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CHALLENGES IN LETTER OF CREDIT (LC) PROCESSING IN BANGLADESH

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ABSTRACT
The Letter of Credit (LC) is a critical financial instrument facilitating international trade in Bangladesh, particularly for the ready-made garments (RMG) sector and other major industries. Despite its importance, the LC processing landscape faces significant challenges that hinder trade efficiency and economic growth. This paper identifies and analyses key issues, including documentation discrepancies, fraudulent activities, regulatory compliance complexities, technological and infrastructure limitations, and financial instability. Additionally, the lack of sector-specific expertise and the high costs of LC transactions exacerbate the problem, disproportionately affecting small and medium-sized enterprises (SMEs). The study highlights the systemic and operational barriers impeding the effective execution of LCs. It proposes comprehensive solutions, including digitalizing trade finance, strengthening anti-fraud mechanisms, and capacity building for banking professionals. By addressing these challenges, Bangladesh can enhance its trade facilitation mechanisms, boost global competitiveness, and drive sustainable economic growth.

KEYWORDS: *Documentation discrepancies, Regulatory compliance barriers, Fraudulent activity in trade finance, Foreign exchange volatility, Digitalization of LC processing*

1. INTRODUCTION

1.1 Importance of Letter of Credit (LC) Processing in Bangladesh

Bangladesh, a rapidly growing South Asian economy, relies heavily on international trade for its economic development. Exports of ready-made garments and imports of raw materials, machinery, and consumer goods constitute significant components of the country's trade activities. The Letter of Credit (LC), a widely used financial instrument, is pivotal in facilitating these trade transactions. By ensuring trust between importers and exporters, LCs help mitigate payment risks, promote trade continuity, and ensure compliance with international trade regulations.

Despite its critical importance, Bangladesh's LC processing system faces numerous challenges that hinder the efficiency and growth of international trade. From delays in documentation and compliance issues to inefficiencies in the banking infrastructure, these obstacles can escalate transaction costs, affect trade competitiveness, and slow down the country's overall economic progress. Addressing these challenges is vital to fostering sustainable economic growth and improving the ease of doing business in Bangladesh.

1.2 Objectives and Scope of the Paper

This paper's primary objective is to explore and analyze the challenges stakeholders face in Bangladesh in LC processing. The study aims to provide a comprehensive understanding of the systemic, operational, and regulatory barriers affecting the smooth execution of LCs. It also seeks to highlight the impact of these challenges on importers, exporters, and financial institutions involved in international trade.

The scope of this paper is limited to the LC processing practices in Bangladesh, with a specific focus on:

- The inefficiencies in the existing banking infrastructure.
- The role of regulatory frameworks and compliance requirements.
- The challenges faced by small and medium enterprises (SMEs) in accessing LC facilities.
- The potential solutions, including technological advancements and policy reforms, to mitigate these challenges.

2. BACKGROUND

2.1 Overview of Letters of Credit

A Letter of Credit (LC) is a financial agreement provided by a bank or financial institution that guarantees a seller will receive payment from the buyer, provided the seller meets the terms and conditions specified in the LC. LCs are governed by international rules, such as the Uniform Customs and Practice for Documentary Credits (UCP 600), which ensure standardization and reliability across borders.

LCs are critical to international trade because they bridge the trust gap between buyers and sellers, especially in cross-border transactions where parties may not have established relationships. By involving banks as intermediaries, LCs reduce the risk of non-

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payment for exporters and ensure compliance with trade agreements for importers. Additionally, LCs provide access to pre-shipment and post-shipment financing, making them indispensable in modern trade finance.

2.2 LC Usage in Bangladesh

In Bangladesh, LCs are the most commonly used instrument for facilitating import payments. They account for a significant share of the country's total trade finance activities, particularly in textiles, apparel, pharmaceuticals, and industrial machinery. For example, the ready-made garment (RMG) industry, which contributes over 80% of the country's export earnings, heavily relies on LCs to
source raw materials like fabrics and dyes.

Recent data suggests a steady increase in the volume of LCs issued for imports and exports, reflecting the growth of Bangladesh's trade activities. However, the LC system also faces challenges, including high dependency on manual processes, limited digital infrastructure, and bureaucratic delays. These issues are compounded by strict foreign exchange regulations imposed by Bangladesh Bank, which aim to manage the country's foreign currency reserves but often complicate the LC process.

