



National Institute of Bank Management

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Trade Financing: Discrepancies and Application of UCP 600

PART B

The case is written by Smita Roy Trivedi for the purpose for classroom discussion. The author does not want to illustrate either effective or ineffective handling of a managerial situation. Primary and secondary data for the case was collected from International divisions in leading public sector banks and through interviews conducted of division heads and select exporters. For confidentiality all names have been changed, including those of the leading bank on which the case is based.

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Ms. Jaiswal has been heading the International Division of India bank at Pune, a key industrial city in Western India for the last four years. Her stint at this division has helped her to keenly appreciate the problems of Indian exporters and importers. She was concerned about how the exporters and importers were presently facing tight liquidity and slow demand conditions globally and confronting inflationary tendencies and infrastructural bottlenecks at home. While the pace of activity at the international division hardly gave any time to stop and think, today, as she went through the Packing Ltd. files, she could not but reflect on these issues.

While globally tightening liquidity conditions and increase in risk perception should have led to an increase in use of letters of credit (L/C), it has hardly happened. While importers do issue L/Cs often, exporters getting letter of credits is less common, and most exporters that her branch serves send bills on collection basis. A few of the established business houses in Pune, who are also customers of her branch, have advance payments coming for nearly 50-60% of their export orders. But most of the mid corporates and smaller enterprises served by her branch, regularly sent bills on collections basis, with L/Cs being used infrequently.

Packing Ltd. was one such company that usually preferred sending bills on collection basis and rarely received letter of credits from counterparties. Many of their bills in fact have been facing late payments

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² This case has been written to aid classroom discussion and do not intent to illustrate the efficient and inefficient handling of a managerial situation. The views or opinions presented do not, in any way, reflect the views and opinions of the institution the author represents.

especially in the last few years. Recently there was a letter of credit from a Bangladesh counterparty and it had been advised by Indian Bank, Pune to Packing Ltd.

However, the credit was available with 'Foreign bank', Mumbai. She was waiting for Mr. Madhukar, a Senior Manager, who looked after international trade transactions at Packing Ltd to come with the documents and looking at the file made her consider the kind of financing for international trade that Packing Ltd. uses.

Bills on Collection v/s Letter of Credit

Trade transactions handled on a draft basis are called documentary collections in banking terminology. Drafts provide the exporter less protection than a letter of credit since the banks are not obliged to honor payments on the buyer's behalf though they are handled through banking channels (See Appendix A and B). The exporter is here depending upon the buyer's financial integrity to pay the draft at maturity though there is some comfort with banks at both ends acting as collection agents. A draft is also a binding financial obligation and can be used by the exporter for litigation on uncollected receivables. However, it must be underlined that banks only serve as servicing / collection agents for a draft transaction, while they step in as *committed agents* for a letter of credit transaction.

With the bank stepping in as a committed agent, the exporter is assured of receiving payment from the bank that issues the L/C, provided it submits documents in accordance with the L/C. The bank that issues the L/C (Issuing Bank) is obligated to honor drawings under the L/C even if the buyer (importer) fails to make a payment.

A crucial issue with bills on collection or draft financing is late payments from counterparties. Risk exposures for banks on export bills are more when such bills have been purchased by the bank. In this case, the exporter get the full value or discounted value of the bill much before the payment is received from the foreign counterparty, and this constitutes an exposure to counterparty and country risk for the bank.

For banks in India, regulations require that if payment is not received by the due date by the bank, the amount due is fixed or '*crystallized*' in rupee terms and debited from the account of the exporter. It is of serious concern to the exporter if a series of crystallization occurs and it can badly impact his receivables and working capital, which also impacts the credit risk exposure of the bank to the client.

For export bills sent on collection, while payment will be made to the exporter only after receipt of foreign exchange from the counterparty abroad, overdue bills mean exposure to regulatory non-compliance if follow-up on such bills is not done and goods/services are sent out of the country without foreign exchange being received through banking channels. Again as banks will usually send bills on collection for their customers only, it can provide vital signals regarding the export performance of client or counterparties of the client, which can impact the credit risk exposure of the bank to the client.

The client: Packing Ltd.

Packing Ltd., established in early 1960s, ventured into packaging in 1970. They believe their cutting edge lies in their experience in packaging industry and in the pioneering innovations they have introduced in the industry, like Vertical Form Fill Seal Machine and the pouch packing systems for dairy and beverage industry. Packing Ltd. is currently spread across 40 offices in India, and plans to become a global company offering end to end integrated packaging solutions. Vertical Form Fill Seal machine (offering a complete range of packaging for solid, liquid and viscous, food or non-food products) is a popular product of Packing Ltd. which it regularly exports to countries in South East Asia and Africa.

