

**THE REPUBLIC OF TURKEY
BAHÇEŞEHİR UNIVERSITY**

**ROLE OF COMMERCIAL BANKS IN INTERNATIONAL TRADE
AND ITS FINANCING, AN ANALYSIS OF FOREIGN TRADE AND
FINANCE OF TURKEY IN THE LAST DECADE AND AFTER
COUP ATTEMPT**

Master's Thesis

YAVUZ ERALP KARADENİZ

İSTANBUL, 2016

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**GRADUATE SCHOOL OF SOCIAL SCIENCES
CAPITAL MARKETS AND FINANCE**

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DEDICATION

My loving wife, for her support and tenderness at every step of my life

My mother, for her never-ending faith in me.



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I also would like to thank all my teachers I met during my 2 years who guided me towards this point where I am finally writing these notes after a hard and long work.



ABSTRACT

ROLE OF COMMERCIAL BANKS IN INTERNATIONAL TRADE AND ITS FINANCING, AN ANALYSIS OF FOREIGN TRADE AND FINANCE OF TURKEY IN THE LAST DECADE AND AFTER COUP ATTEMPT

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Capital Markets and Finance

Thesis Supervisor: Ph.D Ayşe Dilara YILMAZ

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This study aims to examine the methods used in international trade and financing transactions from the point of view of banks. Despite the fact that there are many studies in the literature on foreign trade and payment methods, studies which focus on banks, an important actor in these transactions, are not found enough.

In the research part, information such as foreign trade volume of Turkey, payment methods used in foreign trade and short-term foreign debt stock linked to foreign trade transactions are examined, the foreign trade and short-term debt borrowing of Turkey will be analyzed and the impact of coup attempt that took place on 15 July 2016 will be observed.

Keywords: Foreign trade, financing, compliance, letter of credit, payment methods

ÖZET

ULUSLARARASI TİCARET VE FİNANSMANINDA BANKALARIN ROLÜ, SON ON YILDA VE DARBE GİRİŞİMİ SONRASINDA TÜRKİYE’NİN DIŞ TİCARET VE FİNANSMANI ANALİZİ

Yavuz Eralp Karadeniz

Sermaye Piyasaları ve Finans

Tez Danışmanı: Yrd. Doç. Dr. Ayşe Dilara YILMAZ

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Bu çalışma dış ticaret işlemleri ve işlemlerin finansmanında kullanılan yöntemlerin bankaların bakış açısından incelenmesini amaçlamaktadır. Dış ticaret ve ödeme yöntemlerine ilişkin literatürde bir çok çalışma olmasına rağmen bu işlemlerde önemli bir aktör olan bankalara yönelik çalışmalara yeterince rastlanılmamaktadır.

Araştırma kısmında ise Türkiye'nin dış ticaret hacmi, dış ticarete kullanılan ödeme yöntemleri ve dış ticaret işlemleri ile bağlantılı olan kısa vadeli dış borç stoğu gibi bilgiler incelenerek Türkiye'nin dış ticaret ve kısa vadeli borçlanmasının karakteri tahlil edilecek ardından ise 15 Temmuz 2016'da gerçekleşen darbe girişiminin hem dış ticaret işlemlerine hem de kısa vadeli finansmana olan etkisi gözlemlenecektir.

Anahtar Kelimeler: Dış Ticaret, finansman, uyum, akreditif, ödeme yöntemleri

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ABBREVIATIONS

INCOTERMS	: International Commercial Terms
S.W.I.F.T.	: Society for Worldwide Interbank Financial Telecommunication
ICC	: International Chamber of Commerce
CHIPS	: Clearing House Interbank Payments System
DC	: Documentary Credit
BAFT	: Bankers Association for Finance and Trade
RUSF	: Resource Utilization Support Fund
EBRD	: European Bank for Reconstruction and Development
FCR	: Forwarder's Certificate of Receipt
GSM	: General Sales Manager
IFC	: International Finance Corporation
ISBP	: International Standard Banking Practises
LC	: Letter of Credit
RCA	: Revolving Credit Agreement
TFP	: Trade Facilitation Programme
U.S.A.	: United States of America
UCP 600	: Uniform Customs and Practice for Documentary Credits
USDA	: United States Department of Agriculture
OFAC	: The Office of Foreign Assets Control
SDN	: Specially Designated Nationals

1. INTRODUCTION

While the trade itself occurs between companies banks are needed when it comes to transfer the funds, secure the payment and finance the process. Apart from the companies, governments also put certain responsibilities on the banks in terms of money laundering and terrorist financing. In addition to these two angles banks in emerging markets are also a gateway between their domestic markets and international financial markets. This study will discuss the international trade from the perspective of banks who participate heavily in the process by explaining their roles, the products they can offer and their responsibilities in general and in Turkey specific. We will be mainly focusing the products which are offered in emerging markets as being an intermediary to international financing for their customers.

The motivation behind this study is to observe the period following the coup attempt in Turkey and compare it with the last decade in terms of import, export, payment methods and short term external debt stock that is heavily tied to trade. The import and export volumes, the payment methods used in import and export and the details of short term external debt stock will be analyzed to understand if there has been any significant effect of coup attempt on the trade business and its financing.

Banks having essential role in international trade and its financing are vital in several ways. The customers need them in terms of payment and payment security, the governments need them to track the possible criminal activities and companies need them for the financing of their business. This study will cover these topics from the perspective of banks in a global sense while giving the Turkey specific details related to each topic.

Before reading this study, there are certain notions that the reader should familiarize in order to understand. Even though these topics are covered in the first part of the study it will be useful to introduce them here. How a payment is completed in international level is an important subject to understand. Each currency is in fact kept in its central bank meaning that wherever any TRY account may be, in USA, Germany or France, the funds are kept in the accounts of Central Bank of Turkey of Turkey. Turkish banks having accounts at Central Bank of Turkey of Turkey hold the account of their customers. Their customers may be individuals, companies, associations or other banks in Turkey or abroad.

Another important notion is compliance. Although this is a new topic for customers banks have been dealing with this burden for a few years and the issue keeps getting more and more complicated. Banks are under the responsibility to make sure that there is no criminal activity under any transaction they conduct on behalf of their customers. While this responsibility is hard to meet in domestic level, banks who offer services in international level face a more difficult task. The banking sector has been witnessing fines with unimaginable amounts in the recent years last of which was 8,9 billion USD fine PNB Paribas faced in USA because of the USD payment transactions they intermediated.

S.W.I.F.T. is another product to know in order to understand this study. It is in fact an international company based in Belgium that offers fast and secure communication between financial institutions. They also offer certain messages types, each is aimed to fulfil a need of banks. MT 103 message for instance is used by a bank to instruct another bank that keeps its account to effect a payment on behalf of its customer. MT 700 is the standard form of a letter of credit. MT 202 is the payment instruction message when the fund transfer is between two financial institutions. Each of these message types has different formats and fields to fill to create the finale message.

INCOTERMS is not a banking term but it should be understood by any reader who wishes to understand this study and international trade. It defines the responsibilities of importer and exporter when they are transferring the goods. It elaborates which party should handle the insurance, which party will pay for export and import duties and which party will handle the shipment up to which point.

There are adequate numbers of studies in this field that can be found in different sources. However they mainly focus on the legal side of the products. The number of thesis focusing the role of banks and financing aspect of the topic is less than what it should be.

The study will be gathering the data regarding to import and export volumes of Turkey, payment methods of import and export and short term external debt stock which are provided by Turkish Statistical Institutions and Central Bank of Republic of Turkey. After these data is collected in a meaningful manner an observation and analysis will be carried out in order to make sense of them.

The study itself and the conclusion of analysis will be providing an important source in this field which lacks the theses focusing the financial aspect of the international trade and the role of banks in this domain.

First chapter of the study will be elaborating the notions to be familiar with to understand the international trade by giving details about the notions such as S.W.I.F.T. and compliance. Second chapter will be explaining the payment methods in detail while providing an insight how they are chosen between the parties. Third chapter will be about payment guarantees which are an important part of the products offered by banks in international trade. Forth chapter will be giving details of financing methods in international trade while explaining how they are related to payment methods and how they are applied in Turkey. Finally fifth chapter will be gathering the data and analysing it in line with the purposes of the study.

2. INTERNATIONAL TRADE

In this part, it will be proper to introduce the international trade notion and some other related topics such as International Commercial Terms (INCOTERMS) or Society for Worldwide Interbank Financial Telecommunication (S.W.I.F.T.) in general terms as these are essential for the international trade today. Other topics such as compliance and payment structure will also be covered.

These four subjects are among most important to know if one will understand the international trade and financing from the perspective of banks. Because they will help to grasp the methods, challenges, restrictions and opportunities faced by the banks when dealing with an international transaction.

International trade, in the simplest way, can be described as sales or purchase of goods or services to/from another country. It represents differences from a domestic trade in many ways due to its nature. The way to deliver the goods will not be as simple as loading a truck. Settling disagreements will be much more complicated as one court will not have power over both parties. A payment will need more actors to be completed. There will be more than one set of law that parties will have to abide in order to have the payment and transaction completed.

2.1 INCOTERMS

INCOTERMS, created by International Chamber of Commerce (ICC), aims to standardize the terms of delivery of the goods from the exporter to importer with 11 clauses it contains. Each clause has different definitions in terms of where the goods will be delivered, who will pay the costs of freight, insurance and who will be responsible for export and import duties. Baluna (2012, p. 188) provides an extensive explanation of INCOTERMS in his paper.

“INCOTERMS refers to the mutual obligations of seller and buyer in an international sales contract, and proposed rules for interpreting the most commonly used trade terms in foreign trade. INCOTERMS rules extend their effect on all stages and operations involved in transferring goods from supplier to customer, making explicit reference to the following:

- a) seller obligation is to deliver and buyer obligation to take and pay freight;*
- b) bearing the cost of packing, incumbent returning, usually, the seller, unless the goods are supplied in packs;*
- c) quantity and quality control - the seller is obliged to perform all operations (and to cover costs) related to control, in order to provide goods to the purchaser, in contractual terms;*
- d) determining the place of crossing costs and that risk from seller to buyer;*

- e) seller's obligation to advise the buyer that the goods were made available to or carrier;
- f) to close transport contract and to obtain documents related to delivery;
- g) to obtain other documents related to export (import);
- h) sales organization and customs duties."

While it is not an obligation to insert these rules into a trade agreement, it is quite useful to have them in order to have a common understanding for parties from different countries with different jurisdictions. It is also possible to have them accepted before courts in certain jurisdictions.

The mechanism of INCOTEMRS can be hard to understand nevertheless apart from banking anyone who is involved in international trade should be aware of them.

INCOTERMS includes four rule types; E, F, C and D, listed from least responsibility to exporter to most. Below table shows the 11 rules of INCOTERMS in this order. Some of them are reserved for seaway shipment only while others can be employed for any kind of transport.

Table 1.1: Delivery terms INCOTERMS 2010

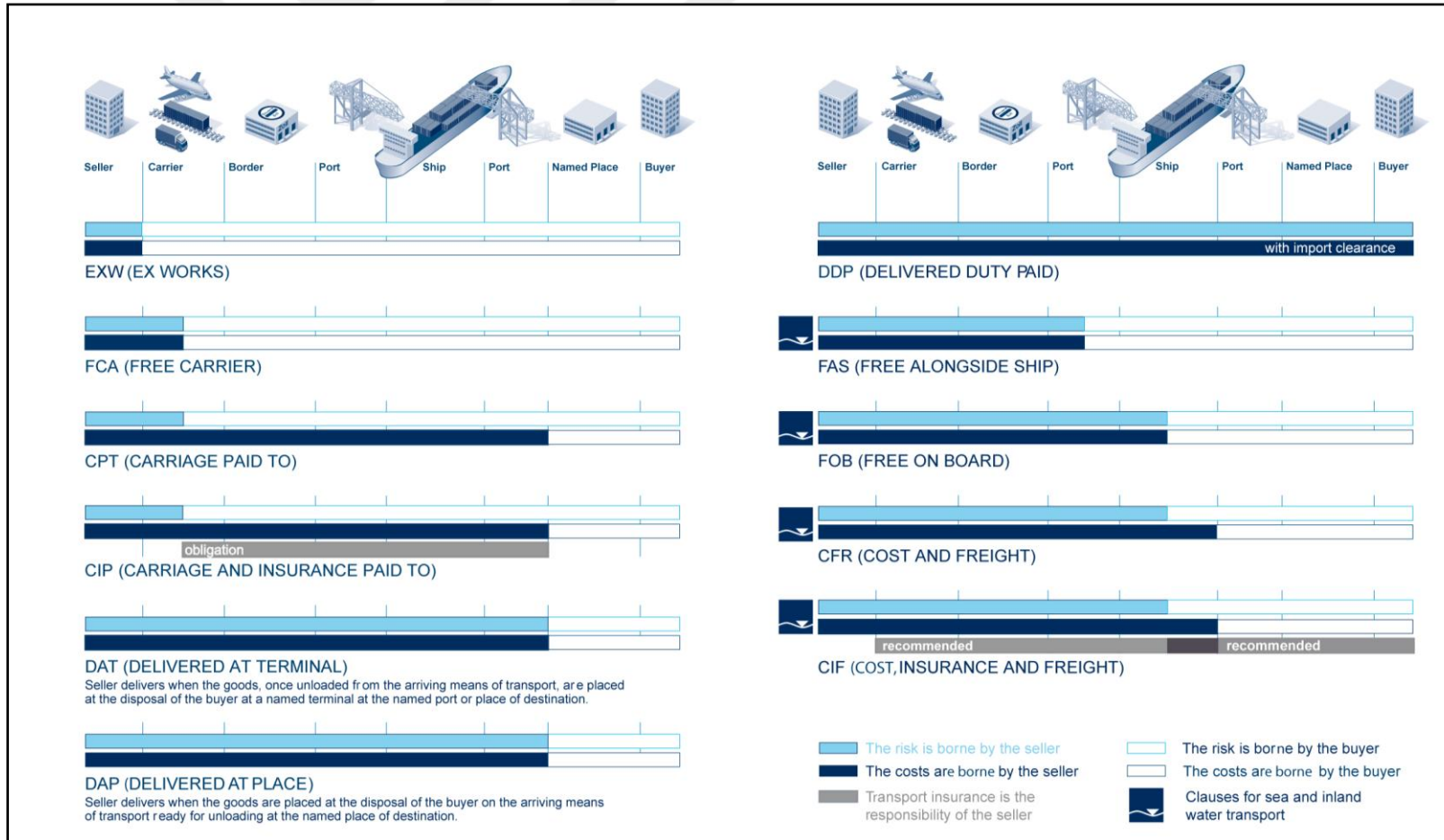
Group	Abbreviation	The delivery	Mode of transport	SD/ SA*
E	EXW...	Ex Works ...	any	SD
F	FCA...	Free Carrier ...	any	SD
	FAS...	Free Alongside Ship...	exclusive maritime	SD
	FOB...	Free On Board ...	exclusive maritime	SD
C	CFR...	Cost and Freight ...	exclusive maritime	SD
	CIF...	Cost, Insurance, Freight ...	exclusive maritime	SD
	CPT...	Carriage Paid To ...	any	SD
	CIP...	Carriage Insurance Paid ...	any	SD
D	DAP...	Delivered At Place ...	any	SA
	DAT...	Delivered At Terminal ...	any	SA
	DDP...	Delivered Duty Paid ...	any	SA

* **SD:** sale on departure; **SA:** sale on arrival.

Source: Baluna (2012)

Below figure will be useful to have a broad understanding about how these rules function and how the responsibilities are distributed.

Figure: 1.1: Insurance liability, assumption of risks and costs pursuant Incoterms 2010



Source: <http://www.rohlig.com/infocenter/incoterms-2010.html>

2.2 S.W.I.F.T.

Society for Worldwide Interbank Financial Telecommunication (S.W.I.F.T.) is a global member-owned cooperative and the world's leading provider of secure financial messaging services¹. Scott and Zachariadis (2012, p. 463) stress what S.W.I.F.T. is and what it is not as below.

“It is important to emphasise that SWIFT is not a bank or a clearing and settlement institution; it does not manage accounts on behalf of customers nor does it hold funds. Although it is involved in the organisation and distribution of data, it does so on a ‘store-and-forward’ basis and does not maintain financial information on an on-going basis; instead, ‘as a data carrier, SWIFT transports messages between two financial institutions.’”

S.W.I.F.T. is often confused as a way to conclude transactions while it is merely a way to communicate between financial institutions. A financial institution will be able to contact its counterparty within seconds, wherever they may be, to have a payment effected, to relay a letter of credit or to instruct how to deliver certain documents and collect payment. Once the instructions are received in the other end the transaction will be handled in a way that is not very much different than a transaction of a customer who simply walks into a branch.

Most important service offered by S.W.I.F.T. is that a banker can rely on a received message via this system because only actually existing financial institutions are accepted into the system. It is safe to say that if a message seems to be sent from a certain bank it is actually sent by that bank.

It is important to have a certain level of knowledge about S.W.I.F.T because almost all international payments, communications about letters of credit, letters of guarantee etc. between financial institutions are executed via S.W.I.F.T.

2.3 COMPLIANCE

Lagzdins, Sloka and Jekabsone (2011, p. 108) explain compliance in general terms as the adherence to existing rules and regulations laid down by those in authority. In the new regulatory environment, knowledge of compliance is becoming increasingly important across all areas of business.