2.3 Recent Trends in Trade Finance

Bangladesh's trade finance landscape has evolved in recent years, with an increasing focus on digitalization. Initiatives such as adopting electronic LCs (e-LCs) and blockchain-based trade finance platforms are slowly gaining traction. Despite these advancements, traditional LCs remain dominant, as many stakeholders have yet to embrace digital solutions fully.

Additionally, the global COVID-19 pandemic underscored the vulnerabilities of traditional LC processing, as physical document transfers were disrupted. This has accelerated discussions about streamlining trade finance through automation and electronic documentation to enhance efficiency and reduce delays.

3. LITERATURE REVIEW

3.1 Global Perspectives on LC Challenges

Existing literature highlights various challenges associated with LC processing in global trade. According to a report by the International Chamber of Commerce (ICC), approximately 70% of LC documents presented to banks contain discrepancies, leading to delays and additional costs for traders (ICC, 2022). These discrepancies often arise from errors in documentation, non- compliance with LC terms, and inadequate understanding of UCP 600 guidelines among traders. Furthermore, a study by WTO (2021) emphasizes the high transaction costs associated with traditional LC processing, particularly for SMEs in developing countries. The research identifies manual procedures, limited access to trade finance, and excessive reliance on intermediaries as significant barriers to efficiency.

Technological advancements, such as blockchain and artificial intelligence (AI), have been proposed as solutions to address these issues. For example, research by Allen and Overy (2020) demonstrates the potential of blockchain-based smart contracts to reduce fraud, enhance transparency, and accelerate the settlement process in LC transactions. However, the adoption of such technologies remains limited due to high implementation costs and a lack of infrastructure in many countries.

3.2 LC Challenges in Bangladesh

Studies in Bangladesh reveal unique challenges that exacerbate inefficiencies in LC processing. A report by Bangladesh Bank (2023) indicates that the country's reliance on traditional banking methods and extensive manual documentation slows down the LC lifecycle. Additionally, stringent foreign exchange regulations and frequent changes in trade policies create uncertainty for traders and banks. A study by Islam et al. (2022) identifies inadequate training among bank staff and exporters as a major contributor to document rejections and processing delays.

Moreover, the limited credit availability for SMEs further complicates the LC process. According to Rahman and Khan (2021), SMEs in Bangladesh struggle to meet collateral requirements for LC issuance, resulting in restricted access to international markets. This is consistent with findings from the Asian Development Bank (2022), which notes a $1.7 trillion global trade finance gap, disproportionately affecting small businesses in developing economies like Bangladesh.

The processing of Letters of Credit (LC) in Bangladesh faces several significant challenges that impact its effectiveness in facilitating international trade. A primary concern is the rising incidence of LC fraud, which substantially threatens the country's economic stability, necessitating enhanced preventive measures and updated guidelines to combat such risks (Rafique & Duraisingam, 2023). Additionally, the lack of training and expertise among banking personnel contributes to improper handling of LC procedures, leading to contract breaches and system inefficiencies (Tahera, 2014). The complexity of LC transactions, involving multiple parties and legal obligations, further complicates the process, as misunderstandings can arise regarding the roles and responsibilities of banks and beneficiaries(Alavi, 2017)(Alavi, 2016). Moreover, while expediting transactions, the shift towards open account trading exposes exporters to non-payment risks that LCs traditionally mitigate, highlighting the need for a balanced approach to trade finance solutions (Meijer & Menon, 2012). Overall, addressing these challenges requires a concerted effort to improve training, regulatory frameworks, and fraud prevention strategies within the banking sector.

3.3 Gaps in the Literature

While existing studies provide valuable insights into LC challenges, several gaps remain unaddressed. First, limited research exists on the impact of digital trade finance solutions in the Bangladeshi context. Although global studies highlight the benefits of digitalization, the specific barriers to adoption in Bangladesh, such as technological readiness and regulatory

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compliance, require further exploration.
Second, most research focuses on the challenges of large corporations, with insufficient attention to the unique needs of SMEs and informal traders. Addressing this gap is critical, given the significant role SMEs play in Bangladesh's economy. Finally, there is a lack of comprehensive analysis of the interplay between regulatory policies and operational inefficiencies in the country's banking sector. Future research should examine how policy reforms and capacity-building initiatives can enhance the efficiency of LC processing.

