

The Case of Usage of Letter of Credit in Turkey's *Foreign Trade*: A Sample of Participation Banks

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ABSTRACT

In this study, the case of usage of letter of credit in Turkey's foreign trade is analyzed. In this context, initially, some information was given about the process of letter of credit method and the preferability of it in Turkey's imports and exports. Then, in accordance with the purpose of study, letter of credit method in Turkey is analyzed in terms of maturity, confirmation, country and magnitude through the letter of credit data regarding 2014 imports of a participation bank operating in Turkey.

KEY-WORDS: Foreign Trade, Letter of Credit, Turkey.

1. Introduction

Depending on the fast growing population of the world, a wide variety of goods and services is needed. Countries cannot meet all needs of goods and services with their own internal resources or cheaper or high quality goods and services can be provided from abroad. Countries not only want to buy goods and services they need but also want to sell goods and services they produce in order to ensure their development. Because of these reasons, in our day, world countries cooperate and pursue ways of developing trade with each other. In this regard, foreign trade plays an important role in existing and developing economic cooperation among countries.

Foreign trade which expresses the trade of goods and services of international economic relation is the realization of trade of goods and services through imports and exports among countries. Trade of goods and services subject to foreign trade across countries and continents bring along many difficulties. Especially, there are many risks in transporting goods and services to buyer and receiving its payment. Therefore, two most important topics are the type of delivery and the type of payment. The first one is how to deliver the goods and services subject to foreign trade and start and end time of obligation of recipient and seller, the second one is how to receive the payment of goods and services subject to foreign trade. There are important risks importers and exporters face in delivering goods and services and receiving its payment. The exporter cannot receive the payment of goods he sends or the importer cannot receive the goods he pays. While the exporter wants to receive the payment first, similarly the importer wants to receive goods and services first. The most common payment method protects buyer and seller from above risks is letter of credit.

The aim of this study is to analyze the case of usage of letter of credit in Turkey's foreign trade. In accordance with the purpose of study, primarily some information about the letter of credit method will be given, then the case of usage of letter of credit of a participation bank operating in Turkey on the basis of letter of credit data of this bank regarding 2014 imports will be analyzed. In this content, first of all it would be fitting to give some information about the letter of credit method.

2. The Letter of Credit

The letter of credit is a written promise consisting of the instruction given by buyer (importer) to his bank and the instruction given by correspondent bank in foreign country of same bank to beneficiary (exporter) that indicates payment in return for submitting particular documents at a particular time (Gökğöz and Şeker, 2014:90). The letter of credit including the functions of payment and credit, as a banking transaction, ensures transactions among the contracting parties securely (Ekici, 1995: 21). Letter of credit is derived from "accredits" which means credibility,

guaranty, acceptance and so on. In the event that buyer and seller do not know each other well, one or more bank commitments can build up trust among parties (Bölükbaşı, 2008: 21-22). There are generally four parties in the letter of credit method. These are; emir(import firm), issuing bank(bank of import firm), beneficiary(export firm) and corresponding bank(bank of export firm).

The process of the method of the letter of credit can be summarized as below (Şirinpınar, 2012: 33):

- 1) The contract between buyer and seller is signed after early negotiations.
- 2) Emir of letter of credit opens letter of credit by applying issuing bank.
- 3) Issuing bank prepares letter of credit and sends it to corresponding bank.
- 4) Corresponding bank examines letter of credit and reports it to export firm.
- 5) Export firm examines letter of credit and dispatches goods subject to trade.
- 6) Beneficiary submits the documents of export delivery to his bank.
- 7) If the letter of credit is confirmed, corresponding bank makes the payment to issuing bank within 7 workdays and sends essential documents.
- 8) Issuing bank submits related documents to emir and receives the payment.
- 9) If the letter of credit is not confirmed, the payment is remitted by issuing bank.
- 10) The payment is transferred to export firm.

Letters of credit can be classified under four titles in terms of some criteria (Kodalak and others, 2015: 72-73):

Letters of Credit in Terms of Liability to Pay	Letters of Credit in Terms of Payment	Letters of Credit in Terms of Purpose of Usage	Commonly Used Letters of Credit in Foreign Trade
a) Confirmed letter of credit	a) Letter Of Credit On Sight	a) Fixed Letter Of Credit	a) Straight Deferred Letter Of Credit
b) Unconfirmed letter of credit	b) Deferred Letter Of Credit	b) Transferable Letter Of Credit	b) Straight Confirmed Deferred Letter Of Credit
	c) Letter of Credit with Acceptance Credit	c) Red Clause Letter Of Credit	c) Straight Cash Letter Of Credit
		d) Green Clause Letter Of Credit	d) Straight Confirmed Cash Letter Of Credit
		e) Back-To-Back Letter Of Credit	
		f) Revolving Letter Of Credit	

