



## **COMMON DISCREPANCIES IN LETTER OF CREDIT: EXPERIENCE FROM SELECTED BANKS IN BANGLADESH**

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### **Abstract:**

*Letter of Credit (LC) opening banks receive transport and other documents from the LC issuing Bank through banking channels. Upon receiving the information, bankers scrutinize the documents to determine if there is a deviation or discrepancy per the previously agreed terms and conditions. Based on the primary data from this study, forty-two discrepancies were identified. The discrepancies were grouped into four categories based on their nature. These are missing information, mismatched information, and non-submission of documents. The data were analyzed using the R Program and visualized with ggplot2. The study reveals that the most common discrepancy is mismatched information in warranty certificates. Most of the cases have only one discrepancy. The study also identified potential outliers, such as mismatched information in Currency, quality assurance certificate, and country of origin. Regression analysis shows that there is no significant relationship between the values of LC and the number of discrepancies.*

### **Keywords:**

Letter of Credit, Discrepancy, LC, International Trade, Bangladesh

## **1. Introduction**

### **1.1 Literature Review**

In international trade, commonly used trade services are cash in advance, open account, documentary collection, documentary credit (LC), standby LC, bank guarantees, bank payment obligation(BPO), supply chain financing (SCF), forfeiting, etc. (Shah, 2017). Among these trade services, documentary letters of credit, commonly known as LC, are considered the "Life Blood of International Trade" because LC builds trust and linkage among unknown international buyers and sellers, hence facilitating international trade. (D'Arcy and Cleave, 2002; Alavi, 2016)

Increasing trade with emerging economies and moving production to low-cost countries create the fear of receiving the goods in incorrect quantity or amount. On the other hand, the exporter fears not receiving the payment, or the importer may refuse to accept the goods.(Chigerwe, 2016; Hamed, 2016). To address this issue, LC is an adequate assurance of payment to the exporter on behalf of an importer by a financially solvent third party. (Islam, Alam and Al-Amin, 2015; Mann, 2000). Such assurance is required because exporters often fear that, once the product is shipped, the importer will not pay the amount to the exporter. Usually, reputed banks provide such assurance. Once the seller or exporter receives the assurance from a bank, the seller becomes confident that he will be paid even if the buyer does not. (Mann, 2000)

To better understand the process,

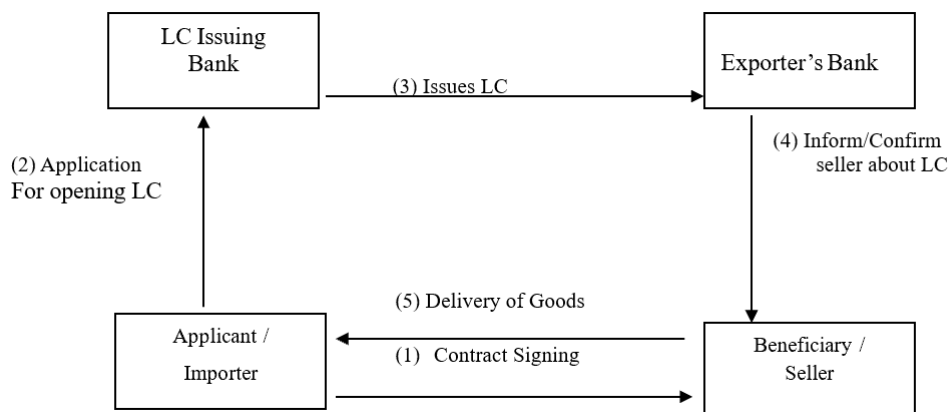


Figure-1: LC Opening Process (Mann, 2000)

LC mainly facilitates international trade in four ways. First, it reduces the non-payment risk for exporters. Second, provide trade finance for exporters. Third, LC works as the basis for a back-to-back letter of credit. Fourth, it assures the seller (Alavi, 2016). International rules and norms guide LC. The International Chamber of Commerce (ICC) is responsible for formulating such guidelines. The ICC publishes a set of rules and norms known as Uniform Customs and Practice (UCP). The UCP ensures rights for both merchants and banks in cross-border transactions. The UCP was first introduced by the ICC in 1933 (Sarfranz Hussain et al., 2021). According to article 5 of UCP-600, banks only deal with documents. It does not work with goods, services, or performances to which the documents may relate. UCP-600 also states that LC is only valid upon the compliance presentation of stipulated documents.