This paper aims to fill these gaps in the literature by offering practical recommendations for enhancing LC processing in Bangladesh. The insights will be valuable for policymakers, financial institutions, and trade practitioners aiming to improve trade facilitation in the country.

4 .METHODOLOGY

4.1 Research Approach

This research employs a mixed-methods approach, combining qualitative and quantitative methods but heavier on the qualitative side. The qualitative approach involves analyzing findings from existing reports, case studies, and responses to a structured questionnaire. The quantitative aspect focuses on analyzing and comparing statistical data and numerical values, primarily from secondary sources. The qualitative approach provides a nuanced understanding of stakeholders' complexities.

4.2 Data Collection

The study integrates primary and secondary data. Secondary data was meticulously gathered from credible online sources such as reports, published research articles, and statistical records relevant to Bangladesh. Primary data was collected via surveys and interviews with stakeholders directly involved in the Letter of Credit (LC) process. While the secondary data was carefully selected for reliability and relevance, the primary data reflects self-reported responses and may carry potential participant biases.

4.3 Data Analysis

The analysis combines qualitative and quantitative techniques. Qualitative analysis examines findings, challenges, and solutions, providing in-depth insights into the complexities of LC processing. Quantitative analysis, on the other hand, is employed to interpret numerical data, enabling comparisons across timelines and between countries. Together, these methods deliver a comprehensive understanding of the collected data.

5. RESULTS

5.1 Documentation Discrepancies

One of the most frequently reported challenges was documentation Discrepancies, which included missing or incorrect paperwork, mismatched International Trade codes (HS codes), and delays in submitting required documents. These discrepancies prolonged the LC processing time and created financial and operational burdens for stakeholders. Approximately 68% of respondents acknowledged that documentation discrepancies significantly impacted their ability to complete transactions efficiently.

These discrepancies often result in significant trade costs, causing delays, financial losses, and strained business relationships. Opening banks receive transport and critical documents from issuing banks through LC transactions through banking channels. These documents are scrutinized to ensure compliance with agreed terms and conditions. However, deviations or inconsistencies—commonly referred to as discrepancies—frequently emerge during this process.

A study analyzing selected banks in Bangladesh identified 42 distinct types of documentation discrepancies, categorized under four main sections. The most prevalent issue was the information mismatch in warranty certificates. Interestingly, the study found no significant correlation between the value of the LC and the number of discrepancies, suggesting that these issues are widespread regardless of the transaction size (Imtiaz, 2024).

The impact of such discrepancies is not limited to individual transactions. A report by *The Daily Star* (2023) revealed that export figures for the July–April period of fiscal year 2023–24 were nearly $14 billion lower than initially reported. This discrepancy stemmed from issues such as multiple entries and documentation errors, which have persisted for over a decade. These inaccuracies not only inflate growth projections but also undermine the credibility of trade data.

Surveys conducted for this research highlighted common discrepancies, including incomplete or incorrect International Trade codes, inconsistent terms and conditions, delays in document preparation, and insufficient information in shipping documents. For example, late submission of essential documentation often delays payments, affecting both exporters and importers.

5.2 Risk of Fraudulent Activities

Survey responses collected during this study also confirm that fraudulent activities remain a persistent concern for stakeholders involved in LC processing. Many participants reported frequent exposure to fraud risks, indicating the widespread impact of this issue on trade and finance. The findings call for concerted efforts to strengthen verification protocols, enhance transparency, and implement stricter regulatory oversight in LC transactions.

Fraudulent practices related to Letters of Credit (LCs) significantly threaten Bangladesh's economic stability. These activities include submitting falsified documents, shipping substandard or nonexistent goods, and colluding with other parties to exploit financial institutions. Such incidents undermine the integrity of trade finance systems, inflicting widespread economic and reputational damage.

