the payment is received before expiry of the Letter of Credit or by a specific date, even if the documents were not presented.

An irrevocable at sight L/C shall be opened by first class Chinese bank, acceptable to the Seller and in favour of the Seller, covering 90% of the amount of each ship set. The L/C shall be opened after the effectiveness of the contract, however, not later than 45 days before delivery of the goods … 1) 85% of the total contract value shall be paid at sight on presentation of the documents stipulated in the clause 11B. 2) The rest 5% shall be paid on presentation of the documents stipulated in the clause 11C, ***however in any event payment will be made against invoice before expiry of L/C without other documents****. … 11C … One original Opening Inspection Report of the Goods signed by the End user, the shipyard and the Sellers.*

5% of the contract value will be released, upon final signed commissioning report, but ***not later than*** *30th Jan 2016. Payment against a confirmed, irrevocable, divisible and transferrable Letter of Credit opened latest on 1 Dec 2015 by the Buyer in a first class international bank, acceptable by to the Seller expiring earliest 15th February 2016. Prior to 30th Dec 2015 documents limited only to the* ***Warranty Bond*** *and photo copy of signed commissioning report to be presented under the Letter of Credit, 30th Dec 2015 and onwards only documents to be presented shall be Sellers payment instructions and Warranty Bond is to be presented under the Letter of Credit.* In this case the Warranty Bond was not included in Letter of Credit documents, even if it was included in the contract as a Letter of Credit document. Customer opened Letter of Credit based on opening instructions from the case company.

15% of Total Amount: within one month upon contract – by wire transfer or L/C against both the Seller Banker's refund guarantee bond covering 15% of the contract price and submission of approval drawings. 10% of Total Amount: Upon shipment of

Hull Fitting Accessories and Seating Bottom Plates, negotiable against the concerned shipping documents by L/C. 15% of Total Amount: Upon shipment of Thruster Inboard Part, negotiable against the concerned shipping documents by L/C. 55% of Total Amount: upon shipment of underwater mountable thruster unit, negotiable by L/C against the concerned shipping documentation. 5% of Total Amount: Retention by L/C to be paid ***against the Seller's final documentation****.* In this case the contract only defines "shipping documents" used in connection with physical equipment delivery, the term "final documentation" was not clearly defined in the contract. In addition to that the 5% retention payment did not include any "not later than" date.

Delivery terms: based on the Trade Finance team the most common reason for the amendments is the need to use air transportation due to delivery delays. Since air transportation is more expensive than sea transportation it is only used when there is a delay with risk of reduced customer satisfaction or late delivery penalties for the case company.

Based on results from the contract investigation many of the amendments were caused by a need to change the delivery terms to fit for air transportation. The main reason for this was delivery delays. In addition to this, in many of the amendments port of loading was changed. When contracts were checked the Letter of Credit related part of the contract did not include information about the port of loading. According to the Trade Finance team some of the changes port of loading (and discharge) can be related to opening bank's errors while opening the Letter of Credit.

Letter of Credit amount: based on the Trade Finance team the most common reason for the Letter of Credit amendments is amended sales contract, which has not been taken into consideration when the Letter of Credit was opened. Based on results from the contract investigation the amendments were caused by an increase in total contract value due to contract amendment. Letter of Credits were opened based on the original contract value without taking into consideration increased contract.

Description of Goods: based on the Trade Finance team the description of goods is not included in the sales contract – it comes from the customer or issuing bank. Based on results from the contract investigation description of the goods to be used in Letter of Credit was not included in the checked sales contracts.

Partial shipment: based on the Trade Finance team changes are needed to Letter of Credits to allow partial shipments. Based on results from the contract investigation there were cases where the partial shipments were not allowed based on the received Letter of Credit document, but no information about partial shipments was included in the contract document or the partial shipments were allowed based on the contract document.

Transhipment: based on the Trade Finance team changes are needed to Letter of Credits to allow transhipment. Based on results from the contract investigation there were cases where the case company had a basic agreement on General Terms and Conditions and project specific Terms & Conditions were handled as Purchase Order. Based on these Purchase Order documents and opened Letter of Credits transhipments were not allowed.

There were also cases where the transhipment was allowed based on the contract (e.g. *if transhipment is necessary, the Seller should inform the Buyer by fax of the name and voyage number of second feeder vessel as soon as transhipment is effected* or *five partial transhipment is allowed*), but the Letter of Credit included additional requirements, like *the transhipment is only allowed at Hong Kong* or *transhipment allowed at Shanghai only*. The Letter of Credit needed to be changed in cases like this, since transhipment (use of feeder vessel) at Finland was required to be able to get the equipment to ocean going vessel for shipment to the final destination. *Shipping instructions: transhipment not allowed.*

Forwarding company: based on the Trade Finance team the forwarding company’s name does not need to be included in the Letter of Credit document, but in some cases when customer arranges the transportation they have include the name of the forwarding company to the Letter of Credit, even if the final decision of the company to be used is not done. Based on results from the contract investigation there were cases where the forwarding company needed to be changed in the Letter of Credit, but the contract did not include information about the company.

Other changes: Based on results from the contract investigation other Letter of Credit related changes were mainly related to typing mistakes, incorrect use of terminology (goods value vs. contract value), type of Letter of Credit (e.g. *irrevocable* in contract, but *irrevocable transferrable* in the Letter of Credit) and split of total contract value.

8.2.6 Summary of results from the sales contract investigation

Based on the sales contract investigation the bad contractual terms & conditions identified were related to not-allowed **transhipments**, use of Letter of Credit without "**not later than date**" when there is no physical equipment delivery and acceptable Letter of Credit **documents** listed in the contract. Examples of not acceptable documents found are Performance Guarantees, Warranty Bonds and non-delivery related reports signed by external parties.

In case of bad contractual terms and conditions, the Trade Finance team has tried to mitigate risks for the case company by issuing opening instructions based on acceptable Letter of Credit and by requiring changes to draft and opened Letter of Credits.

There were also cases where the contractual terms & conditions were acceptable, but the Letter of Credit was not opened based on these terms & conditions. In these cases the Trade Finance team asked for Letter of Credit amendments. In addition to this high number of Letter of Credit related issues and changes were identified where the root cause was not a bad sales contract. For example high number of changes were required due to delayed deliveries (expiry and latest shipment date, terms and documents to allow air transportation), and there was need to allow partial shipments and change letter of credit amount, name of forwarding company, description of goods and port of loading.

8.3 Conclusion based on the research

The assumption based on interviews was that the problems in the Letter of Credit process were seen either directly or indirectly linked to sales contracts. It was also recognised that there might still be problems even if the contractual terms and conditions

support the use of Letter of Credit as payment method, and as a result of that Letter of Credit amendments are needed.
The common problems mentioned were late opening of Letter of Credits by customer due to guarantee requirements from the opening bank and challenges to fulfil Letter of Credit related document requirements due to documents issued for example by customer. In addition to that delays in the shipment schedules, mistakes in documentation and differences between the issuing bank's and the advising bank's interpretation of the Letter of Credit were mentioned as problems.

The results from the case study are in-line with the input from the interviews – there are Letter of Credit related problems due to bad sales contracts and also problems that are not caused by the contracts. The common problems from the interviews are also identified as problems in the case study – document requirements, delays in the shipment schedules and mistakes in documentation.

In summary, based on the case study the bad contractual terms & conditions are related to not-allowed **transhipments**, use of Letter of Credit without "**not later than date**" when there is no physical equipment delivery and acceptable Letter of Credit **documents** listed in the contract. The case company could mitigate payment related risks by improving these terms and conditions in future contracts. This would not remove the need for the Trade Finance team to provide opening instructions and check and ask for Letter of Credit amendments when needed, but it should increase the probability that the term related to these points in Letter of Credits are acceptable.