It is vital to understand what compliance is since banks as institutions working in an overly regulated environment are restricted with many regulations. The laws against money laundering, terrorism financing, bribery, corruption and many more are imposed

¹ <https://www.swift.com/about-us/discover-swift>

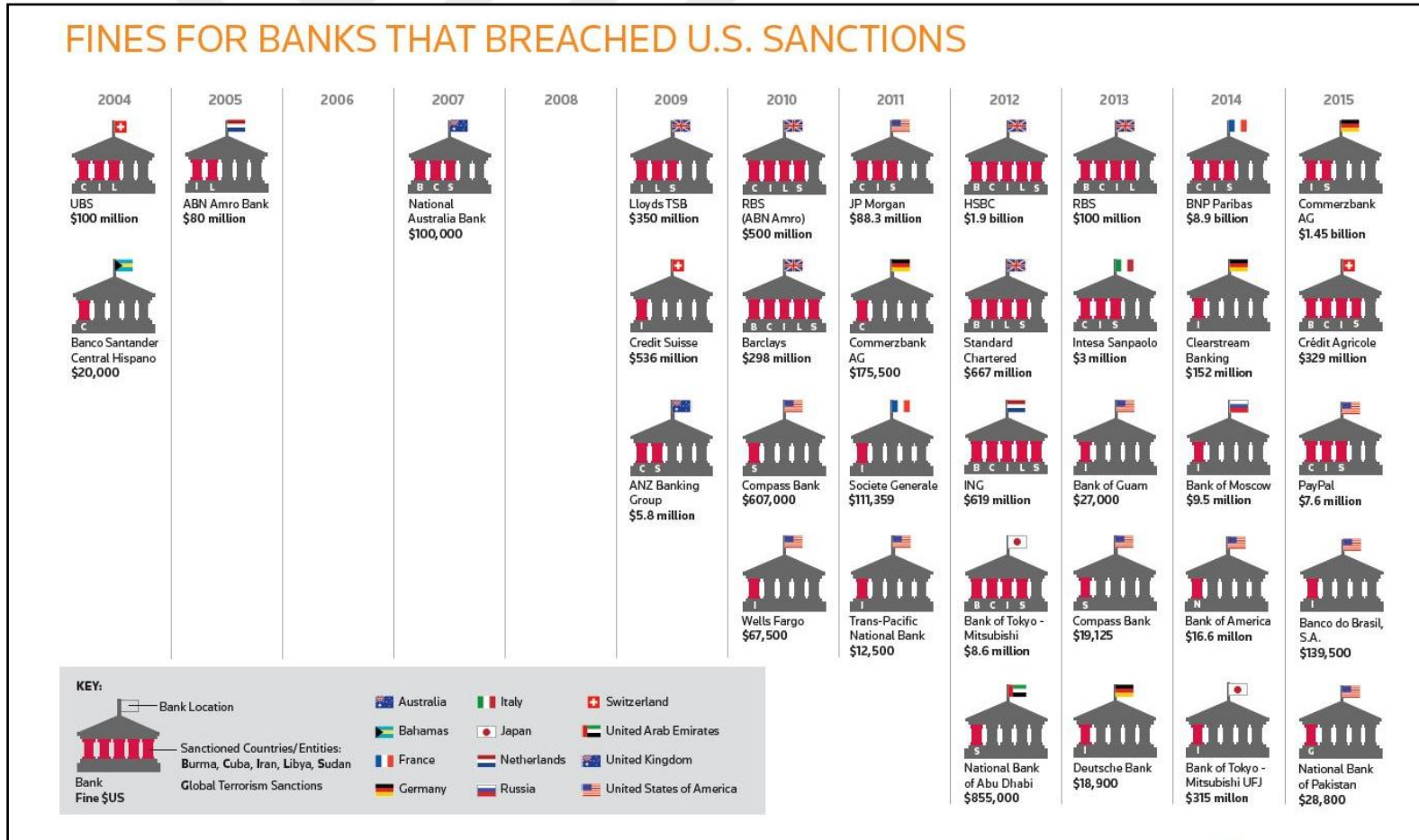
on banks as much as they are to potential criminals. Besides obeying these laws and regulations banks are expected to do extensive due diligence on their customers to make sure that their financial transactions do not include in any criminal activity. Every country has its own regulator such as MASAK in Turkey. These institutions will set rules, monitor transactions and conduct regular checks on the institutions that operate in their jurisdiction. When it comes to an international transaction there will be more than one regulator to satisfy.

A USD payment from Turkey to Germany, for instance, will have to be in compliance with the regulations in Turkey, U.S.A., European Union and Germany. In each step the payment will be checked and should there be any suspicion of breach the payment may be suspended for further investigation, blocked or rejected. Since the payments in international trade are mainly paid in USD The Office of Foreign Assets Control (OFAC) becomes an important institution to know. This institution is in charge of monitoring all financial transactions settled in U.S.A. and make sure that they are in compliance with US regulations. Any bank providing clearing services will have to report all suspicious activities for their investigation. Any transaction relating to sanctioned entities listed in their Specially Designated Nationals (SDN) list will be frozen.

Each country will have their own set of rules or lists about the type of transactions that should not be conducted. These prohibitions are called sanctions. These sanctions may be applied against a specific person, group or a whole country. Today it is impossible to wire USD to and institution based in Iran because of the sanctions in place in USA.

To emphasize the importance of these sanctions it will be enough to have a look at below figure which only shows the fines from US authorities to financial institutions because of the breach of sanctions in place. The fine of 8.9 billion USD faced by BNP Paribas is particularly worth to note.

Figure 1.2: Fines for banks that breached U.S. sanctions



Source: <https://risk.thomsonreuters.com/infographic/fines-banks-breached-us-sanctions>

2.4 PAYMENT STRUCTURE OF USD AND EUR VIA S.W.I.F.T.

Although the new payment systems emerge with new technologies in international payments, particularly sizable trade related payments still rely on traditional banking system. Because international trade is mainly paid with USD and EUR it will be useful to explain how the payment schemes of these currencies work.

Just like any other currency USD payments are made through its own Central Bank, FED. There exist two payment systems that also serve international payments.

First one, Fedwire Funds Service, is a real-time gross settlement system that enables participants to initiate funds transfer that are immediate, final, and irrevocable once processed. Depository institutions and certain other financial institutions that hold an account with a Federal Reserve Bank are eligible to participate in the Fedwire Funds Services.² Second system, The Clearing House Interbank Payments System (CHIPS) is an electronic payments system that transfers funds and settles transactions in U.S. dollars. CHIPS enables banks to transfer and settle international payments more quickly by replacing official bank checks with electronic bookkeeping entries.³

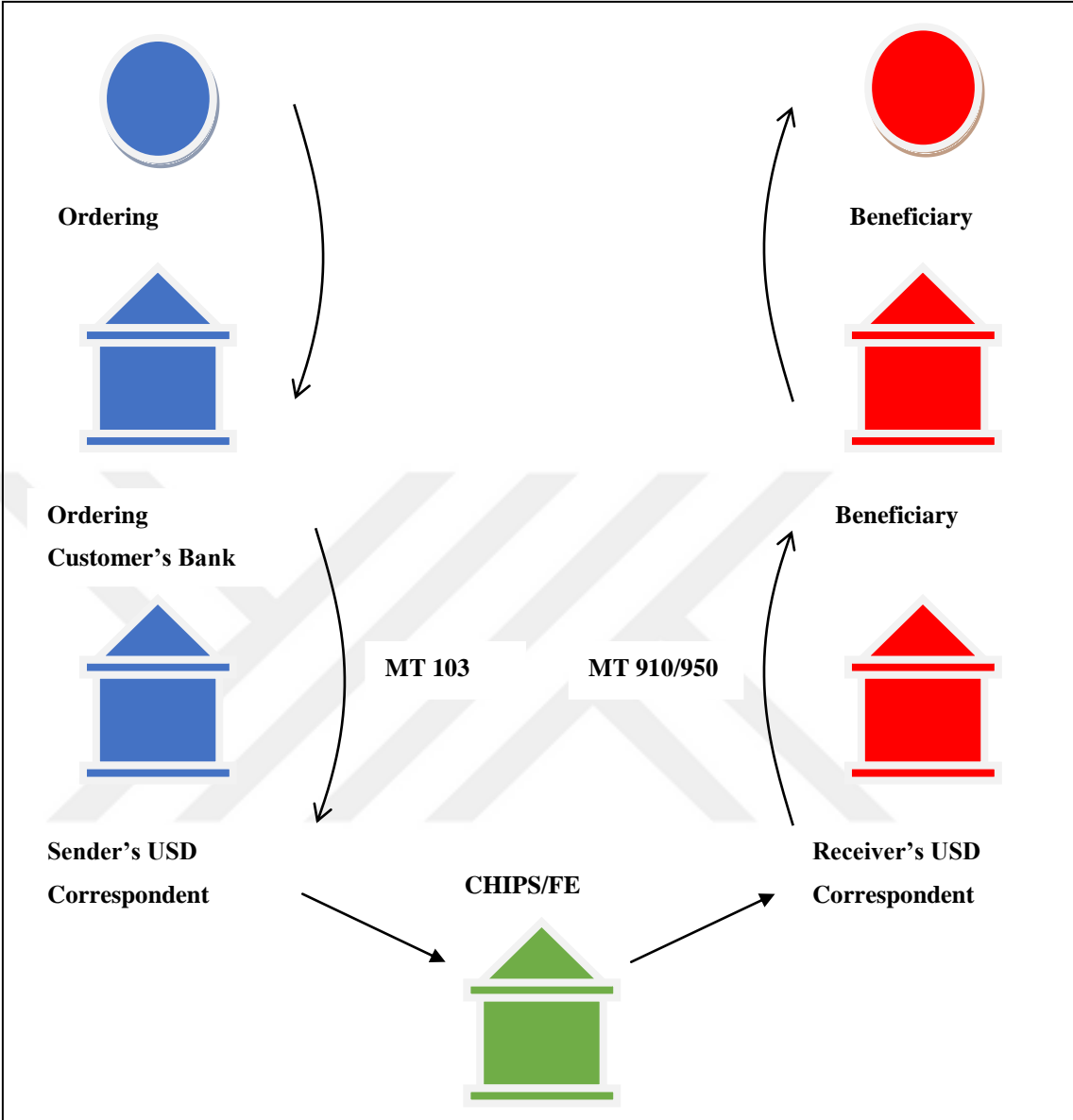
If we are to explain with an example; Ordering Customer in country A has to pay to Beneficiary who is located in country B. Ordering Customer will approach to his bank usually located in the same country and give the payment instruction along with account information of Beneficiary and Beneficiary Bank. Ordering Customer's Bank will send an MT 103, containing data regarding Ordering Customer, Beneficiary, Beneficiary Bank and sometimes Receiver's correspondent, the bank holding its USD account. Sender's USD Correspondent will transfer the funds to Receiver's USD Correspondent via Fedwire or CHIPS along with information regarding the Beneficiary and Beneficiary Bank. Receiver's USD Correspondent will credit the amount to Beneficiary Bank's account and notify it with an MT 910 or MT 950. Once the funds are received by Beneficiary Bank it will credit the amount to Beneficiary's account.

Below figure will be more helpful to understand how a USD payment will work between two firms in different countries.

² https://www.federalreserve.gov/paymentsystems/fedfunds_about.htm

³ <https://www.newyorkfed.org/aboutthefed/fedpoint/fed36.html>

Figure 1.3: International USD settlement system



Same payment system is also used for cross-border EUR payments with the exception that TARGET2 will be utilized instead of CHIPS/FED in USD payments. It was founded as TARGET in the beginning by the central banks of France, Germany and Italy and upgraded to TARGET2 in 2007. Members are 20 euro zone central banks and 5 central banks from non euro zone countries; Bulgaria, Croatia, Denmark, Poland and Romania.⁴

⁴ <https://www.ecb.europa.eu/paym/t2/about/countries/html/index.en.html>

3. PAYMENT METHODS

Transferring the payment from the buyer to the seller is one of the most basic functions of a bank when it comes to international trade. However the payment is not always effected in the same manner. The level of trust, familiarity and dominance between the importer and exporter would result the payment to be done in different ways. This topic will be dedicated to explain these methods.

If we are to list these methods from most secure to least secure for the importer the order will be open account, cash against documents, letter of credit and advance payment.

3.1 CASH IN ADVANCE

With cash-in-advance payment term, which is the least secure method for the importer, an exporter can avoid credit risk because payment is received before the ownership of the goods is transferred⁵. Once the payment is received the exporter is expected to fulfil his obligations, ship the goods in time as agreed on in the contract. This type of payment is, also known as advance payment, usually enforced by international importers such as big textile chain stores on small producers.

The only responsibility of the banks will be intermediating the payment as explained in chapter 1.4 and banks will not offer any security to parties. The risk of non shipment will be carried by the importer.

3.2 OPEN ACCOUNT

In this payment method, also known as cash against goods, the goods are shipped and delivered before payment is due, which is typically in 30, 60 or 90 days⁶. This type of payment is the most commonly used in international trade in the world and the most secure way for the importer since he will be able to see the goods and make sure they are as specified in the agreement before paying.

Banks will not play any role in the method apart from intermediating the payment similar to cash in advance transactions. Again there will be no security provided by the banks. Thus the risk of non payment will be carried by the exporter.

⁵ http://www.export.gov/tradefinanceguide/eg_main_043221.asp#P37_1727

⁶ https://mpr.aub.uni-muenchen.de/65410/1/MPRA_paper_65410.pdf

3.3 CASH AGAINST DOCUMENTS

Cash against document, also referred as documentary collection, is regulated by Uniform Rules for Collection (URC 522) published by ICC. It offers a level of security to both parties. For this type of payment the parties will be named as below

- i. the "principal" who is the party entrusting the handling of a collection to a bank;
- ii. the "remitting bank" which is the bank to which the principal has entrusted the handling of a collection;
- iii. the "collecting bank" which is any bank, other than the remitting bank, involved in processing the collection;
- iv. the "presenting bank" which is the collecting bank making presentation to the drawee;
- v. the "drawee" is the one to whom presentation is to be made in accordance with the collection instruction. URC 522 (1996, p. 1)

In this method the principle will ship the goods, submit the documents to remitting bank instructing them to send the documents to presenting bank. Once the documents are received, the presenting bank will notify the importer and deliver the documents according the instructions sent by the remitting bank. In general practice the presenting bank and collecting bank are the same and usually the importer's bank.

The instructions may dictate that the payment should be made before the documents are delivered. In this case the presenting bank will collect the payment before delivering the documents and wire the funds to remitting bank accordingly. Alternatively the instructions from the remitting bank may be for the payment to be made at a future date specified in the instructions. Collecting bank will deliver the goods and transfer the money to remitting bank on due date. However the collecting bank does not assume any liability for the payment to be made should the importer decide not to pay. In order to mitigate this risk the exporter may add a promissory note among the documents and demand it to be avalized by collecting bank. Thus the collecting bank will be responsible for the payment as well.

Apart from the non payment risk, the exporter will face the risk that the importer decides not to buy the goods after the shipment. In this case the exporter will have only 3 choices; accepting a lower price to persuade the importer, finding another buyer in the same or nearby country or to recall the goods.

3.4 LETTER OF CREDIT

Letter of credit (LC) or documentary credit is the most complicated and secure way for both parties. Importer will know that the payment is only made once the documents listed in the LC are presented in the correct manner. Exporter will know that the payment and goods are in control of banks rather than the applicant and the importer cannot back down on the agreement once the LC is issued. It also allows the parties to utilize credit facilities offered by banks through this product.

According to CheHashim and Mahdzan (2014, p. 225), a letter of credit (LC) is an instrument that is commonly used to facilitate payments in business transactions between buyers and sellers, and can be used either locally or across borders. LCs, which are governed by the Uniform Customs and Practice (UCP) and formulated by the International Chamber of Commerce's (ICC) Commission on Banking and Practice, are a mechanism in which the bank acts as the paymaster on behalf of the purchaser by executing payment to the seller; conditional on compliance of the seller's documents to the LC terms.

Before explaining how this scheme works we need to understand certain notions defined in UCP 600 (Uniform Customs and Practice for Documentary Credits) the brochure that sets up the rules of LC.

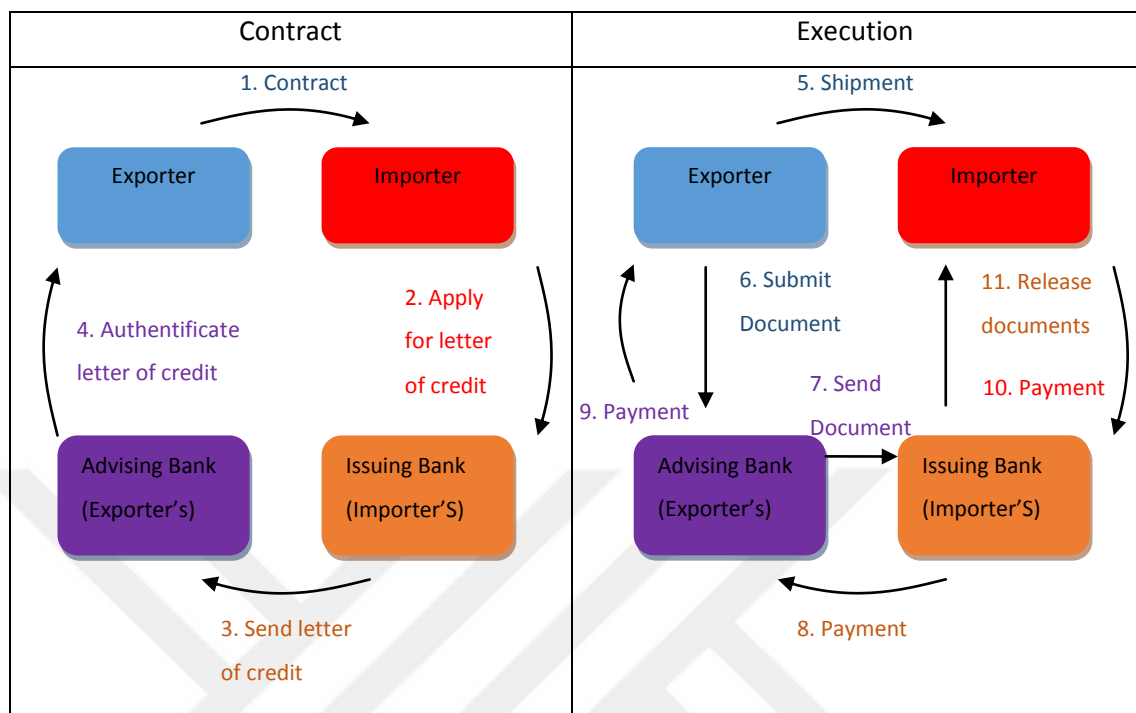
- i. Advising bank means the bank that advises the credit at the request of the issuing bank.
- ii. Applicant means the party on whose request the credit is issued.
- iii. Banking day means a day on which a bank is regularly open at the place at which an act subject to these rules is to be performed.
- iv. Beneficiary means the party in whose favour a credit is issued.
- v. Complying presentation means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice.
- vi. Confirmation means a definite undertaking of the confirming bank, in addition to that of the issuing bank, to honour or negotiate a complying presentation.
- vii. Confirming bank means the bank that adds its confirmation to a credit upon the issuing bank's authorization or request.