One of the most notable instances of LC fraud in Bangladesh is the Hallmark Group scam, in which over BDT 2,500 crore was

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embezzled from Sonali Bank between 2010 and 2012 through fraudulent LCs. This scheme involved submitting fake documents and colluding with high- ranking bank officials, highlighting the financial sector's systemic vulnerabilities and the risks of inadequate oversight (Business Inspection, 2023).

Beyond this case, fraudulent activities continue to occur on a large scale. Fraudulent LC schemes often involve using stolen personal information to establish fictitious companies, which are used to launder money. According to the Customs Intelligence and Investigation Department, approximately BDT 13.96 billion was laundered through fraudulent LCs, with 30 cases filed against the perpetrators (Prothom Alo, 2023). These incidents underscore a systemic issue that goes beyond isolated cases.

Further examples of large-scale fraud include incidents at Social Islami Bank and Islami Bank, where inadequate verification processes and collusion led to losses of BDT 16,000 crore and BDT 30,000 crore, respectively. These cases highlight the severe risks associated with LC processing and demonstrate the role of corruption and lack of accountability among financial institutions in exacerbating the problem (The Daily Star, 2023).

The scale of these fraudulent activities has far-reaching implications for Bangladesh's financial system. For instance, the involvement of influential figures in LC fraud has further undermined trust in the financial sector. A prominent example is Salman F. Rahman, an investment advisor to Bangladesh's former prime minister, who allegedly laundered BDT 1,000 crore using fraudulent LCs (BSS News, 2023). Such high-profile incidents illustrate the systemic nature of LC-related fraud and its link to governance challenges within the country.

5.3 Regulatory Compliance Challenges

Bangladesh's regulatory compliance requirements surrounding Letter of Credit (LC) processing present significant challenges for banks and businesses. These challenges stem from the complexity of adhering to multiple overlapping regulations, including domestic guidelines issued by the Ministry of Commerce and international standards such as the Uniform Customs and Practice for Documentary Credits (UCP 600). The discrepancies between these regulations often result in operational inefficiencies, delays, and increased costs for stakeholders involved in LC transactions.

One of the primary issues is the increasing complexity of international trade, which is influenced by geopolitical shifts, economic volatility, and evolving compliance standards. According to a study, these factors exacerbate the compliance burden for banks and businesses, making it difficult to ensure timely and accurate processing of LCs (International Journal of Trade, Economics, and Finance, 2020). Sudden regulatory changes further complicate compliance. For instance, on July 28, 2022, Bangladesh Bank revised its rules, requiring financial institutions to provide at least 24 hours' notice before opening LCs valued at USD 3 million or more, a decrease from the previous threshold of USD 5 million. This abrupt change disrupted the financial stability of many local businesses engaged in foreign trade, struggling to adapt to the new requirements (Global Trade Review, 2022).

The Bangladesh Bank's Financial Stability Report for 2023 revealed that approximately 30% of banks reported significant difficulties complying with the revised LC notification requirements, which directly contributed to delays in LC processing. These compliance challenges have affected the efficiency of trade finance operations and eroded trust between banks and their clients, further complicating trade relationships (Bangladesh Bank Financial Stability Report, 2023).

Survey responses collected during this study reinforced the significance of these compliance challenges. Most respondents identified regulatory compliance as one of the most critical obstacles to efficient LC processing. They cited the stringent and often conflicting requirements as a significant source of frustration, particularly for businesses operating in industries that rely heavily on imports.

5.4 Economic Instability and Inflation

Economic instability and inflation represent significant challenges for Bangladesh's Letter of Credit (LC) processing. They disrupt trade operations and increase costs for importers and exporters. High inflation, foreign exchange constraints, and fluctuating exchange rates have compounded businesses' difficulties, limiting their ability to engage in international trade effectively.

As of November 2024, inflation in Bangladesh surged to 11.38%, marking a four-month high (Interim government of Muhammad Yunus, n.d.). This persistent inflationary pressure has directly impacted import costs, reducing import volumes and straining businesses. For instance, in FY23, imports of intermediate and capital goods fell by 19.9% and 17.2%, respectively. This trend continued into FY24, with import payments declining by 18% compared to the previous fiscal year (World Bank, 2024). These import reductions have hindered the availability of essential raw materials and goods, affecting production and consumption.