9 RISK MITIGATION BY THE USE OF LETTER OF CREDIT

9.1 Product, production and transport risks

Product itself, delivery (including physical movement of the goods), specified performance and agreed maintenance or service obligations are included in the product risk. The areas covered by the sales contract and related Letter of Credit are description of goods and delivery terms. The transfer of title of goods and risks are normally defined by the delivery terms, like Incoterms. In addition to that, insurance requirements can be included in the sales contract and the insurance policy or certificate can be included in Letter of Credit documentation.

In most of the cases Letter of Credit and related documents include more detailed information about the transportation than the sales contract. Letter of Credit document includes information about port of loading and discharge and the related documents include actual transportation documents, like Bill of Lading or Airway Bill.

Based on the research the Letter of Credit amendments related to this risk were around delivery terms, port of loading, description of goods, partial shipments, transhipments and insurance policy. The only issue caused by bad contract terms and conditions was related **transhipment**.

9.2 Commercial risks

Risk of the buyer going into bankruptcy or being in any other way incapable of fulfilling their contractual obligations, or to prevent seller to fulfil their obligations is commercial risk. The areas covered by the sales contract and related Letter of Credit are payment terms – use of Letter of Credit and its conditions, like validity period (when opened, when expires), payment period (at sight or number of days after documents negotiated), type of Letter of Credit (confirmed Letter of Credit) and banks used (first class bank). The risks for the seller vary based on selection of these conditions.

Based on the research the Letter of Credit amendments related to this risk were around expiry date. These amendments were not cause by bad contractual terms and conditions.

9.3 Political or country risks

In case of political risk the commercial transaction is not realized according to contract due to measures from the government or authority of the buyer’s own or foreign country. The areas that could be covered by the sales contract and related Letter of Credit are delivery terms defining transfer of risk, transportation route and type of Letter of Credit (e.g. confirmed). In some cases the selected alternatives can have impact on political or country risk.

Based on the research the Letter of Credit amendments related to this risk were around delivery terms. These amendments were not cause by bad contractual terms and conditions.

9.4 Adverse business risk

Adverse business risk includes business practices of negative nature which could have impact on individual transactions, general business and financial standing and moral reputation of the seller for example bribery, money laundering and facilitation payments. No areas covered by contract and related Letter of Credit identified to mitigate this risk. This risk is handle by the case company by strict anti-bribery and corruption guidelines and training.

9.5 Currency risks

A currency risk means that the payment is made in another currency than in which the seller incurs their costs. The area covered by the sales contract and related Letter of Credit is used contract currency. The currency risks in the case company are handled by currency hedging which is done outside sales contracts and Letter of Credit process.

9.6 Financial risks

Financial risk covers seller’s liquidity. The areas that covered by the sales contract and related Letter of Credit are payment period (at sight or number of days after documents negotiated), Letter of Credit related documents (since they are a requirement for the payment), period for negotiation and type of Letter of Credit (confirmed). When confirmed Letter of Credit is used the seller has an option to use discounting to get the payment from the bank earlier than by following the normal Letter of Credit process.

Based on the research the Letter of Credit amendments related to this risk were around **Letter of Credit related documents** and Letter of Credits used when no physical equipment delivery took place **without "not later than" date**. These amendments were cause by bad contractual terms and conditions.

9.7 Summary

The Letter of Credit related bad contractual terms and conditions increase transport and financial risks for the case company.

The transportation related risk arises from terms and conditions not allowing transhipments. The case company is not able to deliver equipment based on contractual terms and conditions when feeder vessel is needed before equipment can be loaded into oceangoing vessel and transported to customer.

The financial risk arises from terms and conditions including Letter of Credit related documents outside the case company's control. When these documents are not available within negotiating period the case company is at risk to lose the payment. In addition to that the financial risk arises from use of Letter of Credit when no physical equipment delivery takes place without "not later than date" with documents outside the case company's control.

10 SUGGESTIONS FOR IMPROVEMENT

Based on the case study the bad contractual terms & conditions are related to not-allowed **transhipments**, use of Letter of Credit without "**not later than date**" when there is no physical equipment delivery and acceptable Letter of Credit **documents** listed in the contract. The case company could mitigate payment related risks by improving these terms and conditions in the future contracts for example by providing training to the sales organisation. This would not remove the need for the Trade Finance team to provide opening instructions and check and ask for Letter of Credit amendments when needed, but it should increase the probability that the term related to these points in Letter of Credits are acceptable.

There were also cases where the contractual terms & conditions were acceptable, but the Letter of Credit was not opened based on these terms & conditions. In these cases the Trade Finance team asked for Letter of Credit amendments. In addition to this high number of Letter of Credit related issues and changes were identified where the root cause was not a bad sales contract. For example high number of changes were required due to delayed deliveries (expiry and latest shipment date, terms and documents to allow air transportation), and there was need to allow partial shipments and change letter of credit amount, name of forwarding company, description of goods and port of loading. The case company could check if currently used opening instructions could be change to have more emphasis on the points with high number of identified issues, or the case company could create a cover letter to be included in the opening instructions highlighting the problem areas and providing guidance.

Since the case company has some customers with frequent Letter of Credit deliveries the case company could use the data collected in excel format in connection with the case study and make additional pivot tables to see statistical information about the type of issues each of the frequent customers have had. This information could be shared with the sales organisation with explanation of risks these issues create for the case company. When new orders are negotiated with these frequent customers the sales organisation could take these issues up with the customer and discuss potential solutions to avoid them in the future.

As proposed by the interviewed individuals the company could also reduce risks by providing Letter of Credit related training and instructions, including information about clear contractual terms and conditions to be used (no room for interpretation) and acceptable and not-acceptable Letter of Credit documents. In addition to that it was proposed that better contract templates for sales and providing information about acceptable and non-acceptable contractual terms and conditions to Chinese customers in Chinese and English with proper reasoning why some specific terms should not be used could improve the situation.

In summary, the proposed improvement actions are all around communicating, training and providing guidance within the case company and towards customer.

11 SUMMARY AND CONCLUSIONS

The purpose of this thesis was to increase the case company's information about the type of problems causing issues while Letter of Credit has been used as a payment method and the magnitude of the identified issues. The thesis was made with an emphasis to the role of the sales contract in the Letter of Credit process since it was assumed by the author that the main reason behind the issues with Letter of Credits were the bad contract conditions.

The research started with defining the purposes and goals of the thesis in addition to creating the conceptual framework. The conceptual framework was the basis for the theoretical and empirical part. The theoretical part started with basic information about exporting goods, the risks involved in exporting goods for the seller and ways for handling these risks.

The various risks identified were divided to six different categories which the author used later in the empirical part of the thesis to analyse the risks that the bad contract terms and conditions created for the company. The theoretical part also provided the reader with information about the sales contract and Letter of Credits and the relationship between these two.

After familiarising the reader with the theory, a research strategy and methods were selected. This research was a research based development and the research strategy was a case study. The research methods used were both quantitative and qualitative. The research was conducted mainly in the forms of interviews and by analysing the company's data of selected Letter of Credit cases between the years 2014 and 2015.

The author started the research by looking into the Letter of Credit documents, Letter of credit related opening instructions, Letter of Credit related documents sent to the bank and amendments to the Letter of Credit document of the selected cases. Based on this frequently occurred issues were identified. Then next step was to find out which of these problems were in fact results of bad contract terms and conditions.