### 1.2 LC Discrepancy

The importer's Bank usually examines and reviews documents. According to UCP-600, Banks must examine the documents to confirm their compliance with the terms and conditions of the credit. Documents will be examined on their face, and compliance will be determined against the provision of ISBP and UCP-600 (Alavi, 2016). The exporter is entitled to the payment, or the LC issuing Bank is obliged to make payment once the buyer presents the stipulated documents that conform to the requirements of LC. Otherwise, the seller will get payment only if the buyer waives the discrepancies in the seller's presentation. (Mann, 2000). According to UCP-600, the LC issuing Bank must pay if the documents comply with the LC criteria and the contract. Because all parties involved in LC transactions only trade on paper, not physical goods. Rejection of payment by Bank due to lousy processing and noncompliance of presented documents by beneficiaries. (Hamed, 2016). Discrepancy in LC is considered a significant risk. The global rate of documentary discrepancy in LC transactions is about 60-70% ('ICC, Thailand 2002') The UK lost Euro 113 million due to discrepant documents being presented. (SITPRO Ltd. 2003). However, the use of LC among the other trade services has been decreasing. (ICC, 2017)

### 1.3 LC In Bangladesh

Despite the global slowdown in the use of LC as a trade finance instrument, LC is still very popular in the Asian market. SWIFT data for 2015 demonstrate that 72% of total traffic data in the Asia-Pacific region is concerned with LC. (ICC, 2017). In Bangladesh, there are 62 scheduled banks and five non-scheduled banks. (Bangladesh Bank, 2024). Not all banks have the authority to open an LC. The banks that can open LC are called "Authorized Dealers." Not all branches of authorized dealers can establish LC. Only "Authorized Dealer Branch" or "AD Branch" can open LC. LC can be established only by "Authorized Dealer" branches of commercial Banks.

A survey conducted by the Bangladesh Institute of Bank Management (BIBM) in 2017 clearly shows the dominance of LC in import trade payments. The survey revealed that import payments of 88.5% [in terms of cases] and 94% [in terms of volume] were made through LC in 2016. (Rafique & Duraisingam, 2023; Shah, 2017). However, the worldwide scenario of trade payment is entirely different. Whereas in Bangladesh, LC is the single most common

method of trade payment, globally, the use of LC is decreasing daily. 80% of global trade payments are made through open accounts, whereas in Bangladesh, it is 1%. (Shah, 2017) The low use of cash in advance and open accounts might be attributed to the country's regulatory requirements. This requirement is to preserve the reputation of the country's traders and maintain mutual trust and relationships among various stakeholders of LC. (Islam, Alam and Al-Amin, 2015)

In Bangladesh, most malpractice cases are related to noncompliance with regulations or guidelines. Many of these are due to the knowledge gap of the service providers. Irrelevant terms and inconsistent conditions given by the LC issuing officer through SWIFT often result in discrepancies in Bangladesh. (Shah, 2017). According to UCP-600, the issuing Bank gets reasonable time but is at most seven working days whether to refuse or accept the documents following the day of the receipt. In Bangladesh, LC amendments are frequently made that could result in discrepancies or a failure to regulatory compliance. Some amendments are made in terms of freight. Importers apply for a change in air transport to land transport. However, there is no change in freight cost. So there is a possibility of misappropriation of cost. (Shah, 2017)

A study by (Islam, Alam and Al-Amin, 2015) shows that Bangladesh's LC discrepancy rate is high. They also pointed out that in almost all cases, importers waived the discrepancies, which shows noncompliance behavior by the importers. They also pointed out that exporters are negligent in preparing the LC documents. On the other hand, poor drafting of the LC Clause and inappropriate use of incoterms in LC operations have become concerning to many trading partners. One reason might be that the same template can be used from generation to generation without being modified according to the current global trade environment (Shah, 2017).

Discrepant documents have various implications. Sometimes, the importer asks for a discount against discrepant documents. Exporters do not ask for amendments when they fail to comply with LC clauses. As a result, discrepancies occur. Sometimes, importers need to waive the discrepancies, which can be ignored. They also pressure bankers to reject documents. It is not only the importer, but sometimes bankers refuse to negotiate import/export bills with minor discrepancies that could easily be ignored (Islam, Alam and Al-Amin, 2015). However, the study found no literature regarding the cost associated with LC discrepancies in Bangladesh.

If the LC issuing Bank determines that the documents do not conform with the terms and conditions of the contract, it may approach the importer for a waiver of the discrepancies. ('ICC, Thailand', 2002)

#### **1.4 Research Gap**

There is a severe shortage of research articles on LC or import financing not only in the context of Bangladesh but also from the perspective of other countries (Nazia, 2015). There is not sufficient literature on discrepancies in the LC transaction process. Moreover, very little research on LC has been conducted based on primary data. Most of the research on LC has been conducted on different case studies. As a result, little literature is available on common discrepancies of LC. The gap is more visible when the literature search on LC discrepancies is narrowed down to the context of Bangladesh. Despite the vast use of LC in international trade, no research has been conducted to identify various types of discrepancies.

#### **1.5 Research Objective**

The study has some specific objectives. These are:

- (A) Identify various discrepancies in the LC documentation process.
- (B) Categorizing the discrepancies based on characteristics.
- (C) Identify the most common discrepancy.
- (D) Investigate the relationship between LC value and the number of discrepancies.
- (E) Suggesting policy implications and technological intervention to minimize discrepancies.