- viii. Credit means any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation.
- ix. Honour means:
 - a. to pay at sight if the credit is available by sight payment.
 - b. b. to incur a deferred payment undertaking and pay at maturity if the credit is available by deferred payment.
 - c. c. to accept a bill of exchange ("draft") drawn by the beneficiary and pay at maturity if the credit is available by acceptance.
- x. Issuing bank means the bank that issues a credit at the request of an applicant or on its own behalf. UCP 600 (2007, p. 1)

As shown in below figure; after completing a contract the importer will approach his bank to have an LC issued in favour of the exporter. The issuing bank will issue the letter of credit to an advising bank, which is typically the exporter's bank, who will then authenticate it and advise it to the exporter. If the LC is to be confirmed the nominated bank, which can be same as advising bank, will add its confirmation generally at the time the LC is advised.

After receiving the LC from its bank the beneficiary will ship the goods and prepare the documents as required in the LC. The documents will be presented to exporter's bank. If the exporter's bank is a nominated bank it will examine the documents to decide if they are compliant. If so, it will honour the presentation by paying to the beneficiary, undertaking to pay if the LC is differed payment or accepting the draft drawn on it and send the documents to the issuing bank. If it is only advising bank, it will send the documents to issuing bank without examining. Issuing bank will examine the documents regardless the nominated bank has already examined them. Once found compliant issuing bank will pay to the exporter's bank and release the documents to applicant.

Figure 2.1: How a by payment letter of credit works



Source: Friederik and Schmidt-Eisenlohr (2015)

3.4.1 Types of Letters of Credit in Terms of Payment Term

LCs offer 4 different payment terms out of which the parties may pick the one that suits them the most. If the exporter needs the payment immediately after shipment sight LC will be more appropriate or if the applicant needs a certain time to pay for the goods deferred payment LC will be a better choice. If the beneficiary needs the payment before the applicant is willing or able to pay exporter's bank may provide the funds earlier than the maturity under these terms.

Bozkurt (2006, p. 84-85) defines the sight LC in following explanation; after the issuing bank sends the LC to the advising bank, the latter will notify the exporter. Upon this notification, even in case the importer does not pay the issuing bank undertakes the payment. In this type of LC the presentation amount will be paid by nominated bank in case of confirmed LC or by the issuing bank in case of unconfirmed LC. Sight payment LC requires that the payment should be made immediately once the documents are found compliant. However it should be mentioned that a nominated bank will have 5 banking days after receiving the document to examine and determine if they are

compliant. In theory, once the documents are found compliant the payment should be made immediately, nonetheless the practise differs. An LC will be issued with an additional clause stating that the nominated bank will give two or three days notice to applicant before the payment so that the funds can be arranged.

UCP 600 defines negotiation as “the purchase by the nominated bank of drafts and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.” LCs by negotiation may be issued as deferred payment of sight. In any case the negotiation is essentially the nominated bank advancing the funds to beneficiary before the date the payment is due against the draft or trade documents.

McLaughlin (1990, p. 149) explains deferred payment with an example; suppose a U.S. buyer wishes to import \$ 2 million of merchandise from a Portuguese seller. The parties agree that the sale will be on 60-day credit terms. Two forms of letter of credit could be used in structuring this sale transaction -- the first is an acceptance letter of credit and the second is a deferred payment letter of credit.

A deferred payment letter of credit is that form of letter of credit whereby the issuing bank undertakes an obligation to pay on the date or dates stipulated in the text of the credit, provided of course, that the requisite documents are presented and that the other terms and conditions of the credit are satisfied. In deferred payment LC, the documents will be examined and after they are found compliant the nominated bank will determine the payment date and undertake to pay in that date instead of paying. Market practise is that the payment date is determined with shipment date (i.e. 180 days after the shipment), invoice date (i.e. 60 days after invoice date) or LC issuing date (360 days after issuance). Applicant should be careful if the date will be determined with invoice date because in an LC documents dated before the issuance of LC can be accepted. So 60 days after invoice date does not necessarily mean 60 day tenor.

An acceptance letter of credit, for McLaughlin (1990, p. 149), is that form of letter of credit whereby the issuing bank undertakes an obligation to accept drafts drawn on itself provided that stipulated documents are presented, and provided that the other terms and conditions of the credit are satisfied. By acceptance LCs work quite similar to negotiation however usage of a draft is a must while it is only optional for LCs by negotiation. This draft should be drawn on the issuing bank or a nominated bank but

cannot be drawn on the applicant. A draft drawn on and accepted by the nominated bank is a reliable negotiable instrument and beneficiary may have it discounted any time financing is needed.

3.4.2 Types of Letters of Credit in Terms of Confirmation

A letter of credit will indicate if the LC is to be confirmed with three different instructions in LC text; *Confirm*, *Without* and *May Add*.

Confirm means that the issuing bank is instructing the nominated bank to add its confirmation. Confirmation of a letter of credit means that the confirming bank undertakes to pay to the exporter on due date once the documents are found complying regardless that the importer or the issuing bank pays them. This is usually done with the consent of the beneficiary and it should be said that the nominated bank has no obligation to add its confirmation. As explained by Dann (1983, p 1219), often in international transactions the services of a second bank, a confirming bank, are utilized. Because the beneficiary may not be familiar with the issuing bank, he will often require that a bank in his locale confirm the letter and thereby become "directly obligated on the credit ... as though it were its issuer." The resulting liability of the confirming bank provides an additional measure of security to the beneficiary.

The confirming bank, which can be same as the advising bank, will inform the beneficiary at the time of advising that it is adding its confirmation. This means that the confirming bank will be liable to honour the presentation of the beneficiary. Reimbursing from the issuing bank will be the responsibility of the confirming bank thus the beneficiary will be safe from any risk related to applicant's country.

Confirmation is generally used in order to be safe from dangers related to risks from importer's country; economic problems, political turmoil, terrorism, civil war etc. If the confirming bank is familiar and comfortable with the said risk confirmation will be added. However a bank cannot take the risk of every bank or country in the world to add its confirmation, specially issued by a bank in certain underdeveloped geographies. The reason could be the lack of experience or simply the financial status of the given country and the banks in that country. In these situations if the beneficiary cannot proceed with unconfirmed LC the advising bank can use the guarantees from international financial institutions such as European Bank for Reconstruction and Development (EBRD) or International Finance Corporation (IFC) who will undertake to

fulfil the issuing bank's obligation should the latter fail. While EBRD operates in a more restricted geography such as ex-soviet countries due to its policy IFC covers a much larger area.

Without means that the LC will be advised to the beneficiary with no responsibility on the advising bank other than authentication of the source. Hence the documents will be presented to the issuing bank directly to be examined. Advising bank, which is generally the exporter's bank, may help its customer to prepare the documents. Advising bank will not be able to confirm the LC without the consent from the issuing bank. Thus if the exporter decides that it needs the LC to be confirmed the LC will have to be amended by the consent of issuing bank as well as nominated bank.

May Add will mean the advising bank may add its confirmation upon the request of the beneficiary. Because the confirmation needs the consent from issuing bank May Add option allows the beneficiary and nominated bank to decide if the LC will be confirmed without further consent from issuing bank. If the beneficiary requests confirmation the LC will continue as confirmed and if the confirmation is not requested vice versa.

3.4.3 Installment Letter of Credit & Revolving Letter of Credit

In a scenario where the parties have regular trade using one LC for more than one payment will make the process a lot easier for banks and customers. Installment LC or revolving LCs can be used to eliminate repetitive LC issuances.

According to Vincentiu (2008, p. 792) the applicant of a letter of credit may need to be assured of receiving the merchandise over a period of time in certain given installments. When a bank issues an installment credit or a credit stipulating shipments by installment within given periods, that credit should clearly state "Shipment must be effected in the following installments".

LC may, for instance, call for one shipment of ten thousand metric tons of steel in each month of 2016. Thus the beneficiary will make a shipment between first and last days of each month. This is usually preferred between companies who have regular trade. Should the beneficiary fail to make one of the shipments LC will cease to be available for the rest of the shipments.

A revolving LC is an alternative to shipment periods. The letter of credit under which the shipment is completed will be treated as re-issued, revolved. The letter of credit may revolve upon shipment (LC will revolve upon each shipment and presentation of

USD50,000.00 for 5 shipments/presentations) or on particular dates (LC may revolve beginning each month for 5 months).

Vincentiu (2008, p. 793) explains the differences and similarities between these two instruments. There are similarities and yet major differences between installment and revolving credits. The difference can represent significant risks for all parties involved. For example, with an installment credit, should the beneficiary miss one of the installments, the credit is no longer available for future installments. Revolving credits are either “cumulative” or “non-cumulative”. These classifications control the amounts available for drawing. For example, the consequence of non-shipment in a specified period under an installment letter of credit is that the letter of credit ceases to exist. Under a revolving non-cumulative letter of credit, the consequence is the loss of the amount for that period. In a cumulative revolving credit unshipped goods can be sent in one or several upcoming periods.

Revolving upon shipment is risky for the applicant because theoretically the beneficiary may affect one shipment per day and present the documents thus completing the amount of the LC in a much shorter time than anticipated by the applicant. Most secure way would be issuing the LC so that the revolving will not be automatic so the control of revolving will be on issuing bank.

3.4.4 Red Clause & Green Clause Letter of Credit

From the article of Weissman (1996, p. 46) A beneficiary may require financing in order to complete the manufacture or purchase of merchandise to be sold. A red clause L/C (use of the term "red" is derived from the traditional practice of writing the clause identifying this option in red ink) helps the beneficiary achieve this. Upon instruction from the buyer, the issuing bank authorizes the confirming bank to make a cash advance to the beneficiary against the beneficiary's written guarantee that the documents evidencing shipment will be presented in compliance with the credit terms.

Red clause LC allows a down payment within the frame of the LC before any shipment by the beneficiary. Once the shipment is completed the documents will be submitted to the confirming bank or issuing bank so that rest of the payment will be made. This type of LC is used to create funding to the beneficiary so he may start to produce the goods to be sold. This kind of financing is generally used when the goods to be delivered cannot be prepared in advance and kept for a buyer to purchase. Machineries are

generally produced after contracts are completed between parties. The exporter will need to receive an irrevocable LC to start the production and a down payment will cover preliminary expenses.

Green clause LCs work the same way except they call for presentation of documents for the down payment. The beneficiary should prepare a portion of the goods and deliver them to a forwarder in exchange of Forwarder's Certificate of Receipt (FCR) who will secure the goods to ship them in a future date. The beneficiary will receive payments for each FCR which shows amount of goods delivered and invoice. Once the goods are completed the beneficiary will present the shipment document and the final invoice for total amount showing the down payments made against FCR's and the final balance that should be paid. This type of LC is used when the total amount of LC is larger than the exporter's capacity. So the exporter will only be able to prepare one part of the goods and will need the payment of that portion in order to provide rest of the goods.

3.4.5 Transferable Letter of Credit & Back to Back Letter of Credits

A transferable credit (Transferable Letter of Credit) is generally used when the beneficiary of an import documentary credit is not the actual supplier of the goods, but an intermediary (middleman or agent). A transferable credit is a regular import documentary credit (Import Letter of Credit) with an additional term that allows a named bank to transfer an amount of the import documentary credit to one or more of the actual suppliers or any transferee requested by the beneficiary and agreed to by the bank⁷. This transfer is completed at the request of the beneficiary provided that the bank agrees to the transfer.

The second beneficiary(ies) will ship the goods to the applicant while submitting the documents to the first beneficiary's bank. First beneficiary will replace the invoice by his (and draft if any) and send them to the applicant's bank along with other documents. All terms of the LC should remain unchanged while transferring except for beneficiary, amount, insurance amount, shipment date, and expiry. Other than traders transferable LCs can be used by a producer who will not be able to provide the goods completely so he will transfer the LC partially to another producer for the part he cannot produce.

A back-to-back Letter of Credit is issued using an existing export L/C opened in customer's favour with consistent terms and conditions as security and the source of

⁷ <https://www.cibc.com/ca/tradefinance/transf-lttrs-of-crtd.html>

repayment. Similar to Transferable Letters of Credit the buyer will not normally know the ultimate supplier and the bank's customer can therefore supply the buyer without divulging data relating to third parties⁸.

Back to back LCs are essentially two LCs issued in connection with each other like a transferable LC. Once a beneficiary receives a letter of credit he will instruct his bank to issue a new LC with same conditions expect for the amount, shipment date and insurance amount etc. The only advantage to the beneficiary will be, if accepted by his bank, using the export LC as collateral to have credit facility for the import LC that he wishes to have issued.



⁸ https://www.sc.com/lk/cooperate_and_institutional/trade_products/back_to_back_letter_of_credit/en/

4. PAYMENT GUARANTEES

Payment guarantees function similarly to letters of credit except for while an LC is an active instrument the payment guarantees are passive. An issuing bank under an LC is the party who should make the payment however a bank providing guarantee, under a letter of guarantee or stand by letter of credit, will only act in case its customer does not fulfil its responsibility which may be payment or performance.

These guarantees can be used for different purposes from providing a credit facility to serve as performance guarantee for a construction business.

Financial guarantees are generally issued by the main bank of a company who wishes to use a credit facility for its subsidiary located in another country. The subsidiary that is not in a position to obtain a loan will need collateral to obtain the credit line it needs. This SBLC or LG, which is generally issued by a well known international bank, will serve this purpose. The local bank will grant the loan to said subsidiary with the comfort of the SBLC or LG.

They can also be used for securing the receivables for the goods exported without using a payment guarantee mechanism such as cash against documents or letter of credit.

Another common usage of these guarantees would be deals requiring long term construction of production periods such as buildings or big machineries.

While the mentality behind these two instruments is essentially same they differ in technical aspects. Letters of guarantee are subject to rules called URDG 758 issued by ICC same as UCP 600. SBLC in the other hand was created for US Banks because they were not authorized to issue LGs. Despite the beneficiary can approach both confirming bank and issuing bank under an SBLC the beneficiary will only approach to its bank under an LG.

4.1 STANDBY LETTERS OF CREDIT

Stand by letter of credit is generally used by US Banks and companies. It can be used for a simple trade (purchase of goods) or providing services (a contractor constructing a building for its customer overseas) same as an LG however the geographies they are used differ. Same as LCs they can be confirmed by a nominated by which is usually exporter's bank.

Letters of credit are an efficient and secure means of arranging for payment, but they are relatively expensive, as several banks are involved even in the most straightforward of

transactions, each charging a fee for its services (of varying size depending on the extent of its undertaking). As we have seen earlier in this chapter, if the seller and the buyer are in a long-term relationship involving many consignments of goods over a period of months or years, they are unlikely to use a letter of credit for each consignment of goods because to do so would add unnecessarily to the transaction costs. In such circumstances, the parties are more likely to agree to trade on open account terms, with the buyer periodically sending money to the seller by electronic funds transfer (a much cheaper means of money transfer). The seller may agree to those terms if it trusts the buyer, but it will still demand some form of security that it can draw on in the event of non payment by the buyer. Often, that security takes the form of a standby letter of credit (Davies and Snyder, 2014, p. 311).

To give an example; two companies with regular trade will agree on a \$200,000 worth of shipment per month that will be paid 30 days after the goods are received. The exporter will ship the goods, send the documents to importer and receive the payment 30 days after the goods are received by the importer. Exporter may for some reason request a payment security to use in case the importer fails to pay. While a standard LC is an option an SBLC can be used as well if they do not prefer the documents to be sent through the banks. The importer will approach its bank to have an SBLC issued guaranteeing the payment of \$400,000 and the validity of this SBLC will generally be 1 year with an option to extend it at the end of each period.

Reason to restrict the tenor with one year is that many banks will not go over 1 year tenor because of risk point of view. The risk appetite for same business or cost of this risk may change over 1 year time. The amount of SBLC is equal to two shipments instead of one because the payment is supposed to be affected 30 days after the goods are received the exporter will have made a second shipment when the payment is failed creating a \$400,000 worth of receivables from the importer.

SBLCs require fewer documents for a presentation compared to an LC and sometimes only a demand stating that the applicant had failed would be sufficient. For above example the exporter will approach the issuing bank, or the confirming bank if any, to demand the payment with a simple demand letter or sometimes a copy of unpaid invoices as well. This may seem risky for the applicant however the records of issuing

bank constitute a proof, thus if the payment is made through the issuing bank, a demand stating the payment was not made will not be accepted.