Based on the research most of the issues related to bad contract terms and conditions were linked to documentary requirements, transhipments and to cases where the payment was tied to a document signed by the customer without a condition securing the payment in other ways. However, the author found out that in addition to the problems caused by the sales contract there were also a lot of problems that were unrelated to the bad contract terms and conditions, like issues related to partial shipments, description of goods and to delivery terms.

Based on the findings of the research recommendations were made for the case company. In summary, the proposed improvement actions are all around communicating, training and providing guidance within the case company and towards customer.

The research fulfilled its purpose to increase the case company's and the author's information about the type of problems causing issues while Letter of Credit has been used as a payment method and the magnitude of those issues.

The assumption before starting the thesis was that most of the problems were related to bad contractual terms and conditions. The author was however surprised to learn that in addition to the bad sales contracts there was also a high number of cases where the sales contract did not include bad contract terms or conditions but the problems were in fact caused by something else, like customer not following the sales contract when Letter of Credit was opened or delayed deliveries.

12 FINAL WORDS

The idea for this thesis originated from the practical trainings the author did in the case company during two summers. The topic of the thesis felt interesting for the author due to the previous work experience the author had concerning Letter of Credits.

The author was eager to increase her knowledge of Letter of Credits and thought that choosing this particular topic for the thesis was a good way for this. This topic was also a good way for the author to gain knowledge not only concerning Letter of Credits but also about other things related to Letter of Credits, such as sales contracts and risks.

This thesis also helped the author to better understand the work tasks she has done in the company. For example now the author has not only knowledge about the problems in Letter of Credits but also about the root causes and risks related to these problems.

The author worked on this thesis approximately for five months. The author felt like she gave her full effort and concentration on making this thesis. The author was simultaneously also completing some of her final courses which also took a lot of time and effort. During this period the author had no problems to decide how to spend her free time.

Although the process sometimes included a lot of stress the process was also very interesting and educational for the author. The author felt that she learned a lot more by doing this thesis than she would have learned by just reading theory about the chosen topic. The author has done her best effort to successfully complete this thesis and is satisfied with the results. The author is also very grateful for the extensive support and help she received from the Trade finance team of the case company.

REFERENCES

Alston, R., Cook, T.A., & Raia, K. 2012. Mastering Import and Export Management (2nd Edition). New York: AMACOM Books.Referred 15.02.2016. http://site.ebrary.com.lillukka.samk.fi

Arvonen, T. & Sievi-Korte, M.Documentary Credit (D/C) / Letter of Credit (L/C) Training material of Rolls-Royce Oy Ab 2013 29.11.2013.

Bishop, E. 2003. Finance of International Trade. Oxford: Elsevier Butterworth-Heinemann. Referred 12.02.2016. http://site.ebrary.com.lillukka.samk.fi

Bortolotti, F., Ferrier, D., Lando, O., Matray, D., Meyer Swantee, K & Roberts, V. 1993. The ICC Agency Model Contract: A Commentary. Deventer, Boston: Kluwer Law and Taxation Publishers.

Boyce, Tim. 2003. Project Risk Management: The Commercial Dimension. London: Thorogood.

Branch, A. 2006. Export Practice and Management.London: Thomson Learning.

Eloniemi, M. 2011. Letter of credits and quarantees in international business. Thesis. Vaasa: Vaasa University of Applied Sciences. Referred 28.2.2016. https://publications.theseus.fi/handle/10024/28627

Gordon, S. J. 2000. Export / Import Letter of Credits and Payment Methods Second Edition. Dayton: Global Training Center, Inc.

Grath, A. 2013. The Handbook of International Trade and Finance: The Complete Guide for International Sales, Finance, Shipping and Administration, Third Edition. London: Kogan Page.

Hakala, J.T.2004. Opinnäytetyöopas ammattikorkeakouluille. Helsinki: Gaudeamus.

Heineman, B.W.2008. High Performance with High Integrity.Boston: Harvard Business Press.

Hinkelman, E.G. 2002. A Short Course in International Trade Documentation: The Documents of Exporting, Importing, Shipping and Banking. California: World Trade Press. Referred 15.02.2016. http://site.ebrary.com.lillukka.samk.fi

Hinkelman, E. G. 2008. Short Course in International Payments: Letters of Credit, Documentary Collections and Cyber Payments in International Transactions (3rd Edition). California: World Trade Press. Referred 28.02.2016. http://site.ebrary.com.lillukka.samk.fi

Hirsjärvi, S., Remes, P. & Sajavaara, P. 2007. Tutki ja kirjoita. 13th edition. Keuruu: Otava.

Holtz, H.1997. The Complete Guide to Consulting Contracts: How to Understand, Draft and Negotiate Contracts and Agreements that Work, Second Edition.USA: Kaplan Professional.

Jimenez, G. 2003. Guide to Export-Import Basics 2nd Edition.Paris: ICC Publishing S.A.

Jimenez, G. 2012. ICC Guide to Export / Import Global Standards for International Trade Fourth Edition.Paris: ICC Publishing S.A.

Johnson, T.E. & Bade, D.L. 2010. Export / Import Procedures and Documentation Fourth Edition. New York: AMACOM. Referred 22.02.2016. http://site.ebrary.com.lillukka.samk.fi/

Kananen, J.2015. Opinnäytetyön kirjoittajan opas. Jyväskylä: Jyväskylän ammattikorkeakoulu.

Kuada, J.2012. Research Methodology: A Project Guide for University Students. Frederiksberg: Samfunds litteratur. Referred 30.03.2016. https://books.google.fi

Merriam, S. B. 2009. Qualitative Research A Guide to Design and Implementation. San Fransisco: Jossey-Bass.

Mujis, D.2004. Doing quantitative research in Education.London: Sage Publications Ltd. Referred 30.03.2016. https://books.google.fi

Nayler, P. 2006. Business Law in the Global Market Place. Oxford: Taylor and Francis Ltd. 23.02.2016. https://www.dawsonera.com/abstract/9780080455051

Newman, I. & Benz, C. R. 1998. Qualitative-quantitative Research Methodology: Exploring the Interactive Continuum. Carbondale: Shouthern Illinois University Press. Referred 30.03.2016. https://books.google.fi/

Ojasalo, K., Moilanen, T. & Ritalahti, J. 2009. Kehittämistyön menetelmät. Helsinki: WSOYpro.

Reuvid, J. 2004. A Handbook of World Trade: A Strategic Guide to Trading Internationally, 2nd Edition. London: Kogan Page.

Reynolds, F. 2003. Managing Exports Navigating the Complex Rules, Controls, Barries, and Laws. New Jersey: John Wiley & Sons, INC. Referred 04.02.2016. https://books.google.fi

Saunders, M., Lewis, P. & Thornhill, A. 2003. Research Methods for Business Students Third edition. Harlow: Pearson Education Limited.

Sherlock, J. & Reuvid, J. 2011. An Essential Guide to the Principles and Practice of Export. Maidenhead: Kogan Page. Referred 01.03.2016. https://www.dawsonera.com/preview/9780749462383

Sherlock, J. &, Reuvid, J. 2008. The Handbook of International Trade A Guide to the Principles and Practice of Export Second Edition. London: GMB Publishing Ltd.

Shippey, K. C. 2009. Short Course in International Contracts: Drafting the International Sales Contract for Attorneys and Non-attorneys 4th Edition. California: World Trade Press. Referred 22.02.2016. https://books.google.fi

Silverman, D.2010. Doing Qualitative Research Third Edition. London: Sage Publications Ltd. Referred 30.03.2016. https://books.google.fi/books

Sleezer, C. M., Russ- Eft, D. & Gupta, K. Practical Guide to Needs Assessment Third Edition. San Fransisco: John Wiley Sons, Inc. Referred 26.06.2016. http://site.ebrary.com.lillukka.samk.fi

Todd, P. 2007. Bills of Lading and Bankers Documentary Credits Fourth Edition. London: Informa Law. Referred 01.02.2016. https://books.google.fi

Vilkka, H.2007. Tutki ja mittaa: Määrällisen tutkimuksen perusteet. Helsinki: Tammi.