Table 1: The amount of Turkey's Foreign Trade in Terms of Methods of Payments (2014)

	Imports (1.000 USD)	Percentage (%)	Exports (1.000 USD)	Percentage (%)
Cash against goods	71 528 310	29,54	102 834 175	65,25
Cash in advance	119 326 764	49,27	14 929 437	9,47
Cash against documents	14 920 304	6,16	24 228 910	15,37
Deferred letter of credit	10 542 951	4,35	2 449 256	1,55
Letter of credit	18 442 201	7,62	11 239 517	7,13
Letter of credit with acceptance credit	118 420	0,05	44 238	0,03
Cash against documents with acceptance credit	493 065	0,2	139 269	0,09
Cash against goods with acceptance credit	516 465	0,21	112 354	0,07
Other	6 288 637	2,6	1 633 002	1,04
Total	242 177 117	100	157 610 158	100

Source: TUIK data, www.tuik.gov.tr

As seen from Table 1, most common methods of payments in Turkey's imports are respectively cash, cash against goods, letter of credit and cash against documents. And most common methods of payments in Turkey's exports are respectively cash against goods, cash against documents, cash and letter of credit.

3. The Evaluation of The Letter of Credit Applications in Turkey's Foreign Trade

In this study, the letters of credit data of a participation bank is analyzed with the purpose of determining the place of the type of letter of credit in use. 2060 letter of credit transactions made in 2014 by that bank is analyzed in terms of country, maturity, confirmation and amount of imports.

Table 2: The Relationship between Country and Maturity

Country		Type of Maturity		Total
		Sight payment	Deferred	
Argentina	Quantity	0	2	2
	Percentage	%100	%100	%100
Australia	Quantity	1	2	3
	Percentage	%33	%67	%100
Austria	Quantity	1	1	2
	Percentage	%50	%50	%100
Bahrain	Quantity	1	0	1
	Percentage	%100	%0	%100
Bangladesh	Quantity	60	13	73
	Percentage	%82	%28	%100
Belgium	Quantity	8	3	11
	Percentage	%73	%27	%100
Brazil	Quantity	4	0	4
	Percentage	%100	%0	%100
Bulgaria	Quantity	1	0	1
	Percentage	%100	%0	%100
Colombia	Quantity	1	0	1
	Percentage	%100	%0	%100
Czech Republic	Quantity	0	1	1
	Percentage	%0	%100	%100
England	Quantity	32	4	36
	Percentage	%89	%11	%100
Egypt	Quantity	24	2	26
	Percentage	%92	%8	%100
Eritrea	Quantity	1	0	1
	Percentage	%100	%0	%100
France	Quantity	4	3	7
	Percentage	%57	%43	%100
Georgia	Quantity	0	2	2
	Percentage	%0	%100	%100
Germany	Quantity	22	36	58
	Percentage	%38	%62	%100
Greece	Quantity	1	1	2
	Percentage	%50	%50	%100
Holland	Quantity	8	4	12
	Percentage	%67	%33	%100
Hong Kong	Quantity	17	4	21
	Percentage	%81	%19	%100
Hungary	Quantity	1	0	1
	Percentage	%100	%0	%100
India	Quantity	140	20	160
	Percentage	%88	%22	%100
Indonesia	Quantity	124	9	133
	Percentage	%93	%7	%100
Italy	Quantity	22	30	52
	Percentage	%42	%58	%100

Japan	Quantity	28	2	30
	Percentage	%93	%7	%100
Kenya	Quantity	0	19	19
	Percentage	%0	%100	%100
Luxemburg	Quantity	0	1	1
	Percentage	%0	%100	%100
Macao	Quantity	1	0	1
	Percentage	%100	%0	%100
Malaysia	Quantity	33	3	36
	Percentage	%92	%8	%100
Mersin FreeZone	Quantity	0	1	1
	Percentage	%0	%100	%100
Mozambique	Quantity	1	0	1
	Percentage	%100	%0	%100
Omani	Quantity	0	1	1
	Percentage	%0	%100	%100
Pakistan	Quantity	48	16	64
	Percentage	%75	%25	%100
People'sRepublic Of China	Quantity	598	127	725
	Percentage	%82	%18	%100
Poland	Quantity	1	0	1
	Percentage	%100	%0	%100
Portugal	Quantity	4	0	4
	Percentage	%100	%0	%100
Qatar	Quantity	0	2	2
	Percentage	%0	%100	%100
Russia	Quantity	2	3	5
	Percentage	%40	%60	%100
South Korea	Quantity	108	64	172
	Percentage	%63	%37	%100
Spain	Quantity	5	5	10
	Percentage	%50	%50	%100
Sweden	Quantity	2	2	4
	Percentage	%50	%50	%100
Switzerland	Quantity	15	7	22
	Percentage	%68	%32	%100
Serbia	Quantity	1	0	1
	Percentage	%100	%0	%100
Singapore	Quantity	12	7	19
	Percentage	%63	%37	%100
Sri Lanka	Quantity	1	20	21
	Percentage	%04	%96	%100
Sudan	Quantity	1	0	1
	Percentage	%100	%0	%100
SaudiArabia	Quantity	17	1	18
	Percentage	%94	%6	%100
Taiwan	Quantity	68	43	111
	Percentage	%61	%39	%100
Tajikistan	Quantity	1	0	1
	Percentage	%100	%0	%100
Thailand	Quantity	30	3	33
	Percentage	%91	%9	%100
Turkey	Quantity	0	5	5
	Percentage	%0	%100	%100
UAE (United ArabEmirates)	Quantity	7	4	11
	Percentage	%64	%36	%100
Ukraine	Quantity	0	1	1