Apart from the purchase of goods SBLCs can also be used to guarantee intangible imports such as rights to broadcast NBA games for one year or using a Disney character for advertisement purposes. It could also be used securing the payments against a performance such as maintenance or securing the maintenance performance in case the payment is made up front.

4.2 LETTERS OF GUARANTEE

Letters of guarantees work similarly to SBLCs except for the lack of confirmation. Should the beneficiary require a guarantee from a bank other than issuing bank the structure will work differently than an SBLC. The issuing bank will issue a counterguarantee in favour of beneficiary's bank that is expected to deliver a letter of guarantee that is already quoted in counterguarantee text. Beneficiary's bank in return will provide a separate letter, same as quoted in counterguarantee text, to the beneficiary undertaking same commitment as the bank issuing the counterguarantee.

A demand guarantee (also called independent, autonomous or first demand guarantee) is an irrevocable undertaking issued by the guarantor upon the instructions of the applicant to pay the beneficiary any sum that may be demanded by the beneficiary up to a maximum amount determined in the guarantee, upon presentation of a demand complying with the terms of the guarantee (Affaki and Goode, 2011, p. 1)

LGs may be used in different formats for different needs. Affaki and Goode (2011, pp. 2-4) explain many of them in below list;

- i. Tender guarantees (also called bid bonds) cover the obligation of a tenderer (bidder) not to withdraw its tender (bid) until the adjudication of the contract and, if awarded the contract, to sign the contract according to the terms of the offer and to procure the issue of any other guarantee required in the contract, which is generally a performance guarantee. Tender guarantees are typically issued for an amount equal to 2-5% of the value of the tender. In some cases, where the procurement terms so require, the amount of a tender guarantee is not correlated to the tender amount and the guarantee is therefore issued for a flat amount.

- ii. Performance guarantees cover the obligation of a party to deliver the performance promised in the contract. They are sometimes conceived to balance the buyer's obligation to procure the issue of a documentary credit assuring that the seller or contractor is paid. This is done by offering an assurance to the buyer that it will be paid the guaranteed amount in case of non-performing delivery of the goods, works or services that form the object of the contract. Performance guarantees are typically issued for an amount equal to 5-10 % of the value of the underlying contract.
- iii. Advance payment guarantees cover the obligation of a debtor to reimburse, possibly with interest, any amount paid in advance for the delivery of goods, equipment, services or works if that delivery is not in accordance with the terms of the contract. Advance payment guarantees are issued for the amount of the paid advance, although they often contain a reduction clause that leads to the reduction of the guarantee amount upon determined dates or events generally linked to the performance of the contract.
- iv. Retention money guarantees allow contractors or sellers to receive the full amount due as partial of full payment for their delivery instead of the purchaser retaining part of that amount (usually 5-10%) until full performance is procured or following the lapse of an agreed period thereafter. In corporate acquisition finance, retention money guarantees are commonplace. They allow payment by the purchaser of the full price amount instead of withholding a part of that amount to secure the accuracy of the representations and warranties made by the seller as to the purchased company's net worth, its compliance with its regulatory, environmental and accounting obligations or any other legal liability that may arise in the future as a result of pre-acquisition activity.
- v. Warranty guarantees cover the supplier's or contractor's obligation to maintain the equipment, goods, works or services delivered in state corresponding to the agreed contract specifications during an agreed period. Warranty guarantees are typically issued for an amount equal to 5% of the value of the contract.
- vi. Customs guarantees are issued to the customs authority to cover any duty or liability that may become payable when imported goods or equipment that

would be exempt from duty if re-exported within a specified time are not in fact re-exported within that time.

- vii. Payment guarantees cover payment obligations relating to (i) the price of furnished goods or services, in which case this type of guarantee can be regarded as an alternative to more costly documentary credits; (ii) the reimbursement of a facility; (iii) the payment of receivable such as account payable by a distributor, including cases where receivable is embodied in a promissory note drawn on the account debtor; (iv) the payment of capital contributions by partners to a limited partnership or a joint venture; (v) the payment of decommissioning cost, for example of oil refineries, nuclear power plants and other hazardous activities; or (vi) the payment of rents under a lease or any other payable.
- viii. Credit enhancement guarantees allow a better-rated financial institution to undertake to pay securities holders should the lesser-rated securities issuer default. This enhances the credit rating of the issuing entity and impacts positively on the interest rate that it is expected to pay the holders.
- ix. Parent company guarantees cover the performance or payment obligations of the guarantor's subsidiaries or affiliates. Likewise, banks are sometimes required to issue guarantees in favour of their foreign subsidiaries to avoid having to transfer funds as capital to meet local banking regulatory requirements.
- x. Reinsurance guarantees are used by reinsurer to spread the insured risks among several insurers, by arranging for demand guarantees to be issued in favour of the insurer instead of having to deposit funds against their coverage obligation.
- xi. Risk participations, which are conceptually similar to reinsurance guaranties, allow banks and other financial institutions or entities to issue to a demand guarantee in favour the lender, thus sharing the borrower's default risk without having a relationship with the borrower. As opposed to funded participations, risk participations are put in place where the credit to the borrower does not require the lender to fund it immediately, as in the case of documentary credits. Depending on the particular case risk participations could be structured and drafted as demand guarantees.
- xii. Guarantees issued by multilateral financial institutions cover the payment risk of borrowers from developing economies with a view to encouraging lenders from

developed economies to engage in local financing with a view to fostering growth in the local economy and transferring credit know-how to local banks. One example of this is the successful Global Trade Finance Programme, managed by the World Bank, where guarantees issued in favour of banks confirming documentary credits cover up to 100% of the payment risk of issuing banks from developing economies in relation to short-term trade exchanges. Without the World Bank guarantee few of the global trade finance banks would have accepted the payment risk on the selected issuing banks.

- xiii. Sub-contract guarantees enable the main contractor to procure the issue of a demand guarantee that assures the sub-contractor the payment of sums due to them under the sub-contract in the event that the main contractor default on any payment due. Reversing the flow, sub-contractors can also be required to procure the issue of performance, warranty or advance payment guarantees in favour of the main contractor to secure the performance of their obligations under the sub-contract. Sometimes, the main contractor to choose to transfer to sub-contract guarantees to the project owner instead of reissuing new guarantees in favour of the owner. Guarantors, especially banks are generally cautious when the guarantee transfer request is not accompanied by a transfer to the same transferee of the transferor's rights and obligations arising from the underlying relationship.
- xiv. Court guarantees (judicatum solvi or appeal bonds) are procured by one or both litigants to guarantee the payment of money ordered in judgement, the case and attorney costs or, in the case of arbitration, the arbitrators' fees. Litigation-related guarantees also include guarantees securing the payment of amounts or performance of obligations agreed in a settlement ending the dispute.

5. FINANCING METHODES

While banks offer payment services and security for the payment or performance financing is also a big role of the banks in international trade. For the sake of this study, we should describe trade cycle and short term financing in order to focus our topic. Trade cycle is basically the period that starts where a company buys the goods (which can be end products in case of a trader or distributor and raw materials in case of producers) and ends when the said company collects the payment for its sales of the same product or what it produced out of it. If we are to give an example; a textile company that orders cotton will have below steps;

- i. Ordering the goods from the supplier,
- ii. Making the payment,
- iii. Receiving the goods,
- iv. Producing the end products,
- v. Selling these goods,
- vi. Collecting the payment

The steps may change if the company imports with open account and export with advance payment. In open account terms the importer will make the payment, for instance, 6 months after receiving the goods which may possibly fall around the date where it already collects the payment of its own sales. In this case the importer will need no financing under this transaction because the exporter is practically providing all the finance that is needed. However in this structure the exporter will not receive the proceeds for 6 months and will have to finance this term with its own funds or credit facilities. If the importer pays upfront before or at the time of shipment it will need to finance the period from the payment to such date where it collects the proceeds of its own sales. Below financing methods are used to finance the gaps in trade cycles for both importer and exporter depending on whichever needs on their particular payment agreement.

Short term financing is a loan which can be cash or non cash provided for a tenor up to 6 months or 1 year depending on the country. For the purposes of this study we will focus on instruments that are provided by foreign financial institutions through the intermediary of local banks.

5.1 DISCOUNTING OR NEGOTIATING DEFERRED LETTERS OF CREDIT

We had already established that a deferred LC means the payment is committed, upon compliant presentation, in a future date which is generally determined by taking the shipment as reference. The letter of credit may be issued as by deferred payment as well as by acceptance or by negotiation. As long as the payment is not to be made at sight there will be a term between the time when the documents are found compliant and the payment.

As explained in above this facility can be used by importer or exporter depending on the original payment structure that was agreed on. If the payment is supposed to be with a sight LC, meaning that the exporter is to be paid when the presentation is found compliant the importer will be the one using this loan. If the payment is to be effected in a future date (such as 360 days after the shipment) the exporter may use this credit. In a transaction where the importer pays 360 days after the shipment the applicant will automatically have 360 days credit from the exporter.

At the time of the agreement the parties will determine when the importer is to pay. If the exporter provides credit allowing the importer to pay in a future the exporter will negotiate with its bank how and/or if the funds will be advanced before the payment date. For this to work better the exporter will be contacting and negotiating with its banks prior to the transaction so they will have already agreed on how the funds will be advanced. If the payment is supposed to be at sight and the importer will use discounting then the exporter will advise the acceptable banks so importer can instruct its bank to contact them prior to LC issuance regarding confirmation and discounting. Once the parties agree on the discounting bank as well as the issuing bank in importer's country the LC will be issued.

The exporter's bank weather discounting the exporter or importer will most likely demand to be the nominated bank in the LC and confirmation to be required. This way it can act upon the presentation and determine the payment date and weather the presentation is compliant. Because discounting or negotiating can be performed by the exporter's bank only if it is instructed and nominated to do so in the LC. Otherwise in case of a problem or dispute exporter's bank will have no claim against the issuing bank.

Once the documents are submitted to the confirming, bank the bank will examine the documents according to LC terms, UCP 600 rules and ISBP (International Standard Banking Practises). Should the documents are found compliant the nominated bank will determine the date of the payment as defined in LC wording and undertake to pay in the future date.

Provided that the discounting will be made with the applicant's request then the cost of discounting and when it will be made will also be written in the LC text because these details were already known at the time of issuance. The exporter's bank will, upon compliant presentation, will determine the payment date and advance the funds to the exporter and advise the details such as invoice amount, payment date, date of the advance, Libor and interest amount. If the discounting will be done for the exporter it can request the funds to be advanced any time they need and the pricing will be negotiated out of the LC. Unlike the scenario where the discounting is made upon the request of the importer, the discounting bank will simply deduct the interest amount from the proceeds instead of paying the whole invoice amount to the exporter.

A similar structure can be also applied to acceptance LCs where the nominated bank will accept the draft drawn on it committing the payment in the future date specified in the LC. This structure will not create much difference for the importer who demands the discounting however the exporter holding the draft will have the liberty to have the draft discounted by any bank it chooses instead of being obligated to work with the nominated bank.

Apart from the exporter's bank the financing can also be provided by the issuing bank to the exporter depending on the economic and financial conditions of the countries. In case the importer's country has easier access to liquidity as opposed to our earlier assumption then the issuing bank may, upon compliant presentation and exporter's request, advance the funds by deducting the interest amount. As another alternative the confirming bank will assign the expected proceeds to a 3rd party bank that will in return advance the funds to the exporter. Risk Participation Agreement created by BAFT (Bankers Association for Finance and Trade) will allow an issuing bank to transfer its right to claim the payment from the issuing bank to a 3rd institution and have the payment advanced by this 3rd bank. Thus, the exporter will receive the funds earlier,

because the discounting bank has usually lower cost of funds the cost will be lower to the exporter and the issuing bank will be free of the risk.

In Turkey specific this type of financing has its challenge. Because the government wants to limit import in case the importer does not pay for the goods within two days after the goods are cleared at the customer a 6% tax will be applicable. Resource Utilization Support Fund is applied to all payment methods and it will have to be paid in any kind of deferred payment import transaction. Government provides exemption for certain sectors such as petrochemicals of steel business to help with the export. Apart from these exempted sectors discounted letters of credit is not the best option for Turkish importers.

5.2 POST FINANCING & PRE FINANCING

This is the type of financing provided, same as LC discounting, can be used by importer or exporter depending payment date agreed by the parties. Most of the time the importer will pay at the time of shipment or delivery and will need financing until it can sell the goods as they are in case of a trader or the output it created in case of a producer. In case of export finance pre shipment finance will cover any kind of need that is necessary to make the delivery while post shipment finance will consists of purchase/discount of export documents etc. (Sen Gupta and Keshari, 2013, p.5).

Because this kind of financing has no connection to the payment scheme as in LC discounting the process will work differently. The importer will approach its bank in order to get a loan for the import transaction it is about to make. Its bank will contact possible creditors for their offers and relay its own offer with the best quotation.

Once the parties all agree on pricing the creditor bank will have to be presented the documents related to the transaction for compliance requirements. If the shipment is already made an invoice and shipment document will be presented for a more thorough check. However, if the financing will be in form of pre shipment financing then the sales agreement or contract can be necessary however the borrower will commit to provide the rest of the documents after the shipment. Once necessary checks are completed the importer's bank will send a S.W.I.F.T. message to creditor bank to request the financing. The details such as disbursement date maturity date interest payments will be all determined beforehand and inserted in the text. After fixing the

Libor the creditor bank will provide the interest amount and the repayment instructions along while disbursing the funds.

Once received by the creditor bank, the S.W.I.F.T. will be examined again and the financing will be provided to importer's bank to be extended to the importer as a sub-loan. Because the importer will most probably will not have any credibility against the creditor bank that is located in another country the will be importer's bank thus the repayment will be the obligation of the importer's bank regardless the sub-borrower repays or not. Master Loan Agreement created by BAFT can be an example to these agreements for bank-to-bank loans.

In case the financing is provided to the exporter it will be in form of discounting the expected future collection instead of the advancing however the structure will be similar.

This type of financing is often used by Turkish banks to provide funding to their customers with lower cost. Even though foreign liabilities require higher reserve requirement the cost can still be lower than domestic funding sources.

5.3 AVALIZED PROMISSORY NOTES

This type of loan will use the discountability feature of promissory notes. Same as post financing or pre financing the creditor bank will provide a loan under the import transaction against however this time a promissory note issued by the importer. Because the importer generally has no credibility for the creditor bank located in another country importer's bank will avalize the promissory note committing to pay the value of the promissory note in case the borrower fails to do so. The process will typically be as below.

The importer will approach its bank for financing opportunities. Importer's bank will contact possible creditors for the best quotation. Once the parties agree on the pricing documents relating to the import transaction will be forwarded to creditor bank for compliance check. Depending on their compliance policy a bank may or may not accept financing a transaction before the shipment document and invoice is produced.

Once the check is completed parties will agree on disbursement date. This date will be usually three business days later so that Libor can be fixed two days prior to the disbursement. After the Libor is fixed by the creditor bank and communicated to importer's bank, importer's bank will prepare the promissory note with face value

including principal and interest amount. Importer will sign the promissory note as the borrower and importer's bank will sign it as avalizer. The promissory will be sent to the creditor bank while the importer's bank sends a S.W.I.F.T. message (also known as side letter) including the terms of financing and the account where the funds should be disbursed. Once the promissory note is delivered the creditor bank will discount it and provide the principal amount as loan. The importer's bank will generally effect the payment for the underlying import transaction on behalf of the importer. At the time of repayment the promissory note will be returned to importer's bank 10 to 15 days prior to repayment for the collection of the loan.

Unlike the post financing or pre financing the importer will not have a cash loan but a non cash loan from its bank which is lower cost compared to advancing the funds as a sub loan where the importer's bank will be the main borrower and extend the funds as a separate loan.

This type of financing was used more frequently before RUSF was started to be applied on 2013 as 3% for any financing shorter than 1 year %1 for any financing between 1 and 2 years and 0.5% for any financing between 2 and 3 years. Other than this additional cost it allows importers and local banks to reach international funding sources with a rather easy structure.

5.4 FORFAITING AND FACTORING

Forfaiting and factoring are both used by the exporters to finance their needs, to be more competitive in the trade, provide credit sale to their customer and most of the time to protect themselves in case of non payment.

The term forfaiting literally means to forfeit derived from French word "à forfait". The exporter will forfeit its rights to claim the receivables from the importer of a specific transaction where this right is transferred to the forfaiter. From that moment on the forfaiter will be entitled to claim and receive the payments but will not be able to turn to the exporter should the importer fails to pay.

Factoring is another way for the exporters to acquire their receivables against the goods they sell against deferred payment or instalments. With this agreement the exporter will be able to transfer all its claims of the buyer in exchange of immediate payment from the factor. While providing an immediate payment for the exporter after providing a credit to buyer, the factoring may also protect the exporter from non payment. Thus, the

importer will get to use a credit import, the exporter will have its payment immediately after providing and advantageous service to its client and the factor will make money for the financing it has provided. (Stroevea, Sukhorukova, Tsvyrko and Ivashchenko 2015, p. 52)

Table 4.1: Differences between factoring and forfaiting

Factoring	Forfaiting
Usually with recourse	Always without recourse
Maturity of 6 months or less	Maturity of 6 months to 10 years; Most often 3 to 5 years
On-going revolving deals; Often requires a large portion of customers business	One-time deals
Works mostly with consumer goods	Works with capital goods, commodities, large projects
Avoids developing countries	Works well in developing countries because of the guarantee
Less expensive	More expensive

Source: Hill and Tanju (1998)

Although they may seem similar forfaiting and factoring have several differences. Factoring may be with or without recourse depending the agreement between the exporter and the factor, in case of non payment from the importer; the factor may claim the payment from the exporter. However the forfeiting is supposed to be without recourse.