#### **1.6 Significance of the study**

Various studies (Alavi, 2017) show that discrepancies in LC cause unnecessary delays. As a result, discrepancies incur losses for the business as well as the economy as a whole. Bangladesh experiences a high degree of discrepancy in LC transactions. This paper could be a helpful source of information for organizations wanting to extend their business internationally. This paper fills the gap in a study that identifies various discrepancies. Identified discrepancies could easily be minimized by taking action. As a result, disputes among the parties will be reduced. The flow of international trade will be expedited. Bilateral trust and relationships among the firms will be improved.

## 2. Methodology

The study is descriptive. To ensure practicality, the study entirely relied on primary data. The data was collected from the LC dealing officers of seven commercial banks. Both private and public commercial banks were included in the study to get a representative view and ensure sufficient variety. Only the data from import LC has been collected. These banks are (a) Sonali Bank PLC, (b) Rupali Bank PLC, (c) Agrani Bank PLC, (d) Basic Bank Limited, (e) Janata Bank PLC, (f) Trust Bank PLC, and (g) Bangladesh Krishi Bank (BKB). Dealing officials of these banks are responsible for scrutinizing the LC-related documents. One hundred and twenty-three cases with at least one discrepancy have been considered for the study. Discrepancy-related data, such as the name of the Bank, discrepancy, the value of the LC, and Currency, was extracted from these cases. All extracted discrepancies are grouped into four categories. A list was developed based on various discrepancies identified by the bankers. Identified discrepancies are grouped into four categories based on their characteristics. The discrepancies are coded as a categorical variable. The data was imported to the R program. The results were produced using various commands.

## 3. Data Analysis and Presentation

Identified discrepancies are grouped into four categories based on their characteristics. These discrepancies are-

### 3.1 Missing information-related discrepancies

The study reveals eight pieces of information missing related discrepancies that could be missing in LC-related documents. The study has identified four types of information. These are the registration number, LC number, contract number, and freight amount. Identified information could be missed in the below-mentioned documents:

**Table 1: Missing information related discrepancies**

1	Information Missing in Packing List
2	Information Missing in Commercial Invoice
3	Information Missing in Certificate of Origin
4	Information Missing in Bill of Lading
5	Information Missing in Airway Bill
6	Information Missing in Certificate of Training Completion
7	Information Missing in Bill of Exchange
8	Information Missing in Quality Assurance Certificate (QAC)

### 3.2 Mismatch of information-related discrepancies

Several documents are in an LC. Information could be mismatched across various documents. There are thirteen items in this category.

**Table 2: Mismatched of information related discrepancies**

1	Mismatch Information in Freight Amount
2	Mismatch information in Commercial Invoice
3	Mismatch information in Bill of Lading
4	Mismatch information in Airway bill
5	Mismatch information in the Warranty Certificate

6	Mismatch Information in Quality Assurance Certificate
7	Mismatch Information in Currency
8	Mismatch Information in Airway Bill (Freight Amount)
9	Information Mismatch: Pre-shipment Inspection Certificate
10	Information Mismatch in Bill of Exchange
11	Information Mismatch in Country of Origin
12	Information Mismatch in Forwarding Schedule
13	Information Mismatch in Certificate of Compliance

### 3.3 Documents not Submitted related discrepancies

Often, exporters fail to submit various documents through banking channels. As a result, bankers of LC opening banks mark discrepancies. The study finds eight types of certificates that were marked as discrepant.

**Table 3: Non-submission related discrepancies**

1	Not Submitted: Pre-shipment Inspection (PSI)
2	Not Submitted: Manufacture's Authorization
3	Not Submitted: Shipment Clearance Letter (SCL)
4	Not Submitted: Warranty Certificate
5	Not Submitted: Received Certificate
6	Not Submitted: Treasury Challan
7	Not Submitted: Acceptance Certificate is not submitted
8	Not Submitted: Quality Assurance Certificate (QAC)

### 3.4 Other Discrepancies

The study grouped some other types of discrepancies under 'Other' categories, which include thirteen items.

**Table 4: Other discrepancies**

1	Excess Amount Claimed in
2	Excess Freight Amount Claimed
3	Late Presentation
4	Late Shipment
5	Freight Prepaid is not marked
6	LC Expired
7	Documents are not signed
8	Agency Commission is not deducted
9	Absence of Seal
10	Wrong Contact Date

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11	Authenticity Certificate
12	Part Payment has been made more time
13	LC is Inoperative