Website of Nordea. Referred 28.02.2016. http://www.nordea.fi

Website of Rolls-Royce Oy Ab Intranet. Referred 15.04.2016. http://intra/yritysesittely/index.php

Website of Rolls-Royce Plc Intranet. Referred 15.04.2016. www.infocentre.rolls-royce.com

Website of Taloussanomat. Referred 28.02.2016. http://www.taloussanomat.fi/porssi/sanakirja

Website of the Credit Management World. Referred 11.03.2016. http://www.creditmanagementworld.com

Website of the International Trade Forum Magazine. Referred 11.03.2016. http://www.tradeforum.org

Website of the Law Teacher. Referred 11.03.2016. http://www.lawteacher.net/free-law-essays/commercial-law/letter-of-credit-and-contract-of-sale-commercial-law-essay.php

Website of the Royal Bank of Scotland. Referred 01.02.2016. http://www.rbs.co.uk

Website of the Trade Development Network. Referred 11.03.2016. www.tradev.net/downloads/tools/guide2lc.pdf

Westwood, J.2012. How to Get Started in Export. London: Kogan Page. Referred 10.02.2016. https://www.dawsonera.com/preview/9780749463724

APPENDIX 1

INTERVIEW QUESTIONS

THEME ONE: ISSUES IN THE LETTER OF CREDIT PROCESS

- Has there been any issues when Letter of Credit has been used as a payment method?

- In case there has been any issues, what kind of issues there has been?

- How often do these issues occur?

- What have these issues been caused by?

THEME TWO: CONTRACTS AND LETTER OF CREDITS

- How often are issues in the Letter of Credit process caused by the Sales contract?

- What kind of terms and conditions in the contract usually cause issues in the Letter of Credit process?

- What kind of risks do these issues create?

- How could these issues be avoided?

APPENDIX 2

INTERVIEW RESULTS

THEME ONE: Issues in the Letter of Credit process

- *Have there been any issues when Letter of Credit has been used as a payment method?*

  The answer from all the three persons interviewed was yes

- *In case there has been any issues, what kind of issues there has been? What have these issues been caused by?*

  Chief - Trade Finance: The payment cannot be secured in case the contract terms and conditions do not support the Letter of Credit. The aim is to avoid the problems caused by bad contract conditions in the Letter of Credit by providing the customer with Letter of Credit opening instructions.

  However, it is not always possible to avoid all problems. For example especially in shipments within Korea the requirement for payment is sometimes a document signed by the customer. This means that the seller will not receive the payment unless the buyer provides the signed document.

  There might be still problems even though the contract terms and conditions are correct and support the Letter of Credit. Even if the customer is provided with instructions about how to open the Letter of Credit correctly, the customer may not be willing to open the Letter of Credit with all the conditions defined in the contract. So, in some cases problems might still arise even if the contract supports the Letter of Credit.

  The most common problems that are not related to the contract in Letter of Credits are the delays in the shipment schedule. Delays can be caused by multiple factors, for example delays caused by the subcontractors, component suppliers or delays in production. The shipment can also be delayed due to unavailability of containers or flat tracks.

Other problems are for example mistakes in the documentation. If the document containing errors is made by the case company it can be corrected. In case the document is issued for example by a freight forwarder they might have their own limited ways of making the necessary documents (for example the Bill of Lading), which means that it is not necessarily possible to get all the demands that the Letter of Credit requires to these documents.

There is also a limited period defined in the Letter of Credit (usually 21 days) for the seller to present the documents for the negotiating bank, which can cause problems if the documents defined in the Letter of Credit cannot be attained quickly. The errors in documents issued by the case company can be usually corrected within a short period of time. However, getting new documents from example from a freight forwarder may take some time, and there may not be enough time to get these new documents before the negotiation period is coming to an end.

There are problems that the case company has control over and also problems which the case company has no control over. For example the customer may not open the Letter of Credit on time or at all or there might be problems with banks. The bank's task is to check that the papers do not contain errors. However, in some cases the bank may not notice all the errors or the opening bank may interpret things differently than the advising bank.

General Manager - Contract Management and Engineer to Order: The most common problem is that the customer opens the Letter of Credit too late since the customer does not want to give guarantee to the opening bank. There are also problems in the text of the Letter of Credit document. Although opening instructions are sent to the customer, the customer does not always follow the instructions and amendments are needed.

The conditions of the Letter of Credit can also be sometimes challenging to fulfil. There may be for example challenges concerning the documentation that the Letter of Credit requires. Sometimes the documents required in the Letter of Credit document must be issued and signed by the customer, which means that fulfilling the documentary requirements of the Letter Credit is dependent of the buyer's willingness to offer the correct documentation.

There are diverse reasons for problems with Letter of Credits. However, all of them are somehow related to the contracts.

Area Sales Manager: The problem with Letter of Credit usually is that the buyer opens the Letter of Credit late due to guarantee requirements from the bank. Sometimes the documentation requirements in the Letter of Credit are difficult to fulfil, and in some cases the payment can be delayed due to documents required by the Letter of Credit which are not issued by the case company.

-How often do these issues occur?

None of the persons interviewed were able to give specific information about how often specific issues occurred. However, it was estimated that a common problem were the delays in shipment schedules. The documentary requirements where the document signed by a customer was also mentioned by all three individuals.

THEME TWO: Contracts and Letter of Credits

-How often are issues in the Letter of Credit process caused by the Sales Contract?

The respondents were not able to give specific information about how often the issues are caused by the Sales Contract. However, it was mentioned in the interview that almost all the problems are somehow directly or indirectly consequences of the contract and therefore the contract is an important method for risk handling in the process.

-What kind of terms and conditions in the contract usually cause issues in the Letter of Credit process? What kind of risks do these issues create?

Chief - Trade Finance: Conditions in the contract that create problems in the Letter of Credit are for example conditions where the requirement for payment is a document signed by the customer. This means that the customer can delay the payment in case they are not willing to offer the correct document.

Other problems can also be for example a short negotiation period for the Letter of Credit documentation that the seller must deliver to the bank. The negotiation period for documents is usually 21 days but in some cases it can be for example 10 days in the contract. In case this is not corrected in the Letter of Credit opening this creates a risk for the buyer since in this case the buyer must be able get the correct documents for example from the freight forwarder in a very short time.

Also the expiry date and place must be taken into consideration. If the expiry place is for example in China the correct documents must be sent to China instead of the negotiating bank in 21 days which leads to a shorter time period for the case company to negotiate the documents than usually.

Sometimes the contract does not clearly define the payment terms, for example how the payment is divided between different deliveries, which can cause problems. In case the payment terms are not clearly defined in the contract, the payment is divided according to the deliveries.

The contract should clearly define the opening bank. It can for example be stated in a contract that only a first class bank is acceptable. In some countries there are only a few solid banks and in case the opening bank has not been defined in the contract the opening bank can basically be almost any type of bank, which means that the opening bank may not be solid or trustworthy, which is a risk for the case company.

In case the Letter of Credit is a time credit, for example 90 or 360, the terms of the contract should be carefully considered. In these cases it should be always clearly defined from which day for example the 90 or 360 day period begins. In these cases the terms and conditions of the Letter of Credit must be in order, and a document issued or signed by the customer cannot be a requirement for the payment.