The packaging industry globally is slated to grow with increasing income, changing lifestyle and a greater emphasis on maintenance of quality of packaged items. Recent IBEF updates indicate that the global packaging market has grown hugely, estimated at around USD 1.07 trillion in 2023 (IBEF, 2024). India's packaging industry has also expanded valued at approximately USD 71.9 billion in 2023, and is projected to reach USD 130.1 billion by 2028, implying a forward five-year CAGR of ~10.3% (IMARC Group, 2024). The industry continues to remain fragmented with strong positions held by large players, while numerous mid-tier firms.

Packing Ltd export L/C

Packing Ltd. had regular export orders from countries in South East Asia. Their exports to Bangladesh, in particular, have been growing over the last few years. While Bangladesh's trade with neighbouring countries is unequally distributed, one primary trading partner is India, followed by Pakistan. Initially the Bangladesh counterparty of Packing Ltd, ABC producers, Dhaka wanted to do the trade transaction on basis of bills on collection, but the recent rising non-payments from counterparties made Packing Ltd negotiate for a Letter of Credit. While ABC producers are long-time trade partners for Packing Ltd, some of the bills sent on collection for ABC producers, had become overdue in recent months. Late payments from major counterparties in South East Asia had increased in the last few months, adding to the worries of Packing Ltd. The L/C was issued by 'Foreign Bank', Dhaka branch, and had credit available with 'Foreign Bank', Mumbai.

Given the conditionality of the credit, Packing Ltd. had submitted the documents with India bank, Pune to be sent to 'Foreign bank' bank. However, Ms. Jaiswal's junior executive has pointed out several discrepancies in the document which she must first go through before Mr. Madhukar arrives. She also wanted to talk to him about overdue bills and issues in financing bills on collection basis. Was this always a suitable trade financing mechanism for exporters? Again, if she found documents discrepant, she could then ask Mr. Madhukar to resubmit the documents. **Going through the documents Ms. Jaiswal realized she needed to talk to both Mr. Madhukar and her junior executive, highlighting some crucial issues in documentation for L/C. (See Appendix 2 & 3). Are the documents in order?**

Select References

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Appendix A
Sight Drafts and Time Drafts

Trade transactions on draft basis or documentary collections are of two types: Sight Draft or documents against payments

Under a sight draft, the exporter is paid once shipment has been made and the draft is presented to the buyer. The bank will not release shipping documents needed by the buyer for collection of his goods until the buyer has paid the draft. This is known as documents against payment.

Time Draft or documents against acceptance

Under a time draft, the exporter gives instructions to the importer (buyer)'s bank to release the shipping documents against acceptance (signing) of the draft. This method of payment is also referred to as documents against acceptance. By accepting the draft, the buyer is promising to pay the exporter at the specified future date. The buyer here is able to obtain the merchandise prior to paying for it, and thus it represents an extension of credit to the buyer by the seller. If the seller's bank is purchasing the documents, with the seller obtaining the discounted value of the draft, the seller's bank is in effect extending the credit to the buyer.

Appendix 2
Letter of Credit Financing

A letter of credit (L/C) is an instrument issued by a bank on behalf of the importer (buyer) promising to pay the exporter (beneficiary) upon presentation of complying documents in accordance with terms of the credit.

The process flow for a letter of credit starts with the exporter and importer entering into a contract deciding the terms of payment and other details regarding the commercial transaction. The importer will then apply to its bank, termed as the Issuing bank, to issue a letter of credit in favor of the overseas seller subject to specified terms and conditions. She submits the L/C application, proforma contract and L/C agreement to the bank.

For the bank, issuing an L/C is equivalent to a credit decision as it is giving a conditional undertaking to pay the beneficiary the agreed value against presentation of complying documents. After the issuance of the L/C the importer's bank forwards the L/C to its Correspondent Bank, also referred to as the Advising Bank in the exporter's country. It requests the correspondent bank to 'advise' the L/C to the Beneficiary, which involves checking the genuineness of the credit and advising terms and conditions to the exporter. The correspondent bank on receiving the documentary credit from the issuing bank, advises the credit to the beneficiary.

The seller/ exporter may however be unsatisfied with/ unaware of the financial status of the issuing bank. In that case, the issuing bank will request a bank in the seller's country or a third country, for 'confirming' the credit. The confirming bank steps into the position of the issuing banks and gives an undertaking to affect payment, if the issuing bank fails to do so, on submission of complying documents by exporter. Such a credit is called a 'confirmed credit'.