Another difference from the forfaiting is that factoring will deal with short term debts with a few months tenor which will change depending on the market practices. Forfaiting in the other have can handle medium or long term debts such as collectibles against capital goods. Because of the tenor, goods the risk that is taken forfaiting will be more expensive.

Factoring is not made with only one transaction but the factor will demand to take all the receivable from the exporter in order to have its risk distributed. In the other hand forfaiting can be made for one deal.

In factoring, in case of without recourse agreement, the factor will take the risk himself. That is the reason why the factors will avoid risky regions such as developing countries. In the other hand, the forfaiter will get a guarantee of the payment from a government entity or a financial institution with high credibility so that they can handle longer tenors in developing countries. (Hill and Tanju 1998, p. 53-54)

5.5 MURABAHA

Murabaha may be considered as the Islamic version of postfinancing with the exception of interest. The buyer may acquire the possession of the goods by using a bank loan, discounted deferred LC or postfinancing. But if the buyer wishes to avoid interest he may use this facility. In the simple term the bank will purchase whatever the buyer intends to buy then resell to its customer. The repayments to the bank will not be principal and interest but the payments for the goods with a margin added on top of the original value that is agreed by both parties (El Hachloufi, Hamza and Janssen, 2013, p. 391).

This type of product can only be offered by participation banks so a conventional bank will not be able to offer it. However as in the example of avalized promissory notes where the financing is coming from a bank based abroad the local bank may provide a letter of guarantee so that its customer will be able to have credibility against the creditor institution. Repayments may be with instalments as well as bullet payment depending on the agreement.

This type of financing is subject to same level of RUSF as avalized promissory notes because they are both foreign financing sources used by importers directly.

5.6 RCA AS AN EXAMPLE OF LOANS PROVIDED BY IFI'S

An IFI (or International Financial Institution) such as IMF or EBRD will have facilities dedicated to short term financing of trade. Unlike commercial banks that are profit oriented IFIs work in line with their policies which is generally supporting certain geography for their economic development. Revolving Credit Agreement (RCA) which is a product offered by EBRD under Trade Facilitation Programme (TFP) that offers short term financing to importer and exporter in their countries of operation through selected banks can be an example⁹.

⁹ <http://www.ebrd.com/work-with-us/trade-facilitation-programme/products.html>

The structure is similar to post financing of pre financing. However the importer's bank will not collect loan offers from several creditors because the EBRD pricing will be constant unless any notice stating otherwise is given.

In this product the borrower (importer or exporter) is expected to produce a rationale explaining the requested tenor so that EBRD can match the tenor to actual trade cycle. An importer who needs financing to pay for the goods it is importing until being paid for its own sales or the exporter who need funds until such time the importer makes the payment will need to explain this period. After the documentation and other relevant details are submitted to ERBD they will evaluate if they can support the deal. If the decision is positive importer's bank will send a S.W.I.F.T. containing all the details previously provided and ask for financing.

The funds will be disbursed to the borrower's bank along with a repayment structure which is already established in the framework agreement signed between EBRD and the borrower's bank.

5.7 GSM

General Sales Manager (GSM) created by United States Department of Agriculture (USDA) is a credit guarantee programme aimed to increase the agricultural exports of United States of America (U.S.A.). Code of Federal Regulations lists the purposes of the GSM as; (a) to increase exports of U.S. Agricultural Commodities and expand access to trade finance; (b) to assist countries, particularly developing countries and emerging markets, in meeting their food and fiber needs; (c) to establish or improve facilities and infrastructure in emerging markets to expand exports of U.S. Agricultural Commodities; or (d) for such other purposes as the Secretary of Agriculture determines appropriate¹⁰. Although there are many financing facilities provided by government bodies to promote their countries export, GSM differs with being short term and simple to use.

The GSM facility can be up to 18 months with latest changes and can be used through bank recognised under the program. A US based bank will have to sign a GSM agreement in importer's country that should also have credit line provided by United States Department of Agriculture (USDA) because 98% of the loan will be insured by USDA.

¹⁰ http://www.ecfr.gov/cgi-bin/text-idx?SID=36b91e3d77f1c6113dd865b37ff94d14&mc=true&node=se7.10.1493_12&rgn=div8

For this facility, the process will be started by the exporter who would like to utilise the GSM in order to promote its export business. At the time of this application the exporter will provide the goods to be exported, importer's title, the requested tenor and importer's bank. If the details are acceptable (if the goods are covered by the programme, if the importer's country is included in programme, if the importer's bank has enough availability) the transaction will be given a GSM number that the exporter will forward to importer. The USDA will also notify the importer's bank that a GSM registration has been made in their name.

When the GSM registration is completed the importer will have its bank issue the LC to its correspondent with which it has a GSM agreement. Once the compliant presentation is made to the US bank that will provide the GSM loan, even though the LC states the payment as sight, it will pay to exporter and get this loan insured by US government. Repayments of interest and principal will be made according to the option chosen by the exporter at the time of registration among the alternatives provided by the programme. Because it is quite strait forward and low cost it is used a lot throughout the world. However because the RUSF is applied to this facility same as Murabaha and avalized promissory notes the popularity has declined gradually.

6. FOREIGN TRADE FINANCE AND INTERNATIONAL TRADE VOLUME IN TURKEY ANALYSIS OF POST COUP ATTEMPT ERA

In this chapter, we will be looking into the trade patterns and short term financing of Turkey starting from late 1990's and try to understand the impact whether or not the coup attempt on July 15, 2016 and rating downgrade that followed on September 23, 2016 had any effect on economy. While it is expected that these two events should have a significant effect on how the business is done and how this business is financed, other factors may lead to a different consequence. In order to reach a conclusion, we will be observing the data such as import and export volumes, the payment methods in both import and export and short term debt stock. We will then compare these data in order to see the relation between them and interpret to reach a meaningful conclusion.

Because all these data cannot be found dating back the same year we will have to cut them on 1998 which is the oldest data reachable for payment methods. Even though short term debt stock can be tracked to 1989 and trade data to 1923 in order to make a meaningful comparison we will use the data from 1998 for all of them.

6.1 ANALYSIS OF TRADE DATA

Even though current account deficit is a usual part of our lives now, we can see that it hasn't always been the case if we take a look at the trade data between 1923 and 2016. Starting from 1930 until 1946, only on 1938 a current account deficit was recorded with a very low level of 3.3%. Years coming after that presented a stable growth in current account deficit. Below table showing the import and export data from 1998 to 2015 will illustrate the situation better.

As it can be seen export/import coverage ratio did grow since 1998 however the growth was not nearly sufficient to cover import entirely. In addition to the deficit the trade volume did grow dramatically to create an immense current account deficit which should be financed through external debt. Unfortunately short term external debt constitutes more and more part of total external debt of Turkey. It has come to 33% by end of 2014 from 13% in 2002.

Table 5.1: Import and export volume of Turkey between 1998 and 2015 (million \$)

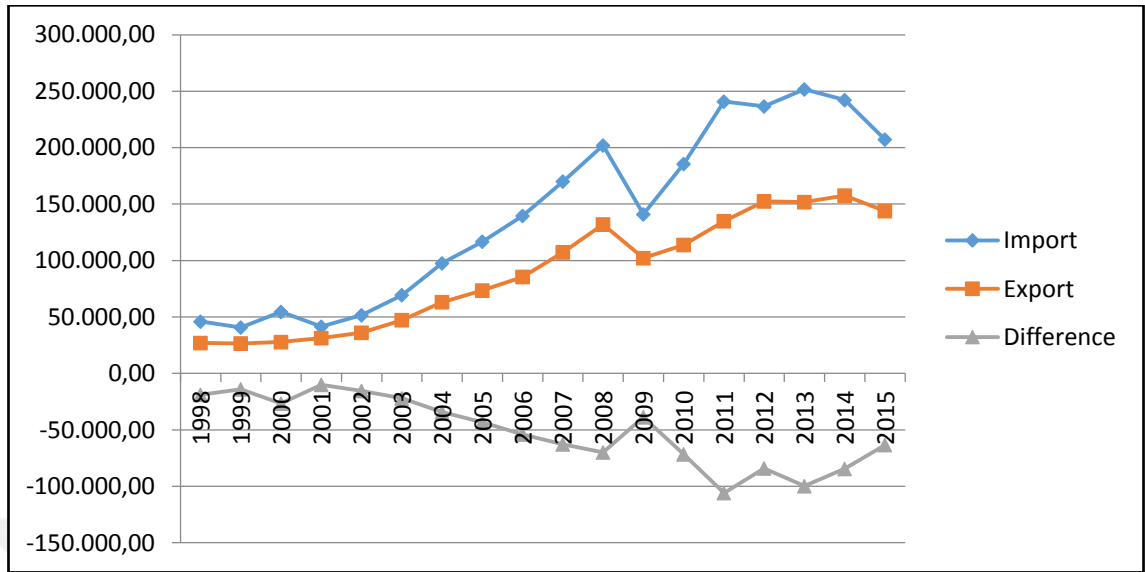
Year	Import	Export	Difference	Export/Import
1998	45.921,39	26.973,95	-18.947,44	58,74%
1999	40.671,27	26.587,22	-14.084,05	65,37%
2000	54.502,82	27.774,91	-26.727,91	50,96%
2001	41.399,08	31.334,22	-10.064,87	75,69%
2002	51.553,80	36.059,09	-15.494,71	69,94%
2003	69.339,69	47.252,84	-22.086,86	68,15%
2004	97.539,77	63.167,15	-34.372,61	64,76%
2005	116.774,15	73.476,41	-43.297,74	62,92%
2006	139.576,17	85.534,68	-54.041,50	61,28%
2007	170.062,71	107.271,75	-62.790,96	63,08%
2008	201.963,57	132.027,20	-69.936,38	65,37%
2009	140.928,42	102.142,61	-38.785,81	72,48%
2010	185.544,33	113.883,22	-71.661,11	61,38%
2011	240.841,68	134.906,87	-105.934,81	56,01%
2012	236.545,14	152.461,74	-84.083,40	64,45%
2013	251.661,25	151.802,64	-99.858,61	60,32%
2014	242.177,12	157.610,16	-84.566,96	65,08%
2015	207.234,36	143.838,87	-63.395,49	69,41%

As it can be seen it below chart, along with trade volume of Turkey the current account deficit also improved dramatically, particularly starting from early 2000's.

The effects of global financial crisis of 2007-2008 can also be observed as a sharp decline in both export and import volumes resulting to a decrease in current account deficit in return. We can also see a small leap in import volume on 2000 that can be the result of 1999 earthquakes and economic crisis of 2000 which was followed by a political crisis in January 2001. The effect of sharp decline in the oil prices that started on 2014 can also be observed as a decline in import and current account deficit even though the export is falling as well. Decrease in export volume starts on 2015 due to stronger USD compared to previous years.

It should be also noted that while the import and export moves in parallel until 2009, after this date import volume started to record a faster increase compared to export. This difference can also be observed in current account deficit that grows faster after 2009.

Figure 5.1: Import and export volume of Turkey between 1998 and 2015 (million \$)



Looking at the table of trade volumes in 2016, we can see that the volume has fallen compared to recent years. The upside is that import has fallen more than exports, easing the pressure on current account deficit. This can be explained with the falling oil prices which make up a big part of Turkey's import.

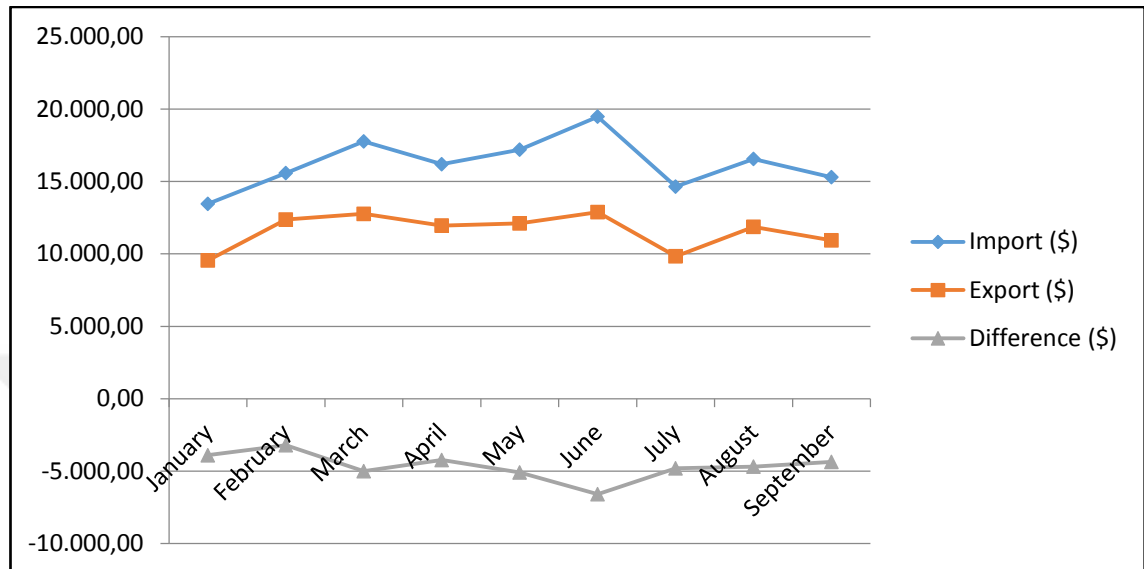
Table 5.2: Import and export volume of Turkey from January to September (million \$)

Monts	Import (\$)	Export (\$)	Difference (\$)	Export/Import
January	13.452,71	9.547,92	-3.904,79	70,97%
February	15.576,67	12.367,87	-3.208,81	79,40%
March	17.763,22	12.759,15	-5.004,07	71,83%
April	16.188,40	11.954,50	-4.233,90	73,85%
May	17.195,24	12.104,65	-5.090,59	70,40%
June	19.474,02	12.883,81	-6.590,21	66,16%
July	14.641,97	9.835,44	-4.806,53	67,17%
August	16.553,82	11.867,05	-4.686,77	71,69%
September	15.296,49	10.934,85	-4.361,64	71,49%
Total	146.142,54	104.255,23	-41.887,30	71,34%

Looking at the below chart for the same data, we can see the effect of coup attempt as a quick drop in volumes in July. While the numbers show a slight recovery on August the data from September still shows a struggle. However we should also take the effect of

stronger USD in to account. We can conclude that the coup attempt did not have a big impact in terms of trade volume of Turkey.

Figure 5.2: Import and export volume of Turkey from January to September (million \$)



Looking at the way how the payments were made in import we can see that open account payments grew significantly from 1998 to 2015. In previous chapters we had already mentioned how the payment methods are shaped between parties. Advance payment which is it least secure way for the importer has always had the highest portion since 1998 and has gone from 32% to 46% until 2015. Coming to open account payments which are the most secure way for the importer that also shows the confidence to Turkish importers, we can observe a steady increase. Despite this increase, open account payments remain below the advance payments volume for the whole period. We can also see a steady decline in both CAD and LC payments which can be interpreted as trust to exporting counterparties. This can also mean that these payment methods lose ground in the market as they are most costly methods. Open account payments seem to gain all the ground (26.5 % increase) that CAD and LC payments lost (29.6% decrease).

Table 5.3: Percentages of payment methods in import between 1998 and 2015

Year	Advance Payment	Open Account	CAD	Letter of Credit	Other
1998	32,67%	13,91%	22,15%	23,28%	7,99%
1999	31,38%	20,22%	17,84%	22,55%	8,01%
2000	33,00%	19,19%	15,74%	24,47%	7,59%
2001	31,03%	20,56%	11,86%	25,70%	10,85%
2002	33,67%	20,06%	11,81%	23,35%	11,11%
2003	38,39%	19,25%	12,19%	20,74%	9,43%
2004	40,98%	21,06%	13,97%	18,52%	5,47%
2005	43,02%	21,53%	12,53%	20,32%	2,60%
2006	47,11%	20,63%	10,66%	18,76%	2,83%
2007	48,35%	20,03%	10,50%	18,50%	2,62%
2008	47,52%	19,52%	10,06%	20,34%	2,56%
2009	48,72%	21,18%	8,83%	18,05%	3,22%
2010	51,44%	18,89%	8,49%	17,62%	3,56%
2011	46,24%	18,01%	7,55%	24,96%	3,24%
2012	45,66%	30,09%	6,58%	14,85%	2,82%
2013	46,75%	31,09%	6,39%	13,37%	2,41%
2014	49,27%	29,75%	6,36%	12,02%	2,60%
2015	46,01%	33,35%	5,39%	11,93%	3,33%

Looking at the below chart we can see the effects of crises which occurred on 2001 and 2001, advance payments starts rising quickly letter of credit payments make a leap and open account payments cease to rise. After this point advance payments did not stop until 2010 where it peaked above 50%. The rise of open account payments fall around same time.