3.5 Distribution of observations among banks

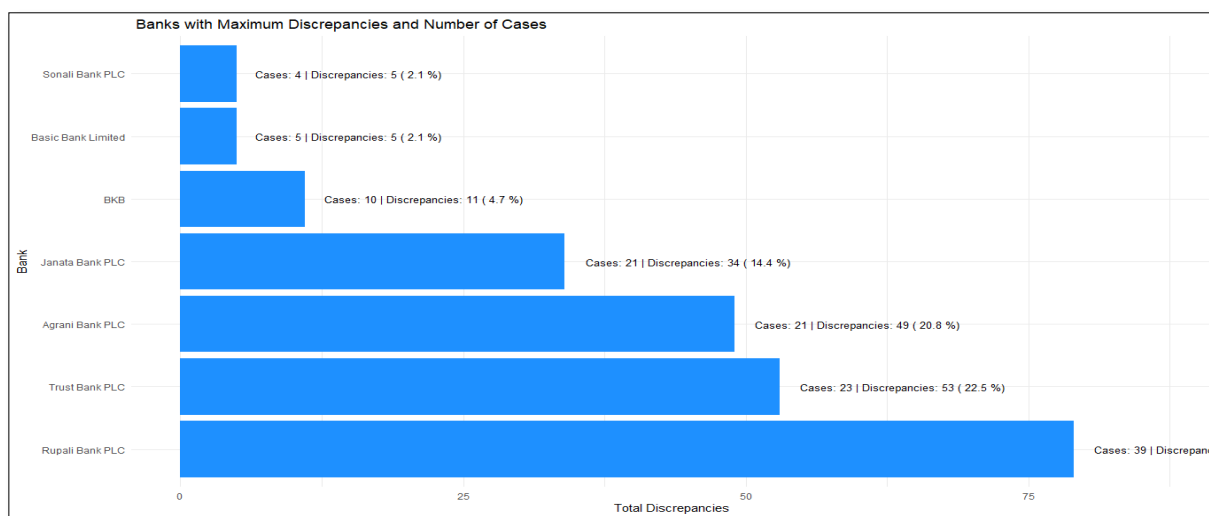
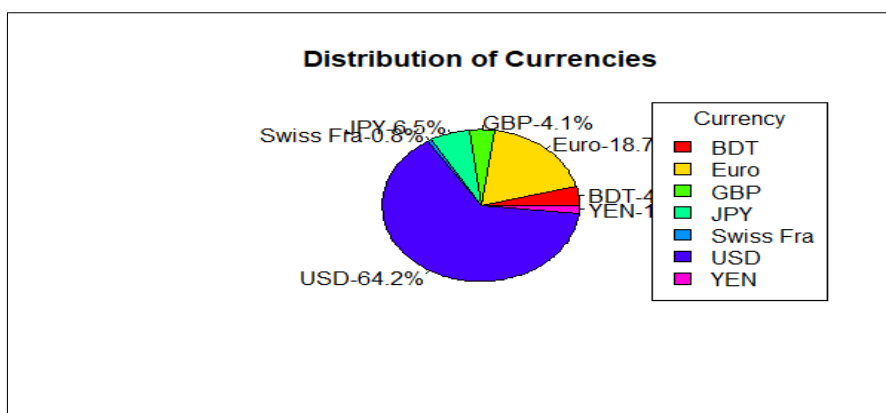


Figure 2: Distribution of observations among banks

This graph also shows the number of observations and number of discrepancies taken from seven commercial banks. The rate of discrepancies differed from Bank to Bank. It ranges as high as 25% and as low as 2.1% across the banks. There are 216 reported discrepancies among the 123 observations of seven banks. Rupali Bank PLC has the highest number of observations. It has 39 observations, of which 53 discrepancies were reported (25.1%). Subsequently, trust banks had 23 cases, of which 53 discrepancies were reported (22.5%). At the same time, Sonali Bank PLC has reported only 4 cases, with five discrepancies.