Unclear contract terms and conditions can cause problems since they leave room for interpretation while executing the Letter of Credit conditions. For example the “term payment 30 days” probably means at sight payment, but this leaves too much room for misinterpretation. Some other unfavourable terms in the contract can also cause delay in the payment. For example if there is a condition "payable 30 days against shipping docs" instead of "payable against sight" the payment can be delayed.

Defining how the Letter of Credit will be opened can also cause problems. For example if there is a big sum of money involved and the Letter of Credit is opened at once this may create issues for the customer with the opening bank. However, it could be safer for the case company if the Letter of Credit would be opened at once.

General Manager - Contract Management and Engineer to Order:
Documents signed or issued by the customer are usually avoided in the contract, but sometimes they are either forgotten or cannot be avoided. For example with some customers in almost all of the final payments require document signed by the customer. The bank is usually very strict with the signature and which person in the customer's company signs the document. Small details that cannot be fulfilled can in the worst case scenario lead to the customer not paying at all.

Area Sales Manager:

Sometimes the payer of the goods is not the same company than the contracting party, which may cause problems. Sometimes the Letter of Credit documents defined in the contract are difficult to execute and sometimes the documentary requirements may include customers’ documents.

- *How could these issues be avoided?*

Chief - Trade Finance: With clear contract conditions that leave no room for misinterpretation.

General Manager - Contract Management and Engineer to Order:
In some cases the contract only states that the Letter of Credit is the payment method, but does not define the Letter of Credit documentation. In these cases there

are only faint methods to define the type of documentation that can be allowed to the Letter of Credit. The contract is also dependent of the competitive situation. In case the company has a strong market position it can require better contractual terms & conditions than a company in a weak market position. If the company does not have a strong position it must sometimes accept bad conditions to be able to get the contract.

Area Sales Manager: The sales would need better contract bases. Commercial education and better instructions about the Letter of Credit and documents would help. For example, a document in Chinese and in English that can be given to customer with information about acceptable and unacceptable terms & conditions and explanation why unacceptable terms cannot be approved. The history with the client also has an effect to what kind of contract condition the client will accept. If some contract condition has been used many times before there needs to be good reasoning why this could no longer be used. The market situation has also an impact to the contract negotiations.

AN EXAMPLE OF LETTER OF CREDIT OPENING INSTRUCTIONS

Appendix: "A request to issue a Documentary Credit"

Please request your bankers to issue a Documentary Credit subject to the specifications stated
below in writing and/or marked with [X] as appropriate:

Beneficiary's name and address	Applicant's name and address

Advising bank

[redacted]

Method of issuing by SWIFT or tested telex

Form of credit
☐ irrevocable ☐ transferable ☐ confirmed by Nordea Bank Finland Plc ☐ unconfirmed

Currency code and amount	Tolerance

Availability
☐ The credit is available with [redacted] by sight payment
☐ The credit is available with [redacted] by deferred payment at
☐ The credit is available with [redacted] by negotiation
☐ The credit is available with [redacted] as follows:

Date and place of expiry	Latest date of shipment

Shipment from	To	Via

By
☐ Sea ☐ Air ☐ Other means, i.e.

Partial shipments are
☐ Allowed ☐ Not allowed

Transhipment is
☐ Allowed ☐ Not allowed

Trade terms

Description of goods

Documents required
☐ Signed Commercial Invoice
☐ Air Transport Document
☐ Rail Transport Document
☐ Insurance Policy or Certificate
☐ Marine / Ocean Bill of Lading
☐ Road Transport Document
☐ Multimodal Transport Document
☐ Packing List

Commissions and charges
☐ All commissions and charges outside the issuing bank are for Beneficiary's account
☐ All commissions and charges are for Beneficiary's account
☐ Extension charges due to a late issuance of the credit or amendment charges due to an unacceptable form of the credit will be payable by the Applicant
☐ All commissions and charges are for Applicant's account
☐ Other instructions, which are:

Documents must be presented not later than days after the date of shipment, however, within validity of the credit.

Reimbursement bank should be nominated.

Issuance of this Documentary Credit should be at the Beneficiary's disposal and in acceptable form to the Beneficiary at the latest days before the stipulated shipment date.

The Documentary Credit to be issued based on the above mentioned specifications will be subject to the International Chamber of Commerce's Uniform Customs and Practice for Documentary Credits (UCP 500) 1993 revision.

This request forms an integral part of the contract(s) and all its terms must be complied with.

End of document

AN EXAMPLE OF LETTER OF CREDIT DOCUMENT

```
[redacted]
 27  SEQUENCE OF TOTAL
1/1
 40A FORM OF DOC.CREDIT
IRREVOCABLE
 20  DOCUMENTARY CREDIT NO
[redacted]
 31C DATE OF ISSUE
150528
 40E APPLICABLE RULES
UCP LATEST VERSION
 31D DATE AND PLACE OF EXPIRY
150731IN FINLAND
 50  APPLICANT
[redacted]
 59  BENEFICIARY NAME
[redacted]
 32B CURRENCY CODE,AMOUNT
[redacted]
 39B MAXIMUM CREDIT AMOUNT
NOT EXCEEDING
 41D AVAILABLE WITH..BY
ANY BANK IN FINLAND
AT SIGHT
BY NEGOTIATION
 43P PARTIAL SHIPMENT
NOT ALLOWED
 43T TRANSSHIPMENT
ALLOWED
 44E PORT OF LOADING/AIRPORT
ANY PORT IN EUROPE
 44F PORT OF DISCHARGE/AIRPOR
JIAOXIN PORT, GUANGZHOU, CHINA
 44C LATEST DATE OF SHIPMENT
150710
 45A DESCRIPTION OF GOODS
[redacted]
 46A DOCUMENTS REQUIRED
(AT LEAST IN DUPLICATE UNLESS OTHERWISE SPECIFIED)
1) SIGNED COMMERCIAL INVOICE IN 3 ORIGINALS PLUS 1 COPY
2) PACKING LIST IN 3 ORIGINALS
3) FULL SET CLEAN ON BOARD OCEAN BILLS OF LADING MADE OUT TO
```

```
   ORDER AND ENDORSED IN BLANK BY THE SHIPPER AND MARKED
   ''FREIGHT PREPAID'' AND NOTIFY [redacted]
4) INSURANCE POLICY OR CERTIFICATE, ENDORSED IN BLANK,
   FOR AT LEAST 110 PERCENT CIF VALUE COVERING INSTITUTE
   CARGO CLAUSES (A) INSTITUTE WAR CLAUSES (CARGO) INSTITUTE
   STRIKES CLAUSES (CARGO) AND SHOWING CLAIMS PAYABLE AT
   DESTINATION IN THE CURRENCY OF THE DC
.
 47A ADDITIONAL CONDITIONS
1) ALL BANKING CHARGES OUTSIDE ISSUING BANK'S COUNTER AND
   REIMBURSEMENT CHARGES ARE FOR ACCOUNT OF BENEFICIARY
2) A HANDLING CHARGE FOR HKD500.00 OR EQUIVALENT WILL BE
   ASSESSED FOR EACH SET OF DOCUMENTS CONTAINING DISCREPANCY(IES)
   PRESENTED UNDER THIS DOCUMENTARY CREDIT. THESE CHARGES ARE FOR
   ACCOUNT OF BENEFICIARY AND WILL BE DEDUCTED AT TIME OF PAYMENT
3) L/C OVERDRAWN COMMISSION AND COMMISSION ON DRAWING UNDER
   EXPIRED L/C,IF ANY ARE FOR ACCOUNT OF BENEFICIARY.
4) ALL DOCUMENTS MUST BE ISSUED IN ENGLISH
5) OUR BANK PROCESS TRANSACTIONS IN ACCORDANCE WITH LOCAL AND
   INTERNATIONAL LAWS AND REGULATIONS, AND RESERVE THE RIGHT TO
   COMPLY WITH FOREIGN SANCTIONS AS WELL. CONSEQUENTLY DOCUMENTS
   ISSUED BY OR SHOWING ANY INVOLVEMENT OF PARTIES SANCTIONED BY
   ANY COMPETENT AUTHORITY OR CONTAINED ANY INFORMATION THEREON
   MIGHT NOT BE PROCESSED BY OUR BANK AT OUR SOLE DISCRETION AND
   WITHOUT ANY LIABILITY ON OUR PART
.
 48  PERIOD FOR PRESENTATION
ALL DOCUMENTS MUST BE PRESENTED
WITHIN 21 DAYS AFTER DATE OF
SHIPMENT BUT WITHIN THE VALIDITY
OF THE CREDIT.
 49  CONFIRMATION INSTRUCTION
WITHOUT
 78  INSTRUCTIONS TO THE BANK
1) ALL DOCUMENTS ARE TO BE DESPATCHED THROUGH BENEFICIARY'S
   BANKER IN ONE LOT BY COURIER SERVICES TO US AT LEVEL 36
   TOWER 1, MILLENNIUM CITY 1,  388 KWUN TONG ROAD, KWUN TONG,
   KOWLOON, HONG KONG  ATTN: BILLS DEPT.
2) PRESENTING BANK MUST CERTIFY ON ITS COVERING SCHEDULE THAT
   THE AMOUNT OF EACH DRAWING HAS BEEN ENDORSED ON THE ORIGINAL
   CREDIT.
3) UPON RECEIPT OF COMPLIANT DOCUMENTS AT OUR COUNTER, WE SHALL
   EFFECT PAYMENT IN ACCORDANCE WITH THE PRESENTER'S INSTRUCTIONS
.
 72  SENDER TO RECEIVER INF
BENEFICIARY'S
[redacted]
```

