



Current challenges in trade finance guarantee processes

Case: Trade Finance Industry

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ABSTRACT

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Trade finance is the financing of international trade transactions. Largely used by export companies, it includes various of financial instruments used in a company's lifecycle to reduce risks. Trade finance processes are complex and time consuming, which the researcher noticed during her internship at a Finnish exporter. However, the industry is currently developing and in an emerging state of digitalization.

The thesis is done to research the current challenges medium-to-large sized exporters face in the guarantee processes. It aims to clearly define the main challenges and their origin. It also aims to find possible solutions through digitalization to the challenges.

The research is conducted using a qualitative research method in form of a case study, with a problem based examination of the current challenges. A sample of 40 specialists was chosen with the advisor's help from a trade finance community. The survey was sent to the sample via email, enabling flexible responding time. For the theoretical framework, risk management and guarantees are studied.

Based on the research findings, the industry is facing some challenges, the main one being the issues with systems. The overall satisfaction to the current guarantee processes is good. Possible solutions to the challenges are introduced.

Key words: trade finance, guarantees, risk management, digitalization

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1 INTRODUCTION

1.1 Trade Finance Industry

From the beginning of international commerce, businesses have looked for methods to finance their transactions and minimize the risks involved in trade, making trade finance the oldest domain of international finance. (Accominotti & Ugolioni 2019.)

According to a study by the Committee on the Global Financial System (2014, 2), trade finance has historically been considered as liquid and well-functioning requiring little attention from policymakers. However, after the financial crisis of 2008, when world trade faced a collapse, the industry experienced issues as funding strains at European banks raised concerns of possible disruptions.

Since then, the importance of a well-functioning trade market industry has been emphasized by economists and analysts. Consequently, trade finance instruments, structure and regulations of the global trade market have been systematically monitored. (Accominotti & Ugolini, 2019.)

Trade Finance Global (2020) states that nearly 80-90 per cent of global trade is dependent on trade finance. Nowadays, trade finance is worth approximately 3 trillion dollars annually, accounting for three per cent of global trade. Therefore, trade finance is a big driver of economic development globally.

Trade finance in its simplicity is the financing of international trade transactions. It is described as the umbrella term for financial instruments required in a company's lifecycle to reduce risks, when exporting goods. It includes Letters of Credit, guarantees, export finance and credit agencies and sale of receivables and invoice finance.

1.2 Thesis background and objectives

Nokia Oyj is an international company located in Finland, working in the telecommunications, information technology and consumer electronics industry. Its headquarters is located in Espoo, Finland. Nokia has been one of Finland's most well-known companies during its history and has played a very large and important role in Finland's economy. Currently the company is one of Finland's largest international actors, with its technology products being exported worldwide.

The researcher did an internship at Nokia Oyj headquarters where she worked as a Trade Finance Trainee in the Global Guarantee Centre of the corporation. During that period, her tasks included working end-to-end guarantees processes and being in contact with local teams internationally as well as with financial institutions.

The researcher's manager from the corporation has agreed to work as an advisor during the thesis process, enabling contacts and information for the researcher. The research is delivered to the advisor, however it is targeted for the entire trade finance industry in Finland.

Trade finance processes can be time consuming and intricate, with several steps in the end-to-end process, that may require several tools and resources. The researcher had the possibility to observe and experience some challenges during her internship, mainly related to the complexity of trade finance processes. Currently, some export companies are in the midst of trying to battle challenges in the industry by investing in projects and tools to further help the development of trade finance processes.

The purpose of the thesis is to provide help for export companies to understand what the prevalent challenges are in the industry, where they stem from and what would be the possible solutions. In the future, export companies could use this research as a guide to know what digital solutions they could adopt into their processes. The solutions will be discussed further later in this thesis.

The objective of the research is to clearly define the current main challenges export companies face in trade finance processes, to understand where they come from and how digitalization could provide possible solutions. Currently the industry is in an emerging state of digitalization, with service providers and corporation innovating new solutions to help the development of the industry.

1.3 Research methodology

This research is a case study, limiting the research area to the Trade Finance industry and medium-to-large sized export companies. Various types of research methodologies are utilized in the thesis. As the researcher has been working in the field, focusing on guarantee processes, document analysis and participant observation are qualitative research methods as well, supporting the theoretical framework.

To further support the theoretical framework and research, several literature sources are utilized in forms of articles and books which one can find in Tampere University of Applied Sciences (TAMK) library and Andor online library portal.

The research was conducted as qualitative research in form of a survey distributed to trade finance specialists of medium-to-large sized exporters, to gain in-depth understanding on the challenges occurring within the guarantee processes. In addition, the researcher interviewed four specialists of the industry, before conducting the main research. This was to enable deeper understanding of the topic and formulating final research questions.

The data collected was analysed using descriptive and inductive approach, with the main goal to specify the current challenges and their cause.