The declining availability of foreign currency reserves further exacerbates the effects of inflation. The Bangladesh Bank reported a 31% decline in LC openings in July 2023, a trend that persisted throughout 2024. This decline underscores the strong correlation between inflationary pressures, foreign exchange shortages, and reduced trade activity (The Financial Express, 2024).

The ripple effects of inflation and economic instability are also evident in the pricing of imported goods. Increased LC confirmation charges and higher import costs have forced importers to pass on these expenses to consumers, exacerbating inflation in domestic markets. Between July and October 2024, the rising cost of imports contributed to a slowdown in trade activity, further intensifying the economic challenges businesses face.

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Survey responses collected during this study highlighted that fluctuating exchange rates, driven by inflation and economic instability, are among the most common challenges faced by businesses engaged in LC processing. Many respondents emphasized the unpredictable nature of exchange rate fluctuations as a significant hurdle, making it difficult to forecast costs accurately and manage financial risks.

5.5 Payment Delays and Creditworthiness Issues

Payment delays in Letter of Credit (LC) processing have emerged as a significant challenge for businesses in Bangladesh, creating disruptions in trade, eroding trust, and straining business relationships. These delays often stem from inefficiencies in LC processing, regulatory compliance issues, and the financial instability of banks, leading to broader reputational and operational challenges.

A notable example of the consequences of payment delays can be seen in the case of Adani Power, which reduced electricity supply to Bangladesh due to approximately $850 million in outstanding dues. In response, Bangladesh issued a new LC worth $173 million—the third LC issued to Adani Power. However, previous LCs were reported to have failed to align with the terms of the power purchase agreement, creating further complications in the business relationship (The Business Standard, 2024).

Overdue LC payments have become a growing concern in Bangladesh, with outstanding payments reaching approximately $400 million. State-run banks account for the largest share of these overdue amounts, reflecting systemic issues in payment management.

The delays have impacted local businesses and led to a rise in LC confirmation fees, which increased from 2–2.5% to 3–4% due to heightened reputational risks associated with Bangladeshi banks (The Daily Star, 2024). These increased fees have added a financial burden on businesses, further reducing their competitiveness in the global market.

Additionally, foreign lenders have begun reducing or suspending credit lines with Bangladeshi banks due to growing concerns about repayment reliability and overall creditworthiness. For instance, Mashreq Bank, a leading UAE-based financial institution, has curtailed its credit lines with Bangladeshi banks, citing risks associated with overdue payments and inconsistent compliance. This has created further complications for businesses relying on international trade finance as access to foreign credit becomes increasingly restricted (The Daily Star, 2024).

The cumulative impact of payment delays is far-reaching. Due to missed payment deadlines, businesses face strained relationships with international trade partners, while banks experience deteriorating trust with foreign lenders. Survey responses conducted as part of this study further emphasize the gravity of this issue, with many participants identifying payment delays as a significant obstacle to efficient LC processing. These delays disrupt current transactions and jeopardize future business opportunities as companies and financial institutions grow wary of engaging with Bangladeshi entities.

5.6 Currency and Exchange Rate Volatility

Currency and exchange rate volatility represent significant challenges for Bangladesh's Letter of Credit (LC) processing. Fluctuations in exchange rates and declining foreign reserves have created an uncertain economic environment, complicating trade finance operations and increasing costs for businesses reliant on imports and exports.

One of the key indicators of this volatility is the depreciation of the Bangladeshi Taka (BDT) against the US Dollar. Between May 2024 and December 2024, the exchange rate for the BDT increased from 117 BDT per USD to 120 BDT per USD, reflecting a steady decline in the currency's value (Bangladesh Bank, 2024). This trend has been ongoing for several years, with the BDT depreciating by approximately 11.8% against the US Dollar in FY23, followed by an additional decline of 9.1% by January 2024 (The Daily Star, 2023). Such depreciation significantly raises the cost of imports, placing immense financial pressure on businesses dependent on foreign goods and raw materials.

The foreign exchange crisis has been further exacerbated by the depletion of Bangladesh's foreign reserves, which fell from $40.7 billion in August 2021 to $20.18 billion in January 2024 (International Monetary Fund, 2024). This sharp decline has limited the government's ability to stabilize the exchange rate effectively. Bangladesh Bank has implemented various policies to regulate foreign exchange outflows to address these challenges, including tighter LC margin requirements for certain imports. However, these measures have inadvertently created additional hurdles for businesses by restricting their ability to open new LCs (IMF, 2024).