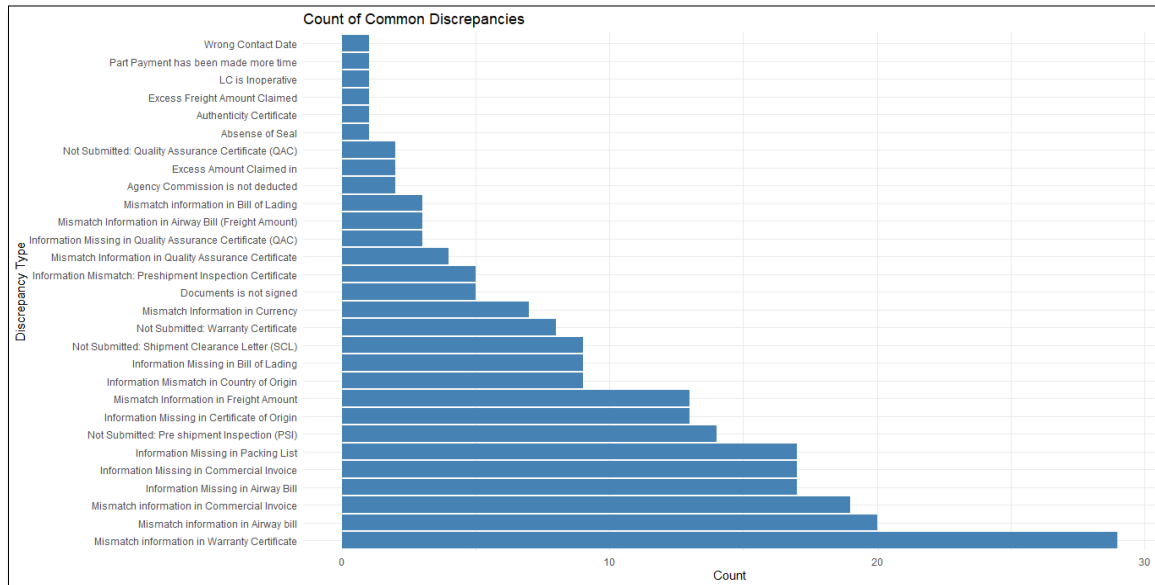
3.6 Distribution of Currencies



**Figure 3: Distribution of currencies**

Most of the LCs were established with USD, around 62%. So, USD is the most influential Currency while establishing LC. Around 18% of the LCs used Euro currency. Besides, JPY, GBP, Yen, Swiss Fran, and BDT are also seen in the observations. Other currencies like JPY, GBP, and BDT have minor representation.

**3.7 Count of Common Discrepancies**



**Figure 4: Count of common discrepancies**

The graph shows a visual representation of discrepancies. “Mismatch information in warranty certificate” is the most common discrepancy. It was reported almost thirty times out of 123 observations. Mismatch information in airway bills and mismatch information in commercial invoices are frequent occurrences. This indicates documentation issues while preparing these documents. Missing information in commercial invoices, airway bills, and packing lists are reported frequently. Banks also reported some discrepancies due to the failure to submit required documents like pre-shipment inspection reports, warranty certificates, and shipment clearance letters. On the other hand, wrong contact date, part payment made, LC in operative, and authenticity certificate have low counts. Overall, all the discrepancies could be divided into two broad categories. One is non-submission compliance, and another is documentation error.

### 3.8 Distribution of discrepancies in order of appearance

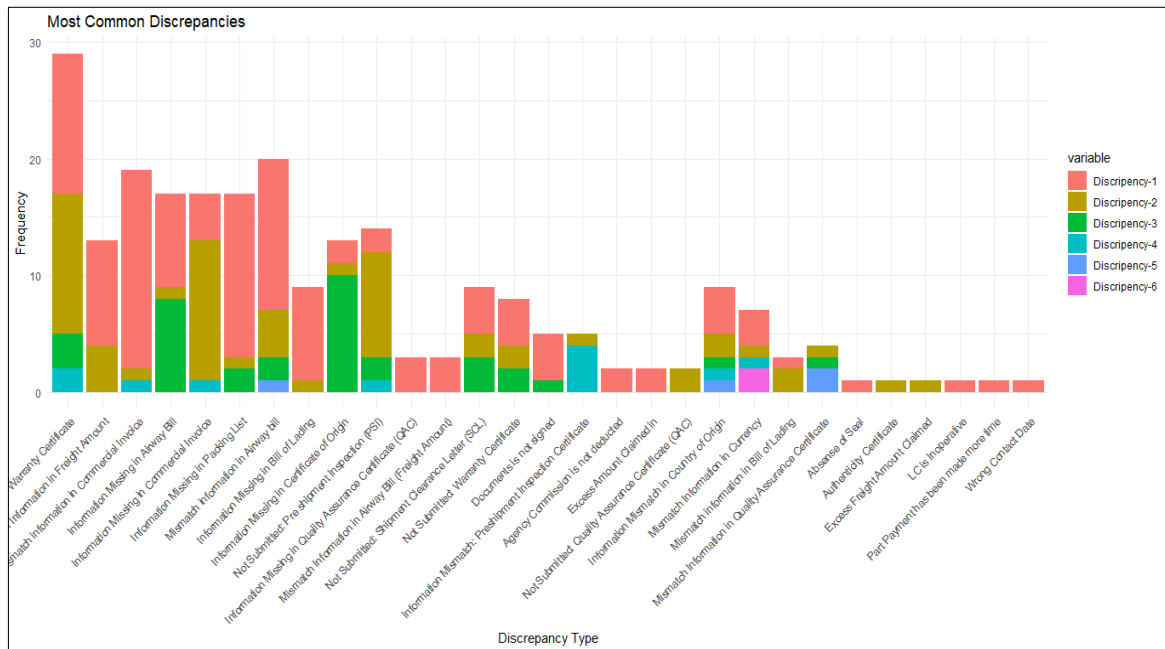
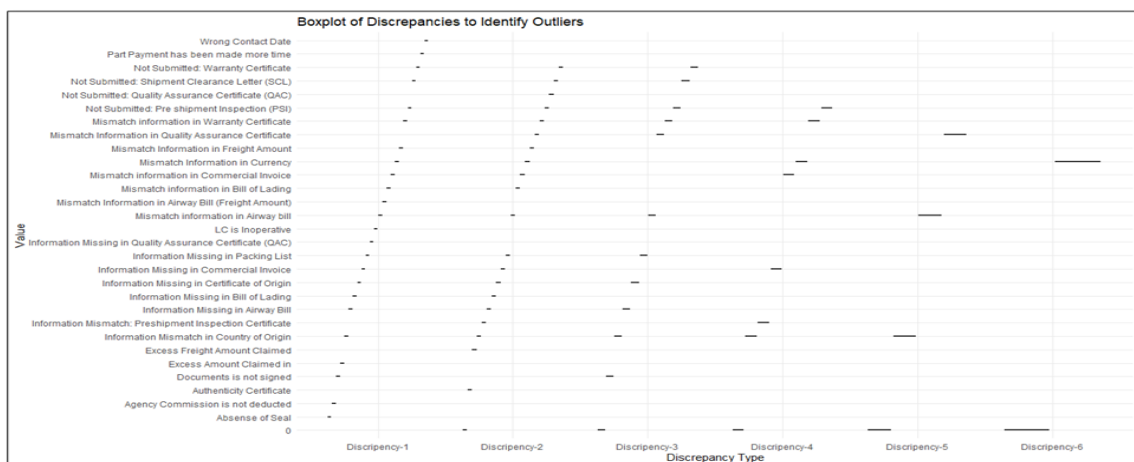