1.4 Thesis structure

In Chapter 2 of the thesis, the theoretical framework is explained. The main focus is on risk management and guarantees. The reader will get a basic understanding of the guarantee process in general and different types of export guarantees.

Chapter 3 provides an overview on the research itself and how it was conducted. Firstly, it explains the basis of qualitative research methods, followed by the details of the sampling, the actual survey and its content as well as the distribution and timetable of the research.

Chapter 4 focuses on the analysis of the research. The data is analysed in a descriptive and inductive approach, with the goal to explain current challenges in guarantee processes of companies.

Chapter 5 consists on the general findings and analysis for a clear and concise understanding of the research.

In Chapter 6 of the thesis, the reader is presented possible solutions for the challenges found in the research. The solutions focus on increasing the knowledge of the industry, standardization, electronic documents and innovation.

Chapter 7 is the final chapter. It concludes the research and thesis.

2 THEORETICAL FRAMEWORK

2.1 Risk management

International trade forms a vast part of nations' economies, especially for a small market economy as Finland. According to the Confederation of Finnish Industries, in 2018 the value of export rose 5,5% from the previous year, totalling 91 billion euros, having made steady growth since the drop in exports in 2009. The relation of export to the country's gross-domestic product (GDP) rose to 39 %. (Confederation of Finnish Industries, 2020.)

International trade involves high risks, due to differences such as culture, language, legislation or currency, which companies need to consider in their operations to ensure best possible business practices. Helppi and Paloheimo (2005, 27) describe risk as the possibility of financial loss. It consists of two sections: the size of possible risk and the likelihood. Other risks in international trade are country and corporate risks.

Financial risk is one of the main risks that companies are exposed to. It is the unexpected changes in the valuation of a company's portfolio of assets and liabilities, as a change in the value of financial instruments, such as exchange and interest rates, or as consequence of a company's financial activities. (Tayeb 2000, 225.)

Export companies have often centralized their trade finance risk management to the financial department, however it is crucial that these risks are also recognized in other organizations of the company to ensure proactive risk management. Then negotiations and actions can be taken to ensure best risk management when i.e. negotiating sales contract and terms. (Helppi & Paloheimo 2005, 28.)

In Figure 1. below, the reader may observe types of risks during the development of a sales contract. Most commonly risks are categorized into short- and long-term risks, political and commercial risks and production and delivery risks (Helppi & Paloheimo 2005, 29.)

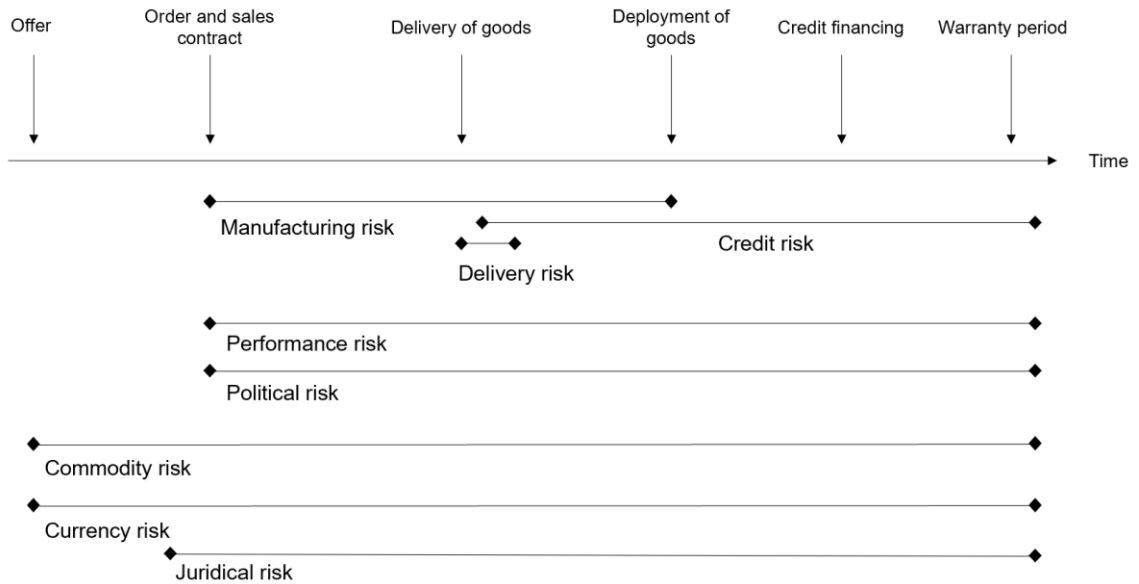


FIGURE 1. Types of risks during sales contract (Helppi & Paloheimo 2005, 34.)

Trade finance provides instruments to reduce these types of risks for companies when operating internationally.