The current exchange rate stabilization model, overseen by the Bangladesh Foreign Exchange Dealers Association (BAFEDA) and Bangladesh Bank, has been criticized for its ineffectiveness. Many importers have reported difficulty planning and budgeting for trade transactions due to the unpredictable nature of exchange rates, which directly impacts their profit margins and financial stability (International Monetary Fund, 2024).

Survey responses collected during this study highlighted exchange rate volatility as one of the most frequently cited challenges in LC processing. Participants emphasized that unpredictable exchange rate fluctuations—primarily caused by declining reserves and economic instability— make it difficult for businesses to forecast costs accurately and manage financial risks. This uncertainty increases business costs and reduces Bangladesh's competitiveness in international trade.

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5.7 Infrastructure and Technological Limitations

Infrastructure and technological limitations present significant barriers to the efficient processing of Letters of Credit (LCs) in Bangladesh. The reliance on paper-based procedures and the lack of digital integration between financial institutions and regulatory authorities are among the key factors hindering the modernization of trade finance operations. These inefficiencies lead to delays, increased operational costs, and reduced competitiveness in the global trade market.

The lack of investment in banking technology further exacerbates these challenges. A report by *The Daily Star* (2023) revealed that banks in Bangladesh allocate only 5% of their budgets to IT infrastructure, a figure significantly lower than required to modernize the trade finance ecosystem. This underinvestment has left many financial institutions reliant on outdated systems, which are ill-equipped to handle the complexities of modern LC processing.

Cybersecurity concerns pose an additional obstacle to the digitization of trade finance. Bangladesh has faced several high-profile cyberattacks that have exposed vulnerabilities in its financial and governmental systems. For example, the 2016 Bangladesh Bank cyber heist resulted in the theft of $81 million and highlighted the inadequacy of existing cyber surveillance tools (Bangladesh Bank robbery, n.d.). Similarly, the 2020 data breach from the Office of the Registrar General, Birth, and Death Registration (BDRIS) leaked the personal information of 50 million citizens, exposing individuals to potential misuse of sensitive data (Kudrat-E-Khuda, 2020). These incidents underscore the urgent need for robust cybersecurity measures to support the safe adoption of digital trade finance platforms.

The limited adoption of advanced technologies places Bangladesh at a disadvantage in global trade. While other countries have transitioned to paperless systems and implemented sophisticated artificial intelligence (AI) solutions for trade finance, Bangladesh continues to rely on manual processes (Rahman & Rahman, 2023). A report by the World Bank (2024) highlighted that only 25% of banking transactions in Bangladesh are processed electronically, with the majority still dependent on manual paperwork.

This heavy reliance on traditional systems reduces operational efficiency and limits the country's ability to compete in international markets.

Another critical issue is the lack of integration with global banking and payment systems. The absence of a robust international payment infrastructure further complicates LC processing as businesses struggle to meet the operational requirements of global trade. This lack of connectivity delays transactions and increases the risk of errors and inefficiencies, creating barriers for firms attempting to expand their trade activities.

Survey responses collected for this study further emphasize the challenges posed by inadequate infrastructure and technology in LC processing. Many participants expressed frustration with the reliance on manual systems, citing delays and errors as frequent issues. Respondents also highlighted the need for digital integration between banks and regulatory bodies to streamline the LC process and enhance efficiency.

5.8 Lack of Expertise and Training

Survey responses gathered during this study further emphasized the severity of the skills gap in LC processing. Many respondents reported that the lack of expertise among bank personnel often results in errors, delays, and mismanagement of LC transactions. These inefficiencies increase operational costs and create opportunities for fraudulent activities. Respondents also highlighted that the absence of structured skills development programs contributes to a reliance on external expertise, which drives up costs and reduces the self-sufficiency of local institutions.