Figure 5: Appearance of discrepancies (Discrepancy-1 to Discrepancy-6)

This bar chart displays the distribution of different types of discrepancies, broken down into six categories (Discrepancy-1 to Discrepancy-6) in order of appearance. Each is represented by a different color. Mismatch information in the warranty certificate appeared most frequently in Discrepancy-1 and Discrepancy-2. But it appeared less frequently in Discrepancy-3 and Discrepancy-4. However, the study did not find this error appeared in Discrepancy-5 and Discrepancy-6. It has been seen that the Discrepancy-1 and Discrepancy-2 categories dominate the chart, indicating these as the most prevalent types of issues.

### 3.9 Boxplot of discrepancies to identify outliers

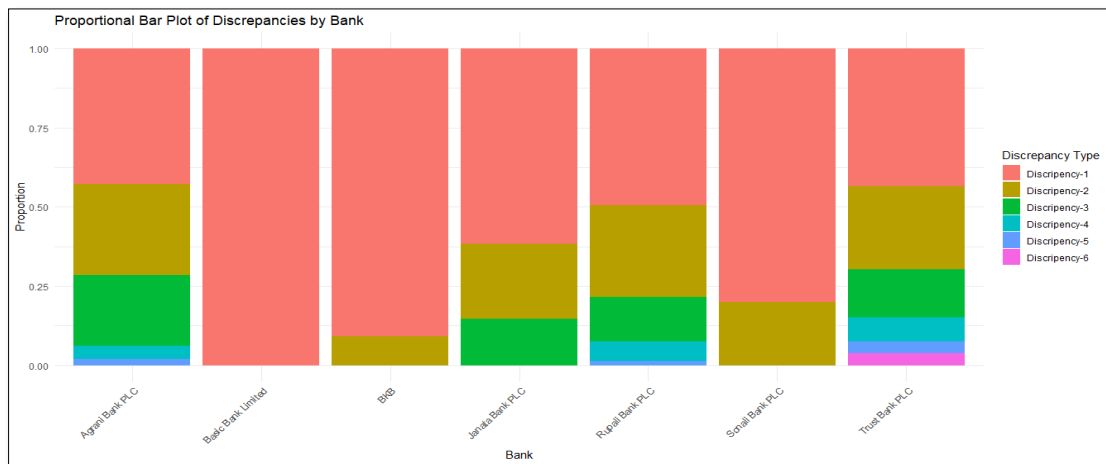




**Figure 6: Identifying the outliers**

This graph identifies potential outliers in each discrepancy type. Outliers are marked by isolated dots that fall significantly above the main values cluster, suggesting that these discrepancy occurrences are unusual compared to the rest. Discrepancy-1 and Discrepancy-2 indicate recurring issues, hence making them common outliers. If organizations emphasize these two categories of discrepancies, they will likely be outliers. Conversely, discrepancies like those showing an isolated high count in categories such as Discrepancy-5 or Discrepancy-6 are likely unique or rare issues that, compared to recurring ones, require less attention.