	Percentage	%0	%100	%100
USA (United State of America)	Quantity	9	6	15
	Percentage	%60	%40	%100
Uzbekistan	Quantity	4	0	4
	Percentage	%100	%0	%100
Vietnam	Quantity	98	9	107
	Percentage	%92	%8	%100
Total	Quantity	1571	489	2060
	Percentage	%76	%24	%100

As seen from Table 2, 76% of letter of credit transactions is sight payment and 24% of letter of credit transactions is deferred. The bank opened the highest number of transactions for People's Republic Of China and 82% of transactions is letter of credit on sight.

Table 3: Relationship between Type of Maturity and Confirmation

Type of Maturity			Confirmation		TOTAL
			Yes	No	
Sight Payment	Quantity		164	1410	1571
		Confirmation rate	%10	%90	%100
	Quantity		94	392	489
		Confirmation rate	%19	%81	%100
Deferred	Quantity		258	1802	2060
	Confirmation rate		%13	%87	%100

As seen from Table 3, 10% of letters of credit on sight is confirmed, 90% is unconfirmed. 19% of deferred letters of credit is confirmed, 81% is unconfirmed. Totally 13% of letter of credit transactions the bank made is confirmed, 87% is unconfirmed.

Table 4: Relationship between Country and Confirmation

Country			Confirmation		Total
			Yes	No	
Argentina	Quantity		1	1	2
	Percentage		50%	50%	100%
Australia	Quantity		1	2	3
	Percentage		33%	67%	100%
Austria	Quantity		1	1	2
	Percentage		50%	50%	100%
Bahrain	Quantity		0	1	1
	Percentage		0%	100%	100%
Bangladesh	Quantity		0	73	73
	Percentage		0%	100%	100%
Belgium	Quantity		8	3	11
	Percentage		73%	27%	100%
Brazil	Quantity		0	4	4
	Percentage		0%	100%	100%
Bulgaria	Quantity		0	1	1
	Percentage		0%	100%	100%
Colombia	Quantity		0	1	1
	Percentage		0%	100%	100%
Czech Republic	Quantity		0	1	1
	Percentage		0%	100%	100%
Egypt	Quantity		0	26	26
	Percentage		0%	100%	100%
England	Quantity		33	3	36

Country		Confirmation		Total
		Yes	No	
	Percentage	92%	8%	100%
	Quantity	0	1	1
Eritrea	Percentage	0%	100%	100%
	Quantity	4	3	7
France	Percentage	57%	43%	100%
	Quantity	29	29	58
Germany	Percentage	50%	50%	100%
	Quantity	2	0	2
Georgia	Percentage	100%	0%	100%
	Quantity	2	0	2
Greece	Percentage	100%	0%	100%
	Quantity	9	3	12
Holland	Percentage	75%	25%	100%
	Quantity	2	19	21
Hong Kong	Percentage	10%	90%	100%
	Quantity	0	1	1
Hungary	Percentage	0%	100%	100%
	Quantity	18	142	160
India	Percentage	11%	89%	100%
	Quantity	4	129	133
Indonesia	Percentage	3%	97%	100%
	Quantity	35	17	52
Italy	Percentage	67%	33%	100%
	Quantity	3	27	30
Japan	Percentage	10%	90%	100%
	Quantity	0	19	19
Kenya	Percentage	0%	100%	100%
	Quantity	1	0	1
Luxemburg	Percentage	100%	0%	100%
	Quantity	0	1	1
Macao	Percentage	0%	100%	100%
	Quantity	3	33	36
Malaysia	Percentage	8%	92%	100%
	Quantity	0	2	2
Mexico	Percentage	0%	100%	100%
	Quantity	0	1	1
Mersin FreeZone	Percentage	0%	100%	100%
	Quantity	1	0	1
Mozambiq	Percentage	100%	0%	100%
	Quantity	1	0	1
Omani	Percentage	100%	0%	100%
	Quantity	4	60	64
Pakistan	Percentage	6%	94%	100%
People's Republic Of	Quantity	17	708	725
China	Percentage	2%	98%	100%
	Quantity	0	1	1
Poland	Percentage	0%	100%	100%
	Quantity	0	4	4
Portugal	Percentage	0%	100%	100%
	Quantity	3	2	5
Russia	Percentage	60%	40%	100%
	Quantity	7	3	10
Spain	Percentage	70%	30%	100%
	Quantity	7	165	172
South Korea	Percentage	4%	96%	100%