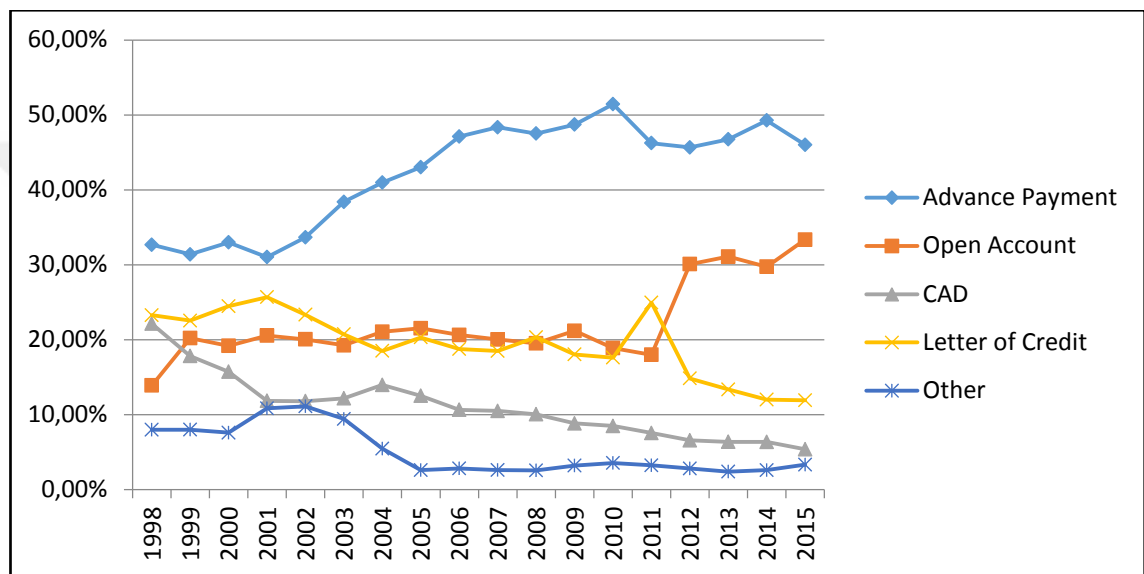
In addition, we can also see the effects of global crisis. Letter of credit payments make a leap on 2011 with 24.96 % highest since 25.70 % on 2001. After this point the confidence to Turkish importers seem to increase as letter of credit, advance payment and CAD payments fall steadily while open account payments rise. Unfortunately this increase is not sufficient for the open account payments to surpass advance payment transactions which will only be possible on 2016.

Apart from the peak of LC payments on 2011 LC and CAD payments steadily decrease. This fall could mean to move away from costly methods however the ground they lose was covered by open account payments which show a trust towards Turkish importers. Other payment methods that contain without payment, barter and barter and are always

negligible present a sharp upwards movement from 2001 to 2003. 2002 is also the first year you can see barter payments in Turkish Statistical Institution data.

Looking at this data in overall we can say that the outlook of Turkish market gets more and more positive throughout the years. LC and CAD payments which are also most expensive ways are in decline in favour of open account payments. The effects of national and global crises are also recovered from quickly enough.

Figure 5.3: Percentages of payment methods in import between 1998 and 2015



If we look at the same data for 2016 we will see that there is not much change in terms of payment methods. Open account payments, following the trend of previous years, surpassed advance payments for the first time. Advance payment kept its slow decrease. Letter of credit and CAD payments did not make any significant change.

Open account payments which are expected to fall did no significant movement in the three months following the coup attempt. In fact it even increased slightly after June. Advance payments which are expected to rise are almost in the same level as the previous months.

Table 5.4: Percentages of payment methods in import between January and September

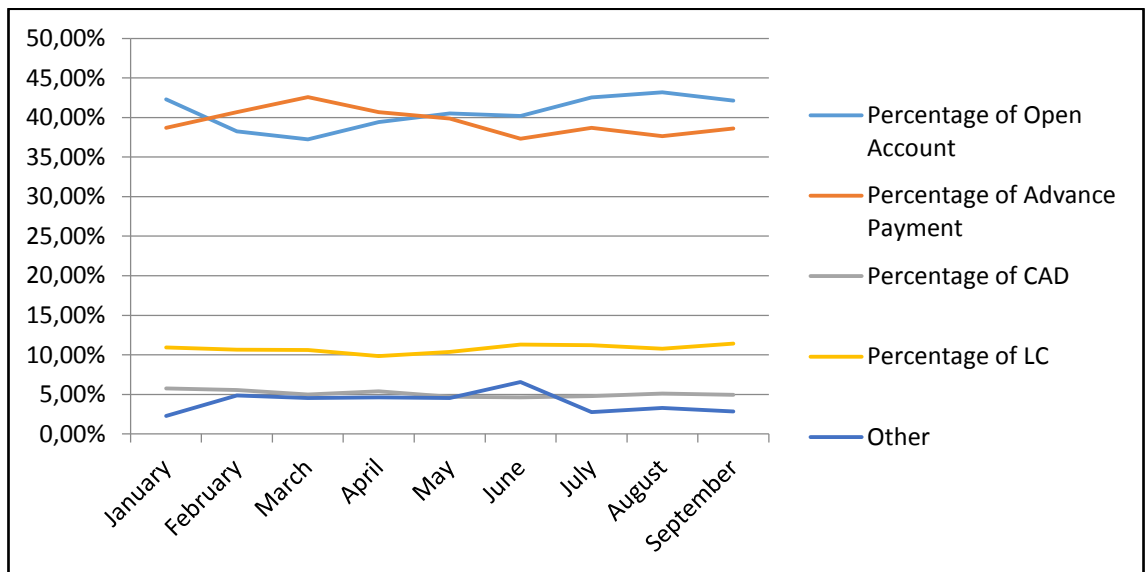
Year	Open Account	Advance Payment	CAD	LC	Other
January	42,30%	38,69%	5,75%	10,96%	2,30%
February	38,25%	40,68%	5,55%	10,64%	4,88%
March	37,26%	42,60%	4,99%	10,61%	4,55%
April	39,43%	40,69%	5,42%	9,83%	4,64%
May	40,53%	39,86%	4,69%	10,36%	4,56%
June	40,18%	37,30%	4,62%	11,32%	6,57%
July	42,55%	38,70%	4,78%	11,21%	2,76%
August	43,19%	37,63%	5,11%	10,78%	3,29%
September	42,15%	38,60%	4,97%	11,44%	2,84%

In below chart, it can be seen that open account payments which had surpassed the advance payments for the first time since 1989 is still above and the difference even widened in August. Even though the difference is getting smaller in September it is not unexpected when the data from previous years are taken into account.

CAD and LC payments remain unchanged except for a small upwards movement in LC transactions.

Overall we can conclude that the coup attempt did not have any significant effect Turkish imports in terms of payment methods.

Figure 5.4: Percentages of payment methods in import between January and September



Coming to export data we will see a different picture. Open account payment which is least secure way for exporter has always been higher than other methods and is on the rise between 1998 and 2015.

Share of CAD and LC payments declined during this period similar to import transactions however the balance between open account and advance payments cannot be seen here. Advance payments could only go over 10% once on 2011 which can be attributed to global financial crisis. Lack of liquidity may have made it harder for the exporters to provide credit sales to their importer counter parties. Open account payment, the least secure way for the exporters, even gained ground against letter of credit and CAD payments.

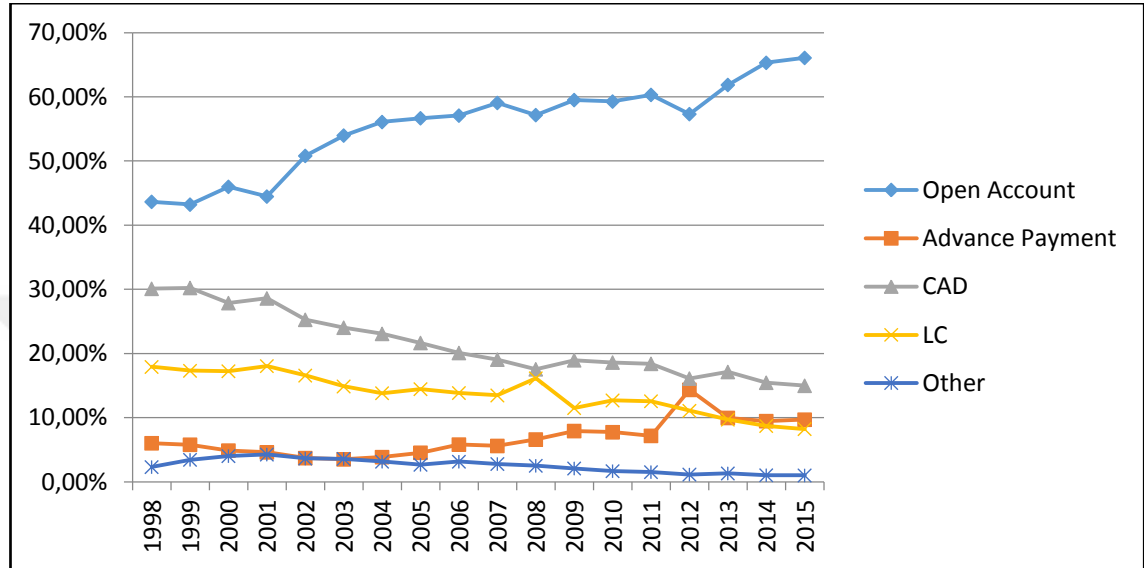
Table 5.5: Percentages of payment methods in export between 1998 and 2015

Year	Open Account	Advance Payment	CAD	LC	Other
1998	43,65%	6,03%	30,10%	17,92%	2,31%
1999	43,21%	5,79%	30,23%	17,32%	3,45%
2000	45,99%	4,88%	27,87%	17,25%	4,02%
2001	44,47%	4,61%	28,60%	18,05%	4,26%
2002	50,81%	3,71%	25,27%	16,57%	3,65%
2003	53,98%	3,52%	24,03%	14,88%	3,59%
2004	56,09%	3,86%	23,08%	13,82%	3,15%
2005	56,68%	4,54%	21,66%	14,45%	2,68%
2006	57,09%	5,81%	20,09%	13,85%	3,15%
2007	59,07%	5,61%	19,06%	13,48%	2,79%
2008	57,17%	6,61%	17,56%	16,15%	2,52%
2009	59,51%	7,93%	18,96%	11,51%	2,09%
2010	59,28%	7,74%	18,60%	12,70%	1,67%
2011	60,32%	7,18%	18,41%	12,57%	1,52%
2012	57,32%	14,35%	16,11%	11,08%	1,14%
2013	61,87%	9,97%	17,13%	9,71%	1,32%
2014	65,32%	9,47%	15,46%	8,71%	1,04%
2015	66,08%	9,70%	14,99%	8,23%	1,01%
2016	67,63%	9,84%	14,37%	7,10%	1,06%

The chart shows us a few more details. There is a small exchange between open account payments and CAD and letter of credit payments in 2001. The effect of 2008 financial crisis is translated as a leap in letter of credit volumes and a fall in open account volumes. After 2012 open account payments keep growing while all other payment

methods lose ground. The increase in advance payments in 2012 was compensated by the decrease in open account exports. This outlook is not as positive as import side of trade of Turkey.

Figure 5.5: Percentages of payment methods in export between 1998 and 2015



The fact that exports are mainly made with the least secure way might be explained with several reasons. First reason is the lack of competitiveness of Turkish exporters. Looking at the below chart we can easily see that the goods exported by Turkish companies do not represent a positive picture. Motor vehicles and basic metals are two leading sectors followed by textile sector in our exports and there is the reason why Turkish exporters mainly export on open account basis.

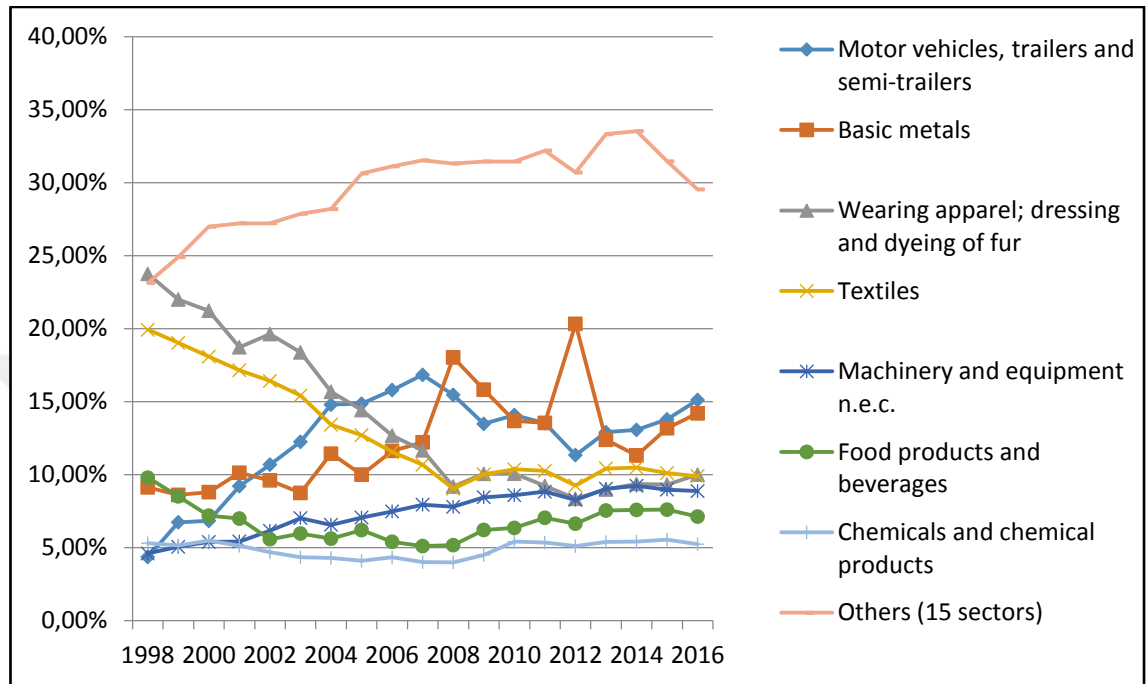
Because basic metals are not sophisticated end goods, the profit margin is very low and competition is very high in this sector. In addition to this, by nature of this sector it is practically impossible to be a distinguished brand. Therefore it is hard for the exporters in this sector to impose their terms.

As for Turkish motor vehicles manufacturing, sector is in fact direct investment of foreign companies from Europe and Japan. It is natural that they will not need any security while doing business with their overseas sister companies.

Textile business is similar to motor vehicles manufacturing. Despite it is 3rd exported product in Turkey, Turkey does not have a recognized brand to market. Thus, all the

production is in fact depended to international brands that will be easily imposing their terms when doing business with small textile producers in Turkey.

Figure 5.6: Shares of sector in export between 1998 and 2016



Looking at the payments in export transactions in 2016, we will see that there is no significant change in the way the business is done. Same as the import business the numbers are expected to change course after July. However open account payments which are expected to rise are in line with previous months. We can observe a slight shift from LC to advance payment but that is not a significant change if we are to look at the data in earlier months.

Advance payments, which are expected to fall, recorded a slight increase in August and September compensating the fall in July.

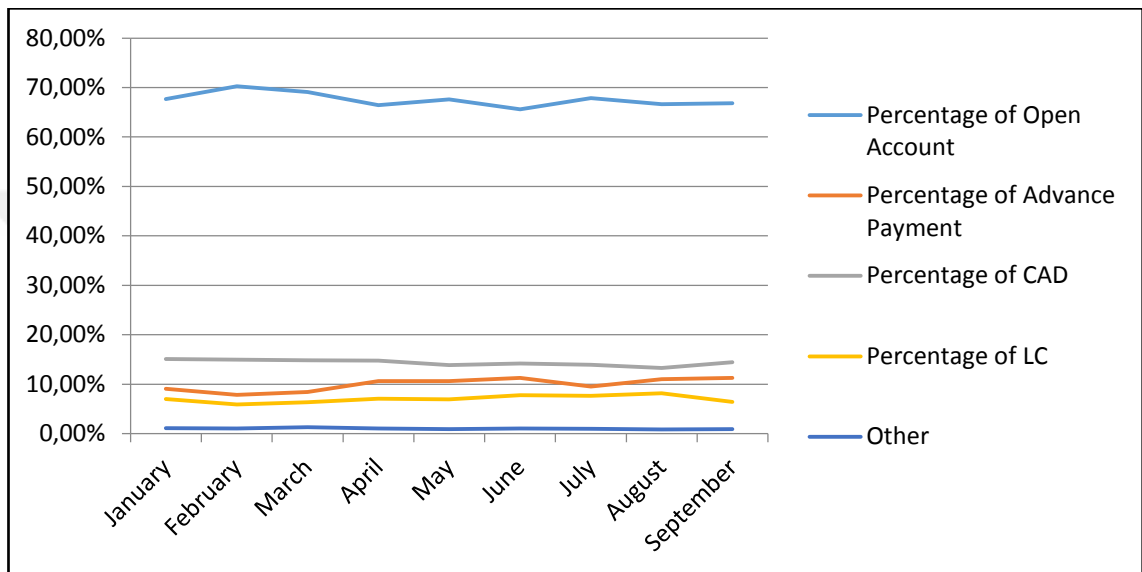
Table 5.6: Percentages of payment methods in export between January and September

Year	Open Account	Advance Payment	CAD	LC	Other
January	67,67%	9,09%	15,12%	6,99%	1,14%
February	70,23%	7,87%	14,96%	5,91%	1,03%
March	69,06%	8,43%	14,84%	6,37%	1,29%
April	66,45%	10,65%	14,75%	7,09%	1,05%
May	67,58%	10,63%	13,87%	6,98%	0,94%

June	65,61%	11,29%	14,23%	7,77%	1,09%
July	67,84%	9,54%	13,94%	7,67%	1,01%
August	66,64%	11,02%	13,28%	8,16%	0,90%
September	66,85%	11,29%	14,46%	6,45%	0,95%

The chart shows us a similar picture, even though there is a slight change in July August and September data shows a recovery.

Figure 5.7: Percentages of payment methods in export between January and September



We can conclude that export business is not either hurt the coup attempt. Over all data we have gathered here shows that

6.2 ANALYSIS OF SHORT TERM EXTERNAL DEBT STOCK

First we will be looking at the debtors of short term external debt stock of Turkey. Looking at the below table, first thing to notice is that the total amount of the short term external debt increased quite quickly over the years. Especially private sector augmented the short term external debt volume very rapidly. The excess liquidity that followed financial crisis in USA made it very easy to access international funding in emerging markets such as Turkey. Because the current account deficit kept growing and short term debt made up bigger part of Turkey's total external debt it was natural that short term debt stock grew this quickly.