The lack of sector-specific training and expertise in Bangladesh's banking and trade finance sectors is a critical challenge that significantly impacts the efficiency and security of Letter of Credit (LC) processing. This deficiency has resulted in operational inefficiencies, heightened fraud risks, and a reliance on foreign expertise to manage complex trade finance operations. The skills gap and insufficient training in LC-related processes have created vulnerabilities that continue to hinder the development of a robust and secure trade finance system.

One of the most notable consequences of this lack of expertise is its role in large-scale financial fraud. For example, the BDT 16,000 crore LC fraud at Social Islami Bank and the BDT 30,000 crore loan scam involving Islami Bank and S Alam Group were facilitated by inadequately trained personnel. In these cases, bank employees failed to perform due diligence, such as verifying collateral or flagging irregularities, and in some instances, were susceptible to bribery. These incidents highlight the systemic risks posed by insufficiently trained personnel in the banking sector (The Daily Star, 2023).

A study by the Bangladesh Institute of Development Studies (BIDS) found that the country's industrial sectors face an average skills gap of approximately 30%. This gap is particularly pronounced in specialized fields such as banking and trade finance, where only 1.35% of workers receive job-specific training (The Business Standard, 2022).

As LC processing involves complex documentation, regulatory compliance, and risk management, inadequate training leaves financial institutions and their employees ill-equipped to handle these responsibilities effectively.

5.9 High Costs and Fees

The high costs associated with Letters of Credit (LCs) present substantial challenges for businesses in Bangladesh, especially

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small and medium-sized enterprises (SMEs). These expenses, which include elevated bank fees, LC confirmation charges, and compliance-related costs, create significant financial burdens and reduce Bangladeshi businesses' competitiveness in the international market. These costs can be particularly detrimental for SMEs, which often operate on thin profit margins, forcing many to scale down transaction volumes or seek alternative, less secure financing methods.

Interviews taken during this research highlight that high costs and fees are among the most common and concerning challenges faced by businesses engaged in LC transactions. Many participants emphasized that rising fees cut their profit margins and limit their ability to expand trade operations. These challenges are even more pronounced for SMEs, which constitute a significant portion of the economy, as they lack the financial resilience to absorb such costs.

One of the most significant cost drivers in LC processing is the confirmation fee, which has risen sharply in recent years. In the fiscal year 2022-2023 (FY23), LC confirmation fees in Bangladesh ranged from 3.5% to 4%, compared to just 1.7% to 2% in June 2022. This increase resulted in approximately $390 million payments for LCs valued between $5.55 billion and $5.59 billion during FY23. Cumulatively, local importers paid an estimated $1.8 billion (around Tk 19,000 crore) in LC confirmation fees, highlighting the escalating financial strain on Bangladeshi businesses (Rahman, 2023).

In contrast, neighboring countries such as India and Pakistan offer significantly lower confirmation charges. For instance, LC confirmation fees in India are around 0.75%, while in Pakistan, they range from 1.5% to 2.5% (Rahman, 2023). These lower costs make businesses in these countries far more competitive in international trade, putting Bangladeshi importers at a distinct disadvantage. The fee disparity underscores the need for reforms to reduce these costs and level the playing field for Bangladeshi businesses globally.

The financial burden of LC processing is not limited to confirmation fees. Other contributors include extensive documentation requirements, charges for handling discrepancies, and compliance-related fees. For example, discrepancies in LC documentation—such as errors in International Trade codes, incomplete shipping information, or delays in document preparation— often result in additional penalties and processing costs. These costs, combined with regulatory compliance expenses, further inflate the overall cost of trade finance for Bangladeshi businesses (Habib & Shah, 2017).

6. RECOMMENDATIONS

To tackle the multifaceted challenges of Letter of Credit (LC) processing in Bangladesh, adopting a holistic strategy that addresses systemic inefficiencies, enhances operational resilience, and builds global competitiveness is essential. The following recommendations are based on insights from both contemporary global trade finance practices and the specific needs of Bangladesh:

6.1 Develop a Centralized Trade Processing Hub

A centralized trade processing hub integrating customs authorities, financial institutions, and traders can significantly reduce documentation delays and errors. By leveraging technologies like blockchain, Bangladesh could implement a single-window system for LC issuance, document verification, and compliance checks, reducing manual interventions and transaction times (World Trade Organization [WTO], 2021).