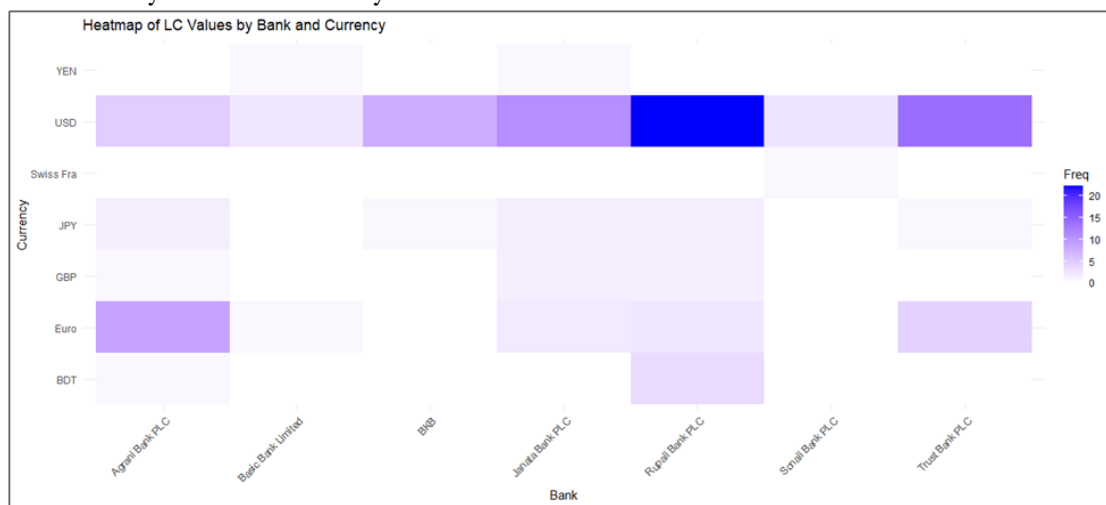
**3.10 Proportional Discrepancies by Bank**



**Figure 7: Proportional Appearance of Discrepancies by Bank**

By analyzing the graphs, the study shows the dominance of Discrepancy-1 in each Bank. Basic Bank Limited reported only one discrepancy among the observations collected from Basic Bank Limited. On the contrary, Trust Bank PLC reported the highest variation of discrepancies, followed by Agrani Bank PLC and Rupali Bank PLC, which had 6 types of discrepancies, respectively.

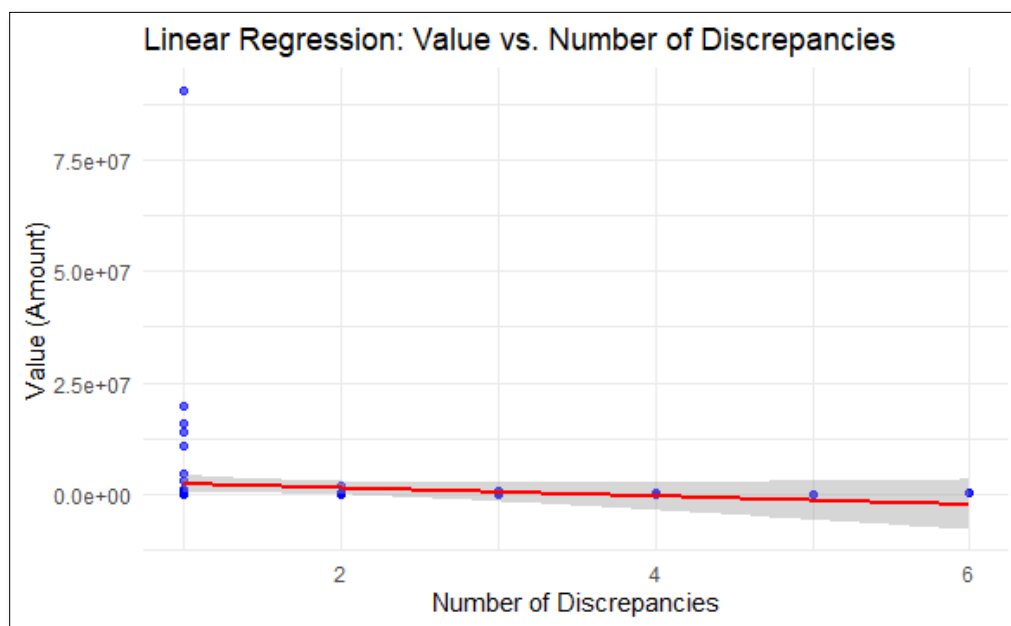
**3.11 LC Values by Bank and Currency**



**Figure 8: LC values by Bank and Currency**

This heat map represents the frequency of LC values for different banks and various currencies. The color intensity shows the frequency of the variable; the darker the color, the higher the frequency. Amongst all the currencies, USD has the highest frequency, which in the case of Rupali Bank PLC and Trust Bank PLC, comes in dark blue. This indicates that USD is the most predominant Currency for LC transactions in these banks. The Euro, by its medium purple color, depicts the moderate frequencies for Agrani Bank PLC and Janata Bank PLC. Other currencies like JPY, GBP, Swiss Franc, and BDT are infrequent. This shows that LC activity in these currencies is limited.

### 3.12 Linear Regression



**Figure 9: Linear Regression**

This scatter plot describes the relationship between the Number of Discrepancies (x-axis) versus Value (Amount) in USD (y-axis) with a fitted linear regression line to analyze any trend. Each dot in blue represents a data point, the red line is a linear regression fit, and the area around the line gray shows the confidence interval. There are a couple of outliers in this plot toward the top left, with some high-value transactions with low numbers of discrepancies. These high-value transactions may skew any potential relationship, but they do not affect the overall trend. The width of this confidence interval, depicted as the grey area around the regression line, represents the range within which the actual regression line might fall; given that this does not widen much or stray far from zero, this strengthens the conclusion of no significant relationship between discrepancies and transaction value. In this case, the graph plotted suggests that the number of discrepancies is not dependent on transaction value. The implication here is that discrepancies occur both in high-value and low-value transactions without any pattern whatsoever.