Public sector however never had a significant part of the debt. And the volume shown under public section in the table calculates public banks in this category too. If we take this one out the short term debt of public sector will be even smaller.

Central Bank holds a small but steady part of the debt until 2013 then reduces the amount that was already small.

Table 5.7: Shares of public and private sector in short term external debt stock per borrower 2002 – 2015

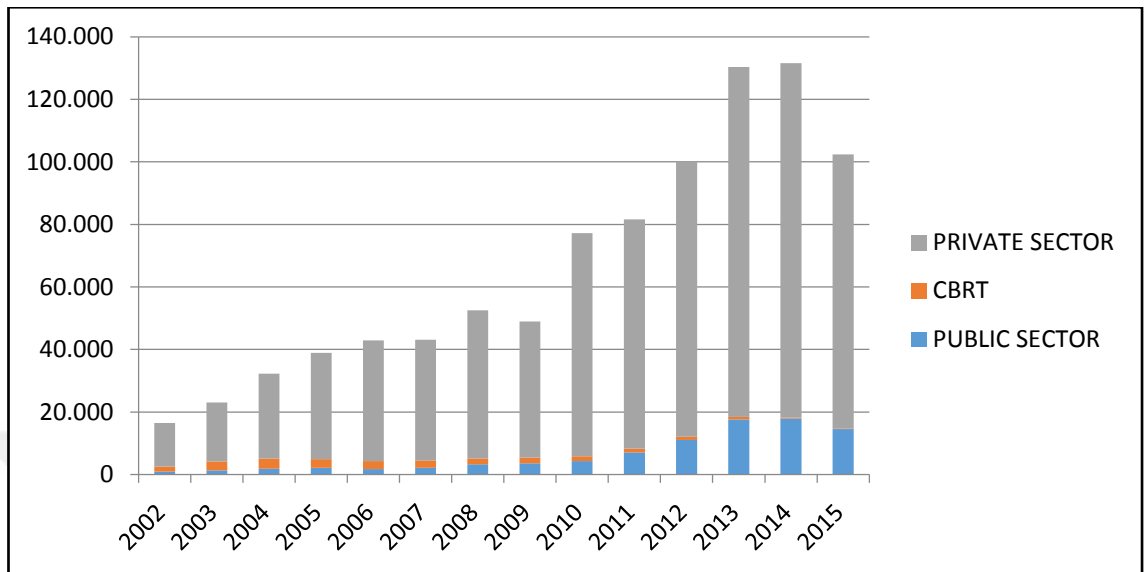
Years	Total	Public Sector	CBRT	Private Sector
2002	16.424	915	1.655	13.854
2003	23.013	1.341	2.860	18.812
2004	32.203	1.840	3.287	27.076
2005	38.914	2.133	2.763	34.018
2006	42.853	1.750	2.563	38.540
2007	43.142	2.163	2.282	38.697
2008	52.512	3.248	1.874	47.390
2009	48.977	3.598	1.764	43.615
2010	77.232	4.290	1.553	71.389
2011	81.556	7.013	1.239	73.304
2012	100.155	11.040	1.036	88.079
2013	130.296	17.605	833	111.858
2014	131.598	17.866	342	113.390
2015	102.424	14.550	176	87.698

Looking at below chart we will notice that the share of Central Bank has been reduced to a negligible level. Public sector in the other hand made a progress in terms of short term borrowing. However when we look at following charts we will see that this data contains public banks as well. The government itself does not have a significant short term external debt. Private sector carried a great deal of short term external debt stock.

Effects of global crisis in 2008 can be seen as a fall in total short term debt stock in 2009. Once the effects of crisis in recovered in Turkey the total amount of short term external debt makes a leap parallel to the import volume that also leaps in 2013.

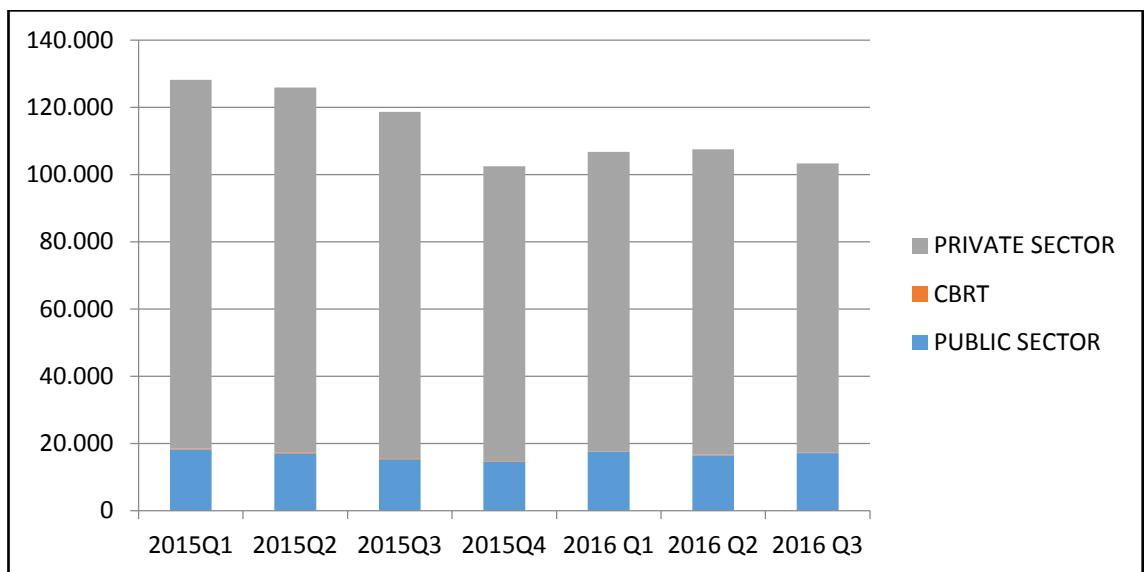
However the amount of total short term debt stock is also in decline in 2015 and the increase in 2014 is not comparable to previous years. This can be attributed to the end of quantitative easing by FED. Interest rate increase by FED also led the foreign funding to exit emerging markets and Turkey was no exception. It should also be mentioned that short term external debt made 33% of total external debt of Turkey in 2014 and in 2015. So the decrease was recorded in short term external debt cannot be explained as a shift to more sustainable long term debt.

Figure 5.8: Shares of public and private sector in short term external debt stock per borrower 2002 – 2015



Coming to 2016 we can observe that there is no immediate change in total amount as well as the shares of the borrowers that would be expected after coup attempt. Total amount still hovers above 100 billion USD and the slight decrease in 2016 is actually the continuation of a trend coming from previous years. In fact it can be seen that the decrease is slower compared to 2015.

Figure 5.9: Shares of public and private sector in short term external debt stock per borrower 2015Q1 – 2016Q3



We can conclude that even though the short term debt is in decrease that cannot be attributed to coup attempt. The negative outlook in this aspect has been going on since two years and coup attempt do not seem to have an effect on the volume. Although there is a slight decrease in 2016Q3 it is in same level of 2015 year end.

We will now look at the breakdown of the short term external debt stock of private sector. In below table it can be seen that banks and other financial institutions have replaced the non-financial institutions over the years. Non-bank financial institutions have also created a substantial volume starting from 2004 after the crisis in Turkey.

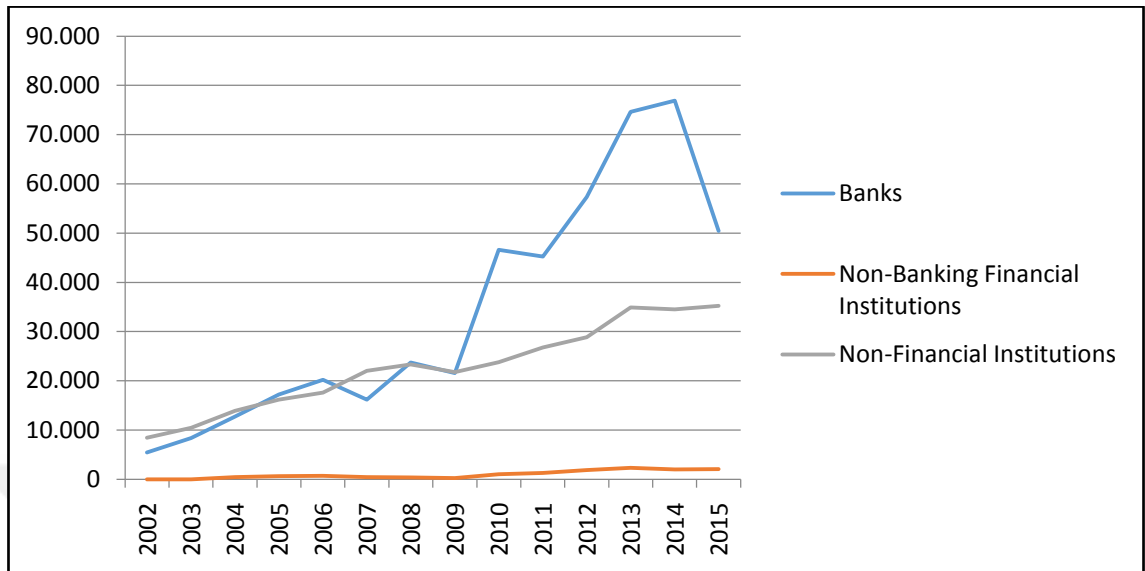
Table 5.8: Breakdown of short term external debt stock of private sector 2002 – 2015

Years	Banks	Non-Banking Financial Institutions	Non-Financial Institutions
2002	5.429	0	8.425
2003	8.351	0	10.461
2004	12.714	458	13.904
2005	17.199	661	16.158
2006	20.230	716	17.594
2007	16.184	469	22.044
2008	23.692	388	23.310
2009	21.587	263	21.765
2010	46.576	1.021	23.792
2011	45.226	1.296	26.782
2012	57.338	1.859	28.882
2013	74.615	2.349	34.894
2014	76.891	1.990	34.509
2015	50.408	2.083	35.207

Looking at the chart for the same data, picture is clearer; banks who carry the actual burden of external debt present a sharp decline while other non banking FIs and non FIs were effected less. The effects of the crises on 2007 and 2011 are also observable as sharp declines in the amount of short term external debt stock carried by banks

We had already mentioned that short term external debt stock of public sector is from public banks which were under public sector category. Looking at below table we will have a clearer picture of the share banks carry in short term external debt stock. General government did not use short term external debt except from 1997 and 2000 both with small amounts.

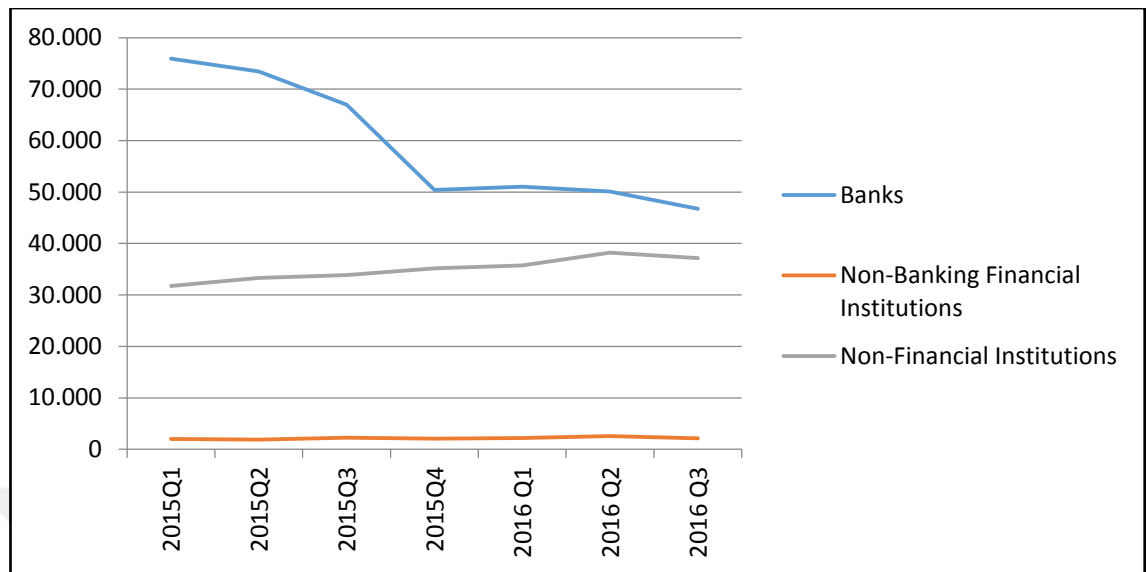
Figure 5.10: Breakdown of short term external debt stock of private sector 2002 – 2015



Private sector is in line with total short term external debt stock in 2016. The decrease in 2016 is moderate compared to 2015. We can see a small but observable decrease in banks which can be explained with the effect of syndication facilities.

Turkish banks go to the market generally twice a year for short term borrowing in USD and EUR from international financial institutions. This facility has certain differences from other international borrowing structures. Most important one is that the pricing is set by the borrower and the participation to this facility shows the commitment to relationship of each bank rather than expectation of interest. This facility that is unique to Turkey has low or in some cases negative return to creditors and is first to abandon in times of high risk. Thus, the syndication facilities of Turkish banks which were closed in September were affected up to 10%. This change could be attributed to coup attempt as the credit approvals and discussions for these facilities were conducted in the following days of coup attempt amid uncertainties.

Figure 5.11: Breakdown of short term external debt stock of private sector 2015Q1 – 2016Q3



In below table we can see that banks have carried more than 50% of short term external debt in average over the last 27 years. That also shows lack of savings in Turkey that financial sector is so dependant to external sources to finance the economy.

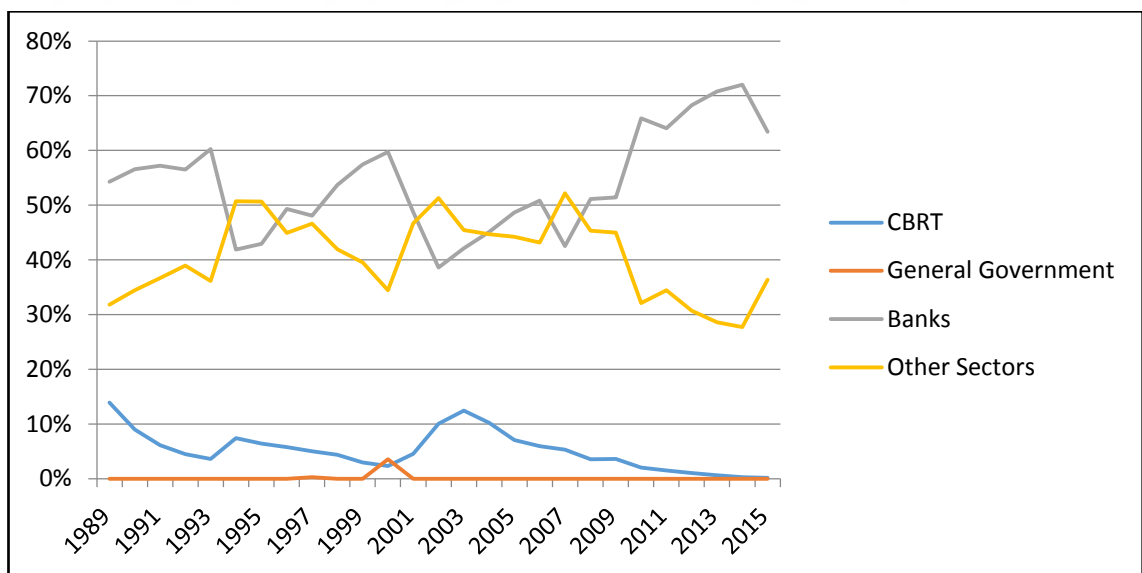
Table 5.8: Share of banks in total short term external debt stock of private sector 2002 – 2015

Years	CBRT	General Government	Banks	Other Sectors
1989	799	0	3.118	1.828
1990	855	0	5.373	3.272
1991	557	0	5.216	3.344
1992	572	0	7.157	4.931
1993	667	0	11.127	6.679
1994	828	0	4.684	5.675
1995	993	0	6.659	7.848
1996	984	0	8.419	7.669
1997	889	54	8.503	8.245
1998	905	0	11.159	8.710
1999	686	0	13.172	9.063
2000	653	1.000	16.900	9.748
2001	752	0	7.997	7.654
2002	1.655	0	6.344	8.425

2003	2.860	0	9.692	10.461
2004	3.287	0	14.529	14.387
2005	2.763	0	18.932	17.219
2006	2.563	0	21.785	18.505
2007	2.282	0	18.347	22.513
2008	1.874	0	26.840	23.798
2009	1.764	0	25.185	22.028
2010	1.553	0	50.866	24.813
2011	1.239	0	52.239	28.078
2012	1.036	0	68.378	30.741
2013	833	0	92.220	37.243
2014	342	0	94.757	36.496
2015	176	0	64.957	37.275

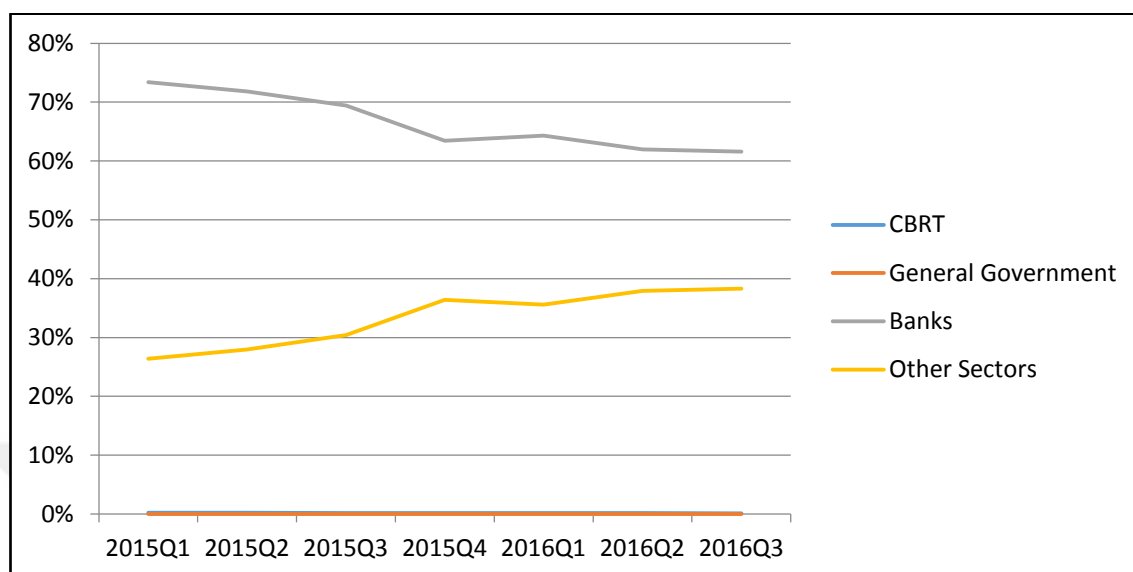
Looking at below chart that shows percentages of short term external debt carried by different debtors, we will also see that other sectors cover a good deal of the short term external debt. The lines of Banks and other sectors almost draw a symmetrical shape. And it seems any decrease in banks side is compensated by other sectors.