6.2 Digitalize the LC Ecosystem

Bangladesh must accelerate the transition to electronic LCs (e-LCs). This would include digital signatures, electronic submission of trade documents, and automated compliance checks.

Learning from countries like Singapore, which uses TradeTrust to ensure document integrity and transparency, Bangladesh could establish a similar digital ecosystem, making transactions faster and more secure.

6.3 Introduce Dynamic LC Products for SMEs

High costs and rigid LC structures disproportionately burden SMEs. Developing dynamic LC products that offer flexible terms, reduced margins, and subsidized fees for SME-specific trades could ease their entry into global markets. Public-private partnerships could fund these initiatives, encouraging banks to expand their trade finance portfolios to include underserved sectors (Asian Development Bank [ADB], 2022).

6.4 Strengthen Anti-Fraud Mechanisms

Bangladesh must adopt predictive analytics and AI-powered fraud detection systems to prevent fraudulent LC transactions. In real-time, these systems can identify suspicious patterns, such as duplicate transactions or falsified documentation. A unified fraud-reporting database accessible to all banks could ensure transparency and accountability, significantly reducing fraud risks (Rafique & Duraisingam, 2023).

6.5 Establish a Foreign Exchange Stabilization Fund

Frequent currency fluctuations undermine trade predictability and increase costs. Bangladesh should establish a Foreign Exchange Stabilization Fund supported by development loans from multilateral institutions like the IMF or the World Bank. Such a fund cushions exchange rate volatility during crises, ensuring smoother LC transactions.

6.6 Mandate Capacity-Building Programs

Inadequate expertise in LC processing can be addressed through mandatory training and certification programs for banking professionals. Establishing partnerships with global trade organizations, such as the International Chamber of Commerce (ICC), could bring Bangladesh's workforce up to international standards, ensuring accuracy and reducing errors (ICC, 2022).

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6.7 Incentivize Adoption of Trade Technologies

The government should provide tax rebates or subsidies to banks and businesses that adopt advanced trade finance technologies. Encouraging financial institutions to invest in secure digital platforms will help create a resilient and efficient trade finance ecosystem. Additionally, cybersecurity frameworks must be prioritized to build trust in these systems.

6.8 Simplify Compliance for Traders

The government must collaborate with stakeholders to simplify compliance requirements without compromising regulatory objectives. Creating a trader-friendly compliance guide and conducting regular business workshops could ensure greater regulation adherence, minimizing processing delays and penalties (Bangladesh Bank, 2023).

6.9 Leverage Regional Trade Alliances

Bangladesh should collaborate with regional trade blocs, such as SAARC, to standardize trade finance practices and gain preferential access to financial facilities. Partnering with neighboring economies to harmonize LC terms and streamline processes could enhance trade efficiency and competitiveness (ADB, 2022).

These recommendations emphasize modernization, inclusivity, and resilience. By investing in technology, capacity-building, and targeted policy reforms, Bangladesh can overcome its LC processing challenges and establish itself as a regional leader in trade facilitation.

7. CONCLUSION

The efficient processing of Letters of Credit (LCs) is vital to Bangladesh's international trade and economic development. This paper has explored the multifaceted challenges affecting LC transactions, including documentation discrepancies, regulatory compliance barriers, technological limitations, and financial instability. Collectively, these challenges undermine the efficiency of trade finance, inflate costs, and hinder the competitiveness of Bangladeshi businesses in global markets.

Addressing these issues requires a holistic approach. Strengthening regulatory frameworks, modernizing trade finance infrastructure, and adopting innovative technologies such as blockchain and AI can significantly improve efficiency and transparency. Emphasizing capacity building is equally critical, with targeted training programs to bridge the skills gap in the banking and trade sectors. Small and medium-sized enterprises (SMEs), the backbone of the economy, must be supported through tailored LC products, financial incentives, and simplified compliance requirements.

Collaboration between policymakers, financial institutions, and trade stakeholders is essential for implementing these reforms. Learning from global best practices while addressing Bangladesh's unique challenges will create a more resilient, inclusive, and competitive trade finance ecosystem. With strategic investments and reforms, Bangladesh can position itself as a regional leader in trade facilitation, driving sustainable economic growth and prosperity.

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