## 4. Discussion

LC is the single most used method for international trade payment in Bangladesh. Forty-two discrepancies were identified in this study, which are grouped into four categories. A total of one hundred and twenty-three samples were taken from seven banks. Most of the sample was taken from Rupali Bank PLC, which is a public commercial bank. The least number of samples was taken from Sonali Bank PLC, which is the largest public commercial Bank.

Most of the LC (65%) is opened with USD. This means USD is the most commonly acceptable Currency in Bangladesh. Other currencies are the Euro, BDT, and JPY. Among the discrepancies, the most common is-mismatched information in the warranty certificate. Warranty certificates are provided by the manufacturers to the importers. Warranty certificates could be taken seriously during documentation preparation, which could significantly reduce the discrepancies in LC.

Mismatched information in the Airway bill is the second-highest discrepancy in order of occurrence. Often, airway bills wrongly mention or miss contact numbers, LC numbers, registration numbers, freight amounts, etc. Such mismatched information leads to discrepancies in reporting. A study shows that missing and mismatched information also occurs in commercial invoices, packing lists, and certificates of origin. Apart from information missing and mismatched, sometimes required documents are not provided. Such documents are a pre-shipment inspection certificate, shipment clearance letter, quality assurance certificate, etc.

In the cases where discrepancies occur, the study shows the dominance of a single discrepancy. If one discrepancy could be checked, most discrepancies could be reduced. Most of the time, Basic Bank Limited has reported only one discrepancy, while other banks reported multiple discrepancies. The study shows that some discrepancies occur infrequently. These are outliers. Such discrepancies are- mismatched information in Currency and quality assurance certificates. The study shows that Rupali Bank PLC uses USD the most to open LC. The study also demonstrates through a linear regression analysis that there is no significant relationship between LC values and the number of discrepancies.

In Bangladesh, exporters and importers try to get immediate services from the Bank. As a result, they tend to give the bankers less time to check the documents. As a result, bankers cannot check the documents with care, and discrepancies occur. Sometimes, while sending LC through SWIFT messages, bankers unnecessarily apply various clauses, which creates problems for the exporters in complying with the terms.

## 5. Policy Implication

To address the most common discrepancies in documents like warranty certificates, commercial invoices, and bills of lading the policy makers could develop standardized templates and guidelines. Such guidelines will ensure consistency and reduce the risk of information mismatch across different documents.

Most of the discrepancies are related to the document processing error. If the LC dealing officers are trained in international LC-related protocols, such as ISBP and UCP-600, such errors could be minimized. Moreover, regular audits and establishing a standard could curb LC-related discrepancies. Such an audit could help to identify and track the pattern of discrepancies. Digital technologies such as blockchain, digital signatures, OCR, and electronic bills of lading could be introduced in LC transactions. Going digital with digital documentation could reduce Bangladesh's trade transaction time. A comprehensive classification of discrepancy framework could be developed. Such a framework could help to prioritize and categorize the discrepancies. By categorizing discrepancies based on severity and impact, banks can adopt a more risk-based approach, focusing resources on preventing critical discrepancies that could delay or compromise trade transactions. Anti-money laundering (AML) is a red flag in international trade in developing countries. Waiving discrepancies could lead to money laundering. So, policies concerning LC discrepancies must be revised per AML requirements.

To create awareness among different stakeholders, such as exporters and importers, policymakers could arrange regular seminars and workshops to curb discrepancies and brainstorm new ideas in this context. By addressing these areas, the policy implications from this study can strengthen the LC process, reduce discrepancy rates, and contribute to a more efficient trade financing environment in Bangladesh.

## 6. Limitation

It has been found difficult to get discrepancy-related data from banks, especially since dealing officers are reluctant to provide such information. Other research outputs also do not cover all the discrepancies reported by the bankers during the operation. There are sixty-seven banks in Bangladesh. However, we have taken a sample of 123 cases from seven banks, which may raise the question of a statistically valid sample size. If the sample size is larger, the study could identify more types of discrepancies. A complete picture of discrepancies would require a more extensive study based on a statistically valid sample drawn from a broader range of transactions.

## 7. Conclusion

In Bangladesh, most international trade payments are made through LC. Several discrepancies were identified in this study. These discrepancies create obstacles in executing the payment. As a result, the relationship among importers, exporters, LC issuing banks, and LC advising banks could be affected. In addition, multinational banks could withdraw from correspondent banking relationships because of regular discrepant payment-related issues. Identified discrepancies could easily be avoided if each concerned party takes proper action. Such concerns must be addressed to maintain the country's reputation and global competitiveness.

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