EXAMPLES OF LETTER OF CREDIT RELATED DOCUMENTS

Bill of Lading

SHIPPER
[redacted]
FINLAND

DRAFT
BILL OF LADING

VOYAGE NUMBER
LT146R
BILL OF LADING NUMBER
FI1289862

CONSIGNEE
TO ORDER

EXPORT REFERENCES
[redacted]

NOTIFY PARTY, Carrier not to be responsible for failure to notify
[redacted]

CARRIER: [redacted]

PRE CARRIAGE BY*	PLACE OF RECEIPT*	FREIGHT TO BE PAID AT	NUMBER OF ORIGINAL BILLS OF LADING
		YANTAI	THREE (3)
OCEAN VESSEL	PORT OF LOADING	PORT OF DISCHARGE	FINAL PLACE OF DELIVERY*
FENJA	RAUMA FINLAND	YANTAI, CHINA	

MARKS AND NOS CONTAINER AND SEALS	NO AND KIND OF PACKAGES	DESCRIPTION OF PACKAGES AND GOODS AS STATED BY SHIPPER SHIPPER'S LOAD STOW AND COUNT SAID TO CONTAIN	GROSS WEIGHT CARGO KGS	TARE KGS	MEASUREMENT CBM
INKU2557337 SEAL B1158042	1 x 40HC	21 PACKAGE(S)	10888.000	3900	30.156
INKU2660068 SEAL B1093719	1 x 40HC	4 PACKAGE(S)	12080.000	3900	45.450
GESU4871360 SEAL B1158041	1 x 40HC	6 PACKAGE(S)	4260.000	3780	15.360
ECMU9623945 SEAL B1093720	1 x 40HC	7 PACKAGE(S)	12290.000	3900	48.390
AMFU8521190 SEAL B1093712	1 x 40HC	14 PACKAGE(S)	5245.000	3930	33.187

CONTRACT
[redacted]

[redacted]

LETTER OF CREDIT [redacted]

FREIGHT COLLECT

INTENDED TRANSSHIPMENT VESSEL IN HAMBURG: [redacted] OR SUBSTITUTE

Sheet 1 of 2

ABOVE PARTICULARS DECLARED BY SHIPPER, CARRIER NOT RESPONSIBLE

ADDITIONAL CLAUSES

4. Cargo at port is at receiver risk, expenses and responsibility
5. FCL
77. THC at destination payable by consignees as per line/port tariff
84. Ground rent/storages costs at POD for Consignee's account according to port rates.
164. For the purpose of the present carriage, clause 14(2) shall exclude the application of the York/Antwerp rules, 2004.
202. Demurrage and detention payable by the Merchant as per [redacted] tariff available on the web site www.cma-cgm.com, or in any of [redacted]
216. Mis-declaration of cargo weight endangers crew, port workers and vessels' safety. Your cargo may be weighed at any place and time of carriage and any mis-declaration will expose you to claims for all losses, expenses or damages whatsoever resulting thereof and be subject to freight surcharge.
225. The shipper acknowledges that the Carrier may carry the goods identified in this bill of lading on the deck of any vessel and in taking remittance of this bill of lading the Merchant (including the shipper, the consignee and the holder of the bill of lading, as the case may be) confirms his express acceptance of all the terms and conditions of this bill of lading and expressly confirms his unconditional and irrevocable consent to the possible carriage of the goods on the deck of any vessel.
274. The Merchant is responsible for returning any empty container, with interior clean at the designated place, and within 60 days following to the date of release, failing which the container shall be construed as lost. The Merchant shall be liable to indemnify the Carrier for any loss or expense whatsoever arising out of the foregoing, including but not limited to liquidated damages equivalent to the sound market value - or the depreciated value due by the Carrier to a container lessor. The Carrier is entitled to collect a deposit from the Merchant at the time of release of the container which shall be remitted as security for payment of any sums due to the Carrier, in particular for payment of all detention and demurrage and/or container indemnity as referred above.

RECEIVED by the carrier from the shipper in apparent good order and condition (unless otherwise noted herein) the total number or quantity of Containers or other packages or units indicated above stated by the shipper to comprise the cargo specified above for transportation subject to all the terms hereof (including the terms on page one) from the place of receipt or the port of loading, whichever is applicable, to the port of discharge or the place of delivery, whichever is applicable. Delivery of the Goods will only be made on payment of all Freight and charges. On presentation of this document (duly endorsed) to the Carrier, by or on behalf of the holder, the rights and liabilities arising in accordance with the terms hereof shall (without prejudice to any rule of common law or statutes rendering them binding upon the shipper, holder and carrier) become binding in all respects between the Carrier and Holder as though the contract contained herein or evidenced hereby had been made between them.
All actions against Carrier under the contract of Carriage evidenced by this Bill of Lading shall be brought before the "Tribunal de Commerce de MARSEILLE" and no other Court shall have jurisdiction with regards to any such action. Actions against the Merchant under the contract of Carriage evidenced by this Bill of Lading may be brought before the "Tribunal de Commerce de MARSEILLE" or, in Carrier's sole discretion, in another court of competent jurisdiction.
In witness whereof three (3) original Bills of Lading, unless otherwise stated above, have been issued, one of which being accomplished, the others to be void.
(OTHER TERMS AND CONDITIONS OF THE CONTRACT ON PAGE ONE)

PLACE AND DATE OF ISSUE	HELSINKI	04 DEC 2013

SIGNED FOR THE SHIPPER

*APPLICABLE ONLY WHEN THIS DOCUMENT IS USED AS A COMBINED TRANSPORT BILL OF LADING

SIGNED FOR THE CARRIER [redacted]
BY [redacted]
as agents for the carrier [redacted]

[redacted]