The exporter will now ship the goods within the specified period and after collecting the documents submit the same to the negotiating bank, to negotiate the documents. The negotiating bank may be a specified bank 'nominated' by the issuing bank, implying that credit is available only with that bank (restricted credit) or could be any bank, if no particular bank is specified as having credit available with by the L/C. The advising or confirming bank could themselves serve as a nominated bank. The nomination of a bank by issuing bank, does not comply an obligation on its part to effect payment unless it has confirmed the credit.

On receipt of documents, and examination of the same, if documents are found to be discrepancy free, the negotiating bank will pay a discounted amount to the seller, also forwarding the documents to the issuing bank, who after examination of the same will affect payment to the exporter's bank. It is on the basis of these documents that the goods can be collected.

Evidently, the comfort for the importer stems from the fact that the she is assured of payment being made to seller only if the goods are shipped and documentary evidence of such shipment is produced. It will also ensure that goods are shipped within a specific period of time. If the exporter fails to comply with any of the conditions, the payment would not be affected. Documentary credit transactions are regulated by a set of rules issued by International Chamber of Commerce (Paris), known as Uniform Customs and Practices for Documentary Credits (UCP).

Appendix 3
Draft of L/C in SWIFT format

40 A: Form of documentary credit

IRREVOCABLE

20: Documentary credit no

1234567

31C: Date of issue

121214

40E: Applicable rules

Current version of UCP

31D: Date and place of expiry:

250314

Mumbai

51 A: Applicant bank

FOREIGN BANK, DHAKA

50: Applicant

ABC PRODUCERS, NATIONAL ROAD,
DHAKA, BANGLADESH.

59: Beneficiary:

PACKING LTD., MG ROAD, PUNE-04, INDIA

32B: Currency Code and Amount

USD 500,000

41 D: Available With

Foreign bank, Mumbai

42 C: Drafts At

Sight

43 P: Partial shipments

NOT ALLOWED

43 T: Transshipment

NOT ALLOWED

44E: Port of Discharge / airport of departure:

NAVA SHEVA PORT, MUMBAI, INDIA

44B: Place of final destination:

DHAKA, BANGLADESH

44C: Latest date of shipment

250220

45A: Description of goods or / services

VERTICAL FORM FILL SEAL MACHINE as per proforma invoice, CIF, Mumbai

46 A: Documents required:

SIGNED COMMERCIAL INVOICE IN TRIPLICATE

FULL SET OF 'CLEAN' SHIPPED ON BOARD OCEAN / MARINE BILL OF LADING WITH 3 NON-NEGOTIABLE COPIES, DRAWN TO ORDER OF FOREIGN BANK, MUMBAI, NOT INDICATING ANY ADDITIONAL CHARGES

CERTIFICATE OF ORIGIN ISSUED BY THE CHAMBER OF COMMERCE STATING THAT GOODS ARE OF INDIAN ORIGIN

PACKING LIST AND WEIGHT CERTIFICATE IN TRIPLICATE CONTAINING DETAILS OF EACH PACKING

CERTIFICATE OF ANALYSIS FROM EXPORT INSPECTION COUNCIL, MUMBAI

INSURANCE DOCUMENT FOR 110% OF CIF VALUE

47 A: Additional Conditions

ALL DOCUMENTS SHOULD INDICATE OUR CREDIT NUMBER

71 : Charges

BANK CHARGES OUTSIDE BANGLADESH WILL BE TO THE ACCOUNT OF BENEFICIARY

48: Period of presentation

WITHIN 21 DAYS FROM DATE OF SHIPMENT BUT NOT LATER THAN THE EXPIRY DATE

49: Confirmation Instruction:

CONFIRM

57A: Advise through bank:

INDIAN BANK, PUNE

Appendix 4
Discrepancies in documents

A. Bill of lading

1. The date of issue on the bill of lading is not the date of shipment
2. Bill of lading is not 'onboard bill of lading' though an onboard stamp is there with signature on it
3. The stamp does not say 'clean'

B. Commercial Invoice

1. The invoice is not signed
2. The address of the applicant on the invoice says

ABC PRODUCERS,

14-B, NATIONAL ROAD,

DHAKA, BANGLADESH

Address on bill of lading reads:

ABC PRODUCERS,

14, NOTIONAL ROAD,

DHAAKA, BANGLADESH.

3. Description of goods in the invoice reads

H 100 VERTICAL FORM FILL SEAL MACHINE

C. Certificate of inspection

1. Certificate is issued by *Export Inspection Council* Mumbai, but dated prior to date of issue of credit
2. It is difficult to understand whether the certificate is original