Figure 5.12: Share of banks in total short term external debt stock of private sector 2002 – 2015



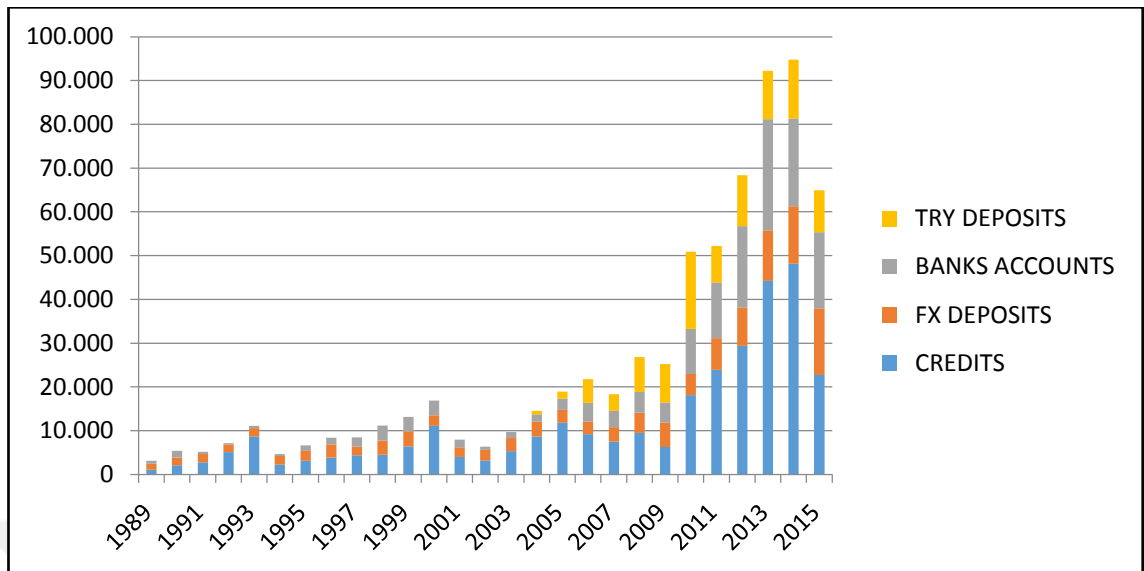
Looking at the data in from 2015 and 2016 end of quarters we can see that the share of role between banks and other sectors remain. While the banks are losing ground steadily other sectors cover the part left by the banks.

Figure 5.13: Share of banks in total short term external debt stock of private sector 2015Q1 – 2016Q3



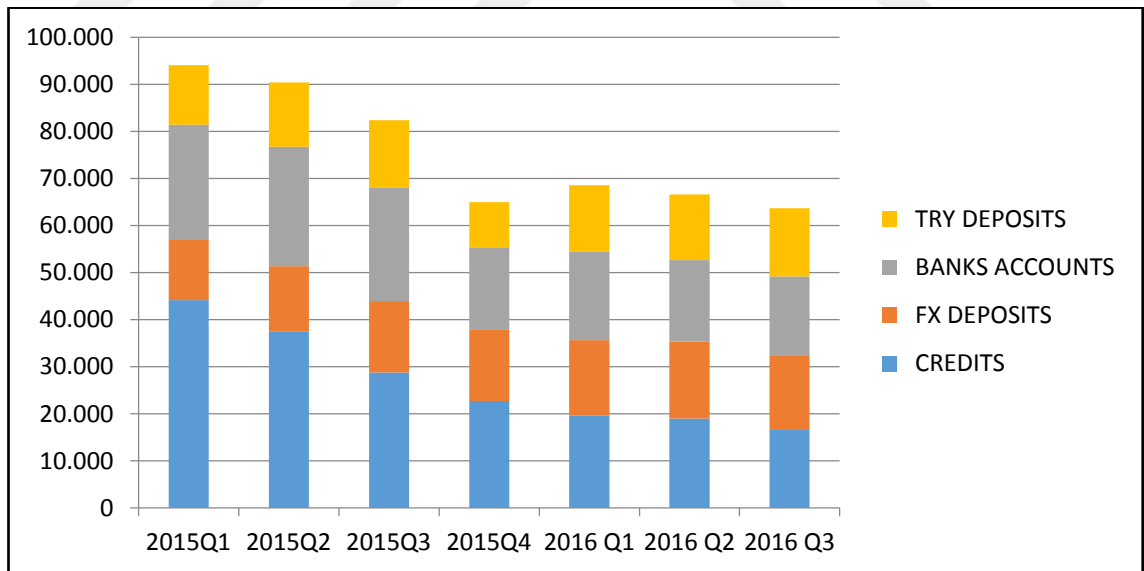
Looking at the breakdown of the sources of the short term external debt carried by the banks we will see that a rather balanced distribution was achieved. We can easily observe the effects of crises which occurred on 2001 – 2002 and 2010. However the fast increase should be mentioned that started on 2010. However there is also a sharp decline that can be observed in 2015. This decline can be explained by the decrease in excess liquidity as well as domestic factor such as political instability. The fact that USD/TRY rate is growing makes foreign TRY deposits irrational, which can be seen in 2015 in below chart. While bank accounts and credits remain constant FX deposits grow as to show the lack of foreign deposits.

Figure 5.14: Sources of banks' short term external debt stock 1989-2015



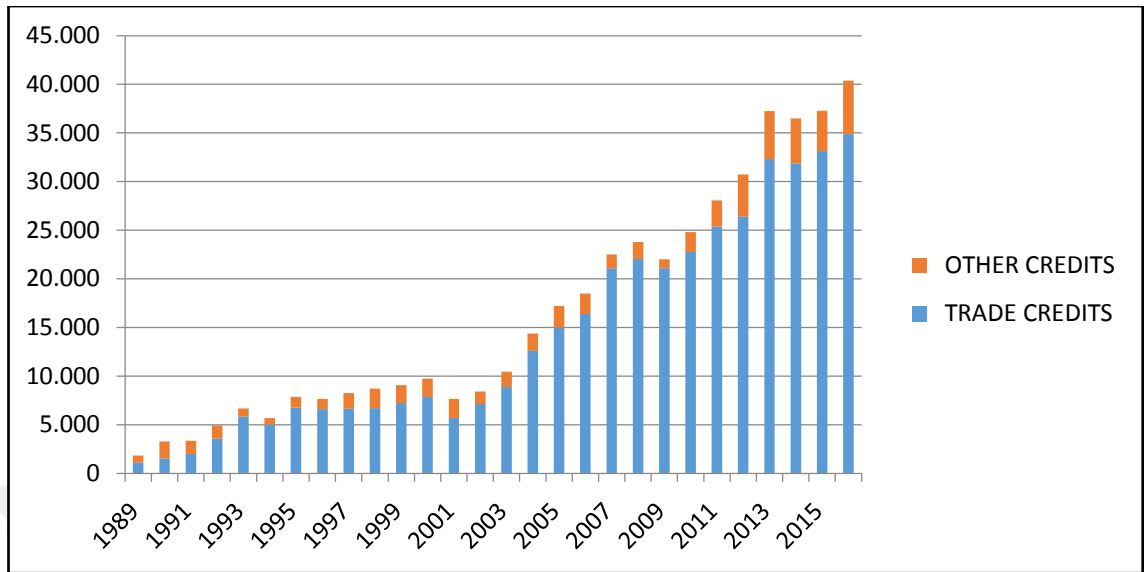
Looking at the same data for quarter end from 2015 Q1 to 2016 Q3 it will be noticed that the distribution remains constant while the total amount of banks' external debt stock fall steadily.

Figure 5.15: Sources of banks' short term external debt stock 2015Q1 - 2016Q3



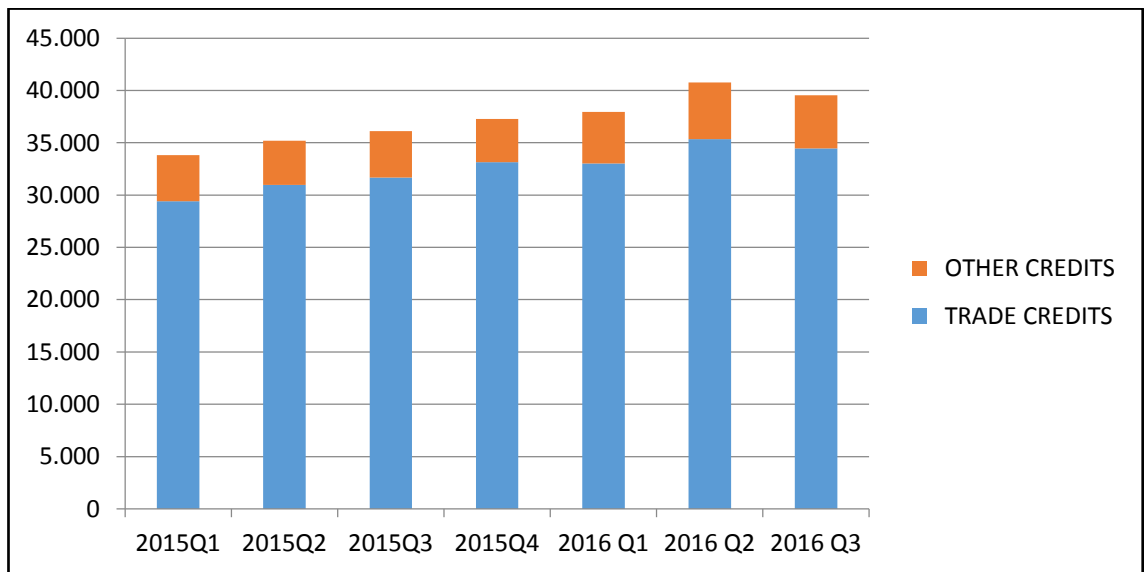
As for the other sectors, second biggest borrower of short term external debt, the debt mainly consists of trade credits. Below chart shows that trade credits almost make all of the short term external debt by other sectors.

Figure 5.16: Distribution of short term external debt stock of other sectors between 1989 and 2015



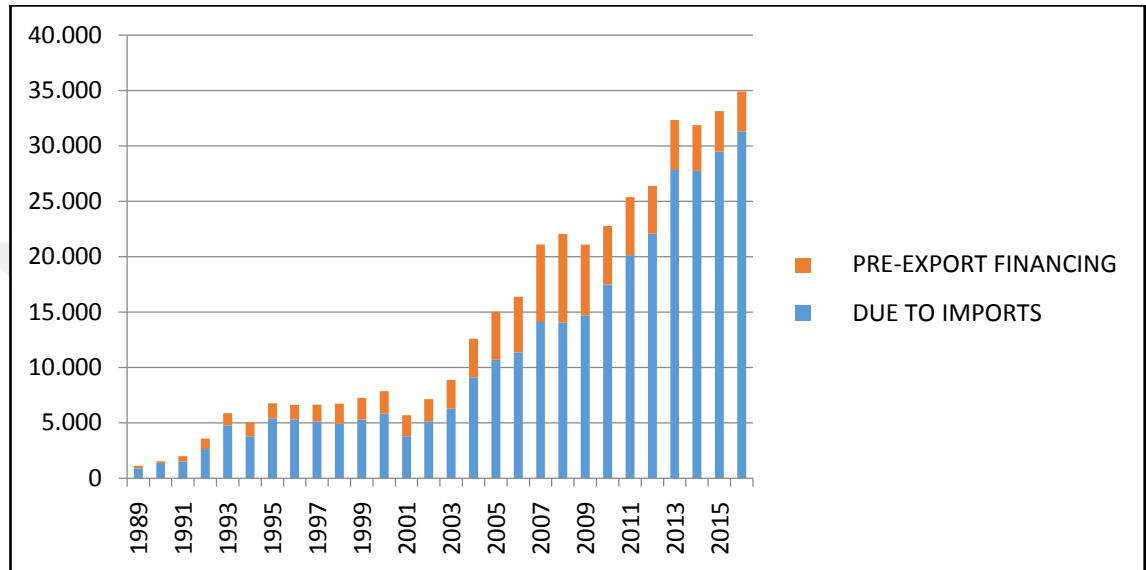
In 2016 the total amount of external short term debt stock carried by other sectors increase replacing the part left by the banks, the distribution remain constant. Other sectors still use heavily trade credits. A small decrease can be seen in the 3rd quarter of 2016 but the change is hardly what is expected after the coup attempt.

Figure 5.17: Distribution of short term external debt stock of other sectors between 2015Q1 and 2016Q3



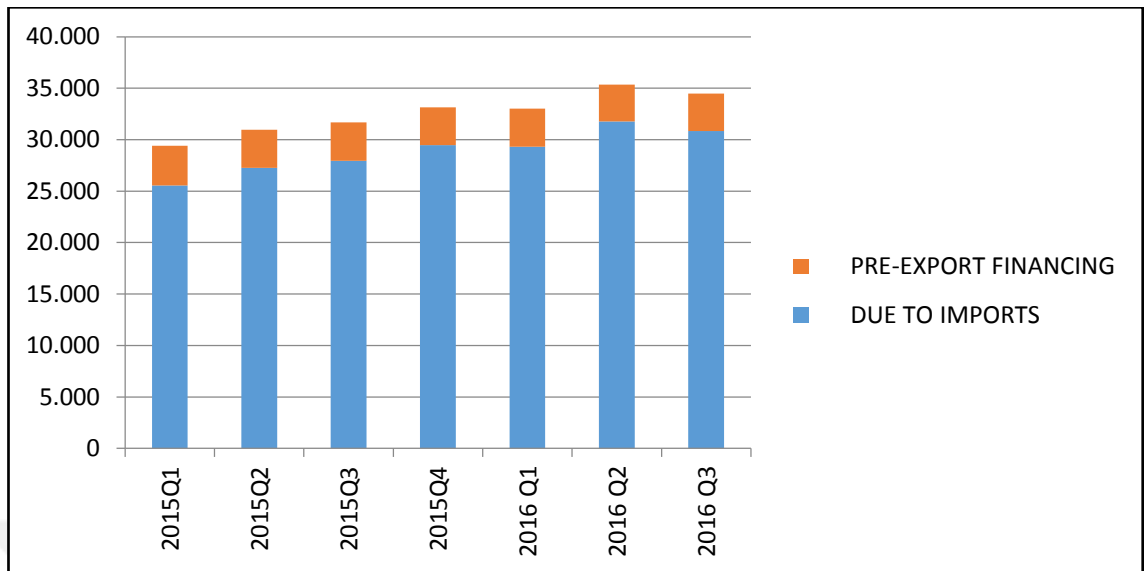
Looking at the below chart, breakdown of trade credits shown above, this debt is heavily composed by import credits. It is natural as international funding towards emerging markets aim to support import since that often means that international banks are consequently supporting the export business of their own customers.

Figure 5.18: Breakdown of trade credits of other sectors between 1989 and 2015



There is not a change in 2016 in this data. The total amount is in a slow decrease in line with total other sectors debt and the big part of this debt comes from due to imports. Small amount of pre export financing should be coming from international financial institutions rather than commercial international banks.

Figure 5.19: Breakdown of trade credits of other sectors between 2015Q1 and 2016Q3



7. CONCLUSION

The data used in the study was limited to a short period of time since the event we have observed is quite recent. However, it should be noted that the effects of the attempted coup should have been witnessed the in immediate after of the event. Once the order is maintained and the confidence is restored the economy will re-find its balance. Particularly in Turkey, where there is always different news coming it will be hard to measure the effects after a while.

Import and export volumes went back to their normal courses pretty quickly after July. In fact the fall in the July can be associated with the Ramadan Holiday which was in July as well. The steady downfall in trade volume coming from 2014 and 2015 seems to be stabilized now that the commodity prices have found a balance.

Payment methods also show an optimistic picture, especially in import side. The confidence to Turkish importers remains where it was before the event on July 15th. There is no shift to safe and traditional payment methods as one would expect. In fact open account payment keeps its place as the most utilized way of payment in terms of volume.

Same thing can be said for short term external debt stock. The coup attempt did not have a significant effect on the volumes. However if current economy is observed it would be seen that banking sector is losing ground in favour of other sectors in terms of short term external debt stock same as the crisis periods on 1994, 2001 and 2008.

In conclusion, it can be said that the coup attempt on July 15th did not have any immediate effect on trade volumes, way of doing business and the short term external debt as it would be expected. However once a broader observation is made it can also be seen that the volumes are declining gradually there are similarities to crisis periods.

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