DRAFT BILL OF LADING

VOYAGE NUMBER
LT146R
BILL OF LADING NUMBER
FI1289862

PRE CARRIAGE BY*	PLACE OF RECEIPT*	FREIGHT TO BE PAID AT	NUMBER OF ORIGINAL BILLS OF LADING
		YANTAI	THREE (3)
OCEAN VESSEL	PORT OF LOADING	PORT OF DISCHARGE	FINAL PLACE OF DELIVERY*
FENJA	RAUMA FINLAND	YANTAI, CHINA	

MARKS AND NOS CONTAINER AND SEALS	NO AND KIND OF PACKAGES	DESCRIPTION OF PACKAGES AND GOODS AS STATED BY SHIPPER SHIPPER'S LOAD STOW AND COUNT SAID TO CONTAIN	GROSS WEIGHT CARGO	TARE	MEASUREMENT
			KGS	KGS	CBM
		Shipped on Board FENJA 04-DEC-2013 CMA CGM Finland OY As agents for the Carrier			
Weight in Kgs Total: 5 CONTAINER(S)		Sheet 2 of 2	44763.000	19410	172,643

ABOVE PARTICULARS DECLARED BY SHIPPER. CARRIER NOT RESPONSIBLE.

PLACE AND DATE OF ISSUE	HELSINKI	04 DEC 2013	SIGNED FOR THE CARRIER [redacted] BY [redacted] as agents for the carrier [redacted]
SIGNED FOR THE SHIPPER			
*APPLICABLE ONLY WHEN THIS DOCUMENT IS USED AS A COMBINED TRANSPORT BILL OF LADING			

Air Waybill

180 | HEL | 55437115 HOUSE AWB NO. 02901548

Shipper's Name and Address

[redacted]

Shipper's Account Number

Not Negotiable

Air Waybill

Issues by

Copies 1, 2 and 3 of this Air Waybill are originals and have the same validity.

Consignee's Name and Address

consigned to [redacted] Bank

Consignee's Account Number

It is agreed that the goods described herein are accepted in apparent good order and condition (except as noted) for carriage SUBJECT TO THE CONDITIONS OF CONTRACT ON THE REVERSE HEREOF. ALL GOODS MAY BE CARRIED BY ANY OTHER MEANS INCLUDING ROAD OR ANY OTHER CARRIER UNLESS SPECIFIC CONTRARY INSTRUCTIONS ARE GIVEN HEREON BY THE SHIPPER, AND SHIPPER AGREES THAT THE SHIPMENT MAY BE CARRIED VIA INTERMEDIATE STOPPING PLACES WHICH THE CARRIER DEEMS APPROPRIATE. THE SHIPPER'S ATTENTION IS DRAWN TO THE NOTICE CONCERNING CARRIER'S LIMITATION OF LIABILITY. Shipper may increase such limitation of liability by declaring a higher value for carriage and paying a supplemental charge if required.

Issuing Carrier's Agent Name and City

[redacted]

Accounting Information

L/C NO M03UC404BU00541

DATED 140422

FREIGHT COLLECT

Agent's IATA Code: 1947101

Account No.: 19-4 7101/0156

Airport of Departure (Addr. of First Carrier) and Requested Routing: Helsinki* HEL ARN ICN

Reference Number

Optional Shipping Information: 28085600

To	By First Carrier	To	by	To	by	Currency	CHGS Code	WT/VAL	Other	Declared Value for Carriage	Declared Value for Customs
ARN	KE	ICN	KE			EUR		X		NVD	NCV

Airport of Destination: Incheon**

Requested Flight/Date: KE 4308 /25 KE 510 /27

Amount of Insurance: XXX

INSURANCE – If carrier offers insurance, and such insurance is requested in accordance with the conditions thereof, indicate amount to be insured in figures in box marked "Amount of insurance".

Handling Information

NOTIFY:[redacted]

actual flight date : 25.06.2014

[redacted]

26-JUN-14 15:19:26

SCI: X

No. of Pieces RCP	Gross Weight	kg lb	Rate Class / Commodity Item No.	Chargeable Weight	Rate / Charge	Total	Nature and Quantity of Goods (incl. Dimensions or Volume)
5	1680	K		1680.0			[redacted]
							86x146x128CM x 4
							27x70x37CM x 1
							FREIGHT COLLECT
5	1680						6.499 CBM

*European airport

**South Korean airport

***freight services denmark a/s

goods have been accepted for carriage

Prepaid	Weight Charge	Collect
		AS AGREED

Valuation Charge

Tax

Total Other Charges Due Agent

Total Other Charges Due Carrier

Other Charges

Shipper certifies that the particulars on the face hereof are correct and that insofar as any part of the consignment contains dangerous goods, such part is properly described by name and is in proper condition for carriage by air according to the applicable Dangerous Goods Regulations.

FREIGHT SERVICES FINLAND OY

AS AGENT FOR [redacted]

Signature of Shipper or his Agent

Total Prepaid	Total Collect
	AS AGREED

Currency Conversion Rates | CC Charges in Dest. Currency

AS CARRIER:[redacted]

2014-06-26 HELSINKI [redacted]

Executed on (date) at (place) Signature of Issuing Carrier or its Agent

For Carrier's Use only at Destination | Charges at Destination | Total Collect Charges

02901548

ORIGINAL 3 (FOR SHIPPER)

Commercial Invoice

[redacted]

Commercial Invoice

Page: 1(1)

Invoice date: [redacted]

Our order/project No.: [redacted]

Purchase reference/ Hull no.: [redacted]

Project/Service Reference: [redacted]

Config. Code: [redacted]

Invoice No: [redacted]

Attended to by: [redacted]

Our sales representative: [redacted]

Consignee: [redacted]

Buyer: [redacted]

Notify: [redacted]

Country of origin: EU/FINLAND

Country of destination: CHINA

Means of transportation: BY SHIP

Terms and time of delivery: [redacted]

Place of discharge: SHANGHAI PORT, CHINA

Terms of payment: AGAINST IRREVOCABLE DOCUMENTARY CREDIT NUMBER [redacted]

Final destination

Reference

Number and kind of packages: 2 unpacked, 2 wooden boxes

Volume, m^3: 296,349

Total number of packages: 4

Packing slip/List No.: CR0366829, CR0366830

Net weight, kg: 94334

Gross weight, kg: 94462

Shipping mark: [redacted]

[redacted]

Description of goods

[redacted]

Description of goods as per D/C:

[redacted]

		Amount
Total contract amount	EUR	[redacted]
Paid in advance	EUR	[redacted]
To be paid	**EUR**	[redacted]

Irrevocable documentary credit number [redacted]