Country		Confirmation		Total
		Yes	No	
Switzerland	Quantity	16	6	22
	Percentage	73%	27%	100%
Serbia	Quantity	0	1	1
	Percentage	0%	100%	100%
Singapore	Quantity	3	16	19
	Percentage	16%	84%	100%
Sri Lanka	Quantity	0	21	21
	Percentage	0%	100%	100%
Sudan	Quantity	0	1	1
	Percentage	0%	100%	100%
SaudiArabia	Quantity	17	1	18
	Percentage	94%	6%	100%
Tajikistan	Quantity	0	1	1
	Percentage	0%	100%	100%
Thailand	Quantity	0	33	33
	Percentage	0%	100%	100%
Taiwan	Quantity	1	110	111
	Percentage	1%	99%	100%
Turkey	Quantity	3	2	5
	Percentage	60%	40%	100%
Ukraine	Quantity	1	0	1
	Percentage	100%	0%	100%
UAE (United ArabEmirates)	Quantity	2	9	11
	Percentage	18%	82%	100%
USA (United State of America)	Quantity	11	4	15
	Percentage	73%	27%	100%
Uzbekistan	Quantity	0	4	4
	Percentage	0%	100%	100%
Vietnam	Quantity	2	105	107
	Percentage	2%	98%	100%
Total	Quantity	261	1799	2060
	Percentage	%13	%87	%100

According to Table 4, only 13% of letter of credit transactions is confirmed. 2% of letter of credit transactions of People's Republic of China which has the highest number of transactions is confirmed, 98% is unconfirmed.

Table 5: Relationship between the Amount of Imports and Type of Maturity

							Total
		1	2	3	4	5	
Sight Payment	Quantity	401	447	441	168	114	1571
	Percentage	%87	%77	%72	%74	%64	%76
Deferred	Quantity	62	135	168	59	65	489
	Percentage	%13	%23	%28	%26	%36	%24
Total	Quantity	463	582	609	227	179	2060
	Percentage	%100	%100	%100	%100	%100	%100

When the magnitude of letter of credit transactions is considered, transactions between 100,000-250,000 USD comes first and transactions between 50,000-100,000 USD comes in second. 72% of letter of credit transactions is letter of credit on sight, 28% is deferred. 77% of letter of credit transactions between 50,000-100,000 USD is letter of credit on sight, 23% is deferred.

Table 6: Relationship between the Amount of Imports and Confirmation

		Categorical Imports					Total	
		1	2	3	4	5		
Confirmation	Yes	Quantity	30	59	67	38	65	258
		Percentage	%06	%10	%11	%17	%36	%13
	No	Quantity	433	523	540	189	114	1799
		Percentage	%94	%90	%89	%83	%64	%87
	Total	Quantity	463	582	609	227	179	2060
		Percentage	%100	%100	%100	%100	%100	%100

When the relationship between the amount of import and confirmation is considered, according to Table 6, 11% of letter of credit transactions between 100.000-250.000 USD is confirmed, 89% is unconfirmed. 10% of letter of credit transactions between 50.000-100.000 USD is confirmed, 90% is unconfirmed.

4. Conclusion and Evaluation

The most commonly used methods of payment are respectively cash, cash against goods, letter of credit and cash against documents in Turkey's imports. As for Turkey's exports, the most commonly used methods of payment are respectively cash against goods, cash against documents, cash and letter of credit. The letter of credit method does not take place near the top. The percentage of the letter of credit method in Turkey's imports and exports is only nearly 7%. The fact that cash and cash against goods payment methods respectively comes first in Turkey's imports and exports makes Turkey disadvantageous and face important risks in foreign trade.

As a result of the analysis of a participation bank's letter of credit transactions in 2014, it is determined that 76% of letter of credit transactions is letter of credit in sight and 87% of letter of credit transactions is unconfirmed. When the magnitude of letter of credit transactions is considered, it is seen that the most transactions are between 100.000-250.000 USD.

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