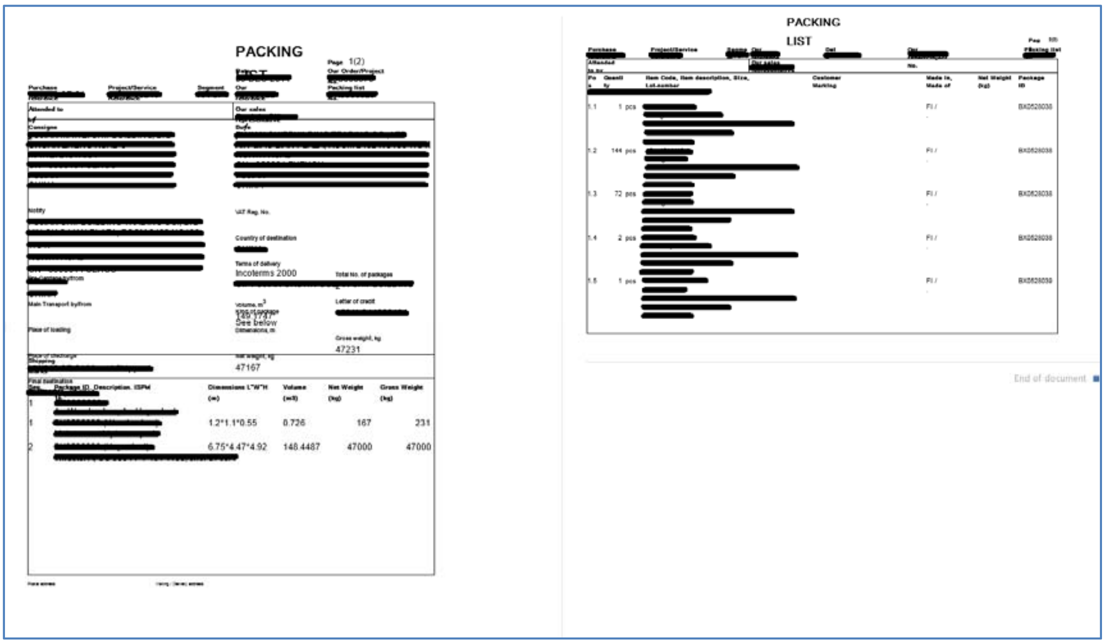
[redacted]

VAT 0 %, DELIVERY OUTSIDE EU

Postal address: [redacted]

Visiting / Delivery address: [redacted]

Packing List



PACKING LIST [redacted]

Page 1(2)

Our Order/Project no. [redacted]

Packing list no. [redacted]

Purchase reference [redacted] Project/Service reference [redacted] Segment [redacted] Our reference [redacted]

Attended to by

Our sales representative [redacted]

Consignee [redacted]

Buyer [redacted]

Notify [redacted]

VAT Reg. No.

Country of destination [redacted]

Terms of delivery Incoterms 2000

Total no. of packages [redacted]

Pre-Carriage by/from [redacted]

Main Transport by/from

Volume, m3 149.1747

Size of package See below

Dimensions, m

Letter of credit [redacted]

Place of loading

Gross weight, kg 47231

Place of discharge

Net weight, kg 47167

Shipping marks [redacted]

Final destination

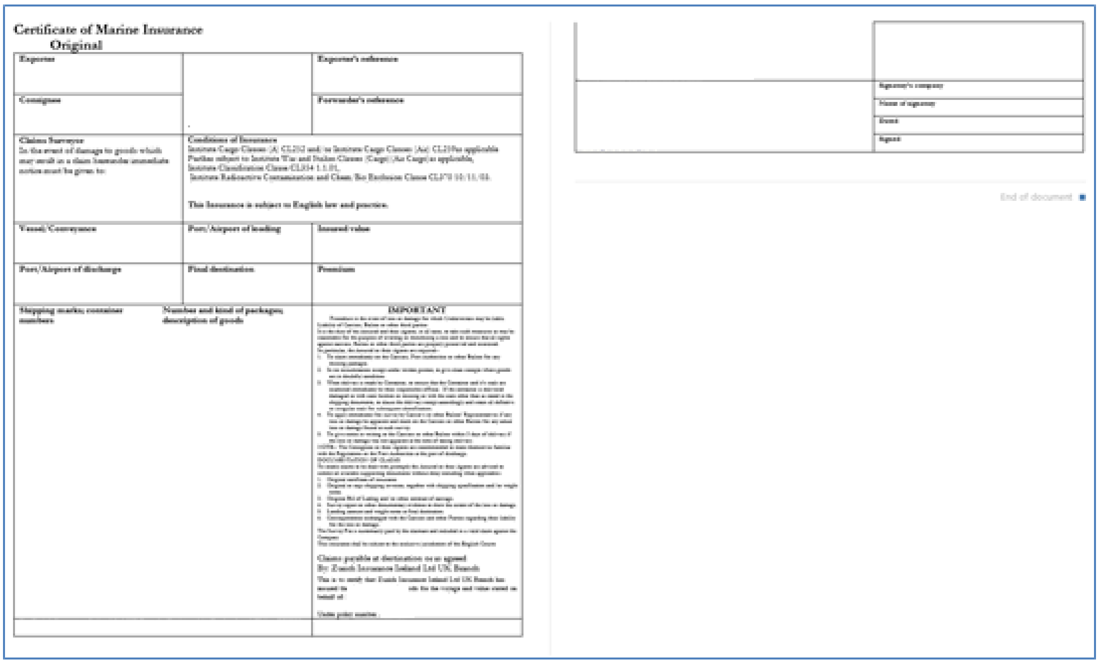
Seq.	Package ID, Description, ISPM	Dimensions L*W*H (m)	Volume (m3)	Net Weight (kg)	Gross Weight (kg)
1	[redacted]				
1	[redacted]	1.2*1.1*0.55	0.726	167	231
2	[redacted]	6.75*4.47*4.92	148.4487	47000	47000

PACKING LIST

Po s	Quantity	Item Code, Item description, Size, Lot-number	Customer Marking	Made in, Made of	Net Weight (kg)	Package ID
1.1	1 pcs	[redacted]		FI /		BX0528038
1.2	144 pcs	[redacted]		FI /		BX0528038
1.3	72 pcs	[redacted]		FI /		BX0528038
1.4	2 pcs	[redacted]		FI /		BX0528038
1.5	1 pcs	[redacted]		FI /		BX0528039

End of document

Insurance Certificate



Certificate of Marine Insurance
Original

Exporter

Exporter's reference

Consignee

Forwarder's reference

Claims Surveyor

Conditions of Insurance

This Insurance is subject to English law and practice.

Vessel/Conveyance

Port/Airport of loading

Insured value

Port/Airport of discharge

Final destination

Premium

Shipping marks; container numbers

Number and kind of packages; description of goods

IMPORTANT

End of document

Certificate of Origin

CERTIFICATE OF ORIGIN

[redacted]

[redacted] products have been manufactured according to standards set by [redacted] and have been inspected by quality control department and found to be fully in compliance with requirements in specification, quality, quantity and proper packing and marking.

We hereby certify that the goods are of Finland origin.

[redacted]

[redacted]

Packing Material related Certificate

DECLARATION OF WOODEN PACKAGE

WE HEREBY CERTIFYING THAT THIS SHIPMENT

- B/L No. [redacted]
- Contract no. [redacted]
- Commodity [redacted]
  [redacted]
- Packages 13 WOODEN CASE, 8 CRATES

We hereby confirm all the wooden packages that the scope of delivery as per your above mentioned order has been treated with IPPC standard and with IPPC mark on them.

[redacted]

[redacted]

APPENDIX 6

AN EXAMPLE OF LETTER OF CREDIT AMENDMENT

[redacted]

```
 20  SENDER'S REFERENCE
[redacted]
 21  RECEIVER'S REFERENCE
[redacted]
 52D ISSUING BANK
BRANCH FCBU
HNB
HNB
 31C DATE OF ISSUE
141002
 30  DATE OF AMENDMENT
141103
 26E NUMBER OF AMENDMENT
1
 59  BENEFICIARY (BEFORE AME)
[redacted]
 79  NARRATIVE
UNDER FIELD 47A CLAUSE 11 DELETE THE WORDS,
' SHIPMENT OF [redacted] FROM
EUROPE TO BE SHIPPED ON OR BEFORE 31/10/2014 '
AND INSERT
' SHIPMENT OF [redacted] FROM
EUROPE TO BE SHIPPED ON OR BEFORE 20/11/2014 '
.
ALL OTHER TERMS AND CONDITIONS REMAIN UNCHANGED.
 72  SENDER TO RECEIVER INF
[redacted]
```