2.2 Guarantees

Guarantees are an integral part of trade finance and export business. International customers often require guarantees as a safety procedure for payments and performance of goods, thus making them an integral part of a company’s risk management.

2.2.1 Guarantee process

In Figure 2 below, the guarantee process is explained. The process includes several steps and takes time.

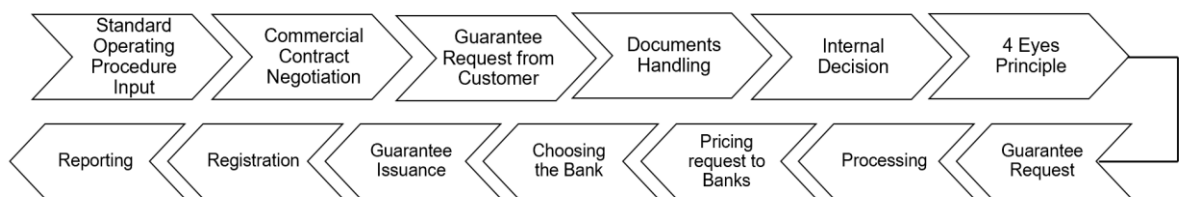


FIGURE 2. Guarantee Process

The process starts when negotiating the commercial contract with customers. Already at this stage, the sales team or department involved in negotiations should be aware of the standard Operating Procedures (SOP) regarding guarantees. It often states the guarantee wordings approved and used by the company and other guidelines and rules.

As the customer requests guarantees, the documents needed are handled at the accountable entity. In case if the customer is new, an analysis of the customer is needed before the internal decision. After a thorough analysis and internal approval from the corporation, the process will proceed. In some cases, if the customer has been a business partner for a longer period of time, the company may internally approve a bond limit of certain amount, usually valid for one year. All guarantee request issued during that period are automatically approved, without a separate approval. If the bond limit is exceeded, a new approval is in place.

The Four (4) Eyes Principle is an internal control tool, to minimize the risk involve in decision making (Collins English Dictionary, 2020). Simply, it means that two people (four eyes) have to review all documents to ensure no mistakes or fraudulent actions have been made, as well as increasing transparency. The two people reviewing the documents most often are the ones signing and approving the documents.

Depending on the company's structure, trade finance processes can be centralized to one location or de-centralized to different locations. After the sales contract has been signed and internal documentation, the guarantee is requested to the department handling the processes. That department is responsible for the end-to-end process of guarantee from issuance, amendments and lastly release.

After receiving and reviewing the guarantee request, the department will contact the bank or multiple banks, for pricing request. Depending on the guaranteed amount, it may be necessary to tender the financial institutions and choose the best offer. Banks rival on the commission of the guarantee and expenses.

Once the issuing bank has been chosen and the guarantee has been issued, it is registered into the company's files. There are several ways companies are able

to do this, some uses service providers and others saves them in paper format. It is entirely dependent on the company's internal processes and choice. Registering the guarantees will help in reporting, both internal and external.

During their lifetime, guarantees may be amended. Amendments are usually regarding the guaranteed amount, expiry date or other terms. Commonly they are requested to the issuing organization by the beneficiary. Cancellations are always requested by the beneficiary to the issuing bank. Once released by the customer, guarantees should be closed and archived to release the company from its obligation and prevent fraudulent claims.

2.2.2 Types of guarantees

Companies can issue both bank guarantees and corporate guarantees, the later one being the more recommended option, due to them being less expensive than bank guarantees. In order to issue guarantees, the company must understand the types of guarantees used and their contents, such as wordings and terms.

The International Chamber of Commerce is governing guarantee procedures with guidelines and rules, familiarly known as ICC Uniform Rules for Demand Guarantees (URDG 758). The globally-recognized rules regulate the basic principles of a demand guarantee:

- The independence of the guarantee from the underlying transaction
 - The documentary nature of the guarantee
 - The limitation of the guarantor's duty to review the written claim to an examination of whether the claim conform with the terms of the guarantee.
- (Jimenez 2012, 159.)

Guarantees can be divided into commercial and non-commercial guarantees. Commercial guarantees are used in business processes and always related to a sales contract. Non-commercial guarantees are i.e. rental guarantees of premises or customs guarantees. The focus in this thesis is especially on commercial export guarantees, therefore non-commercial guarantees will not be studied further.

Guarantees are also divided into direct and indirect guarantees. Direct guarantees involve three parties: the applicant, beneficiary and the guarantor (the bank), whereas indirect guarantees involve a fourth party, that being the beneficiary's bank. The complexity of involving two financial institutions into the process, results in the guarantee becoming more expensive for the applicant. In addition, the indirect guarantee poses another disadvantage to the applicant. The beneficiary's bank may subject the guarantee to mandatory local law of the country, which may avert the defences against fraudulent claims. (Jimenez 2012, 162.)

In Figure 3 below, one can observe the types of export guarantees issued during a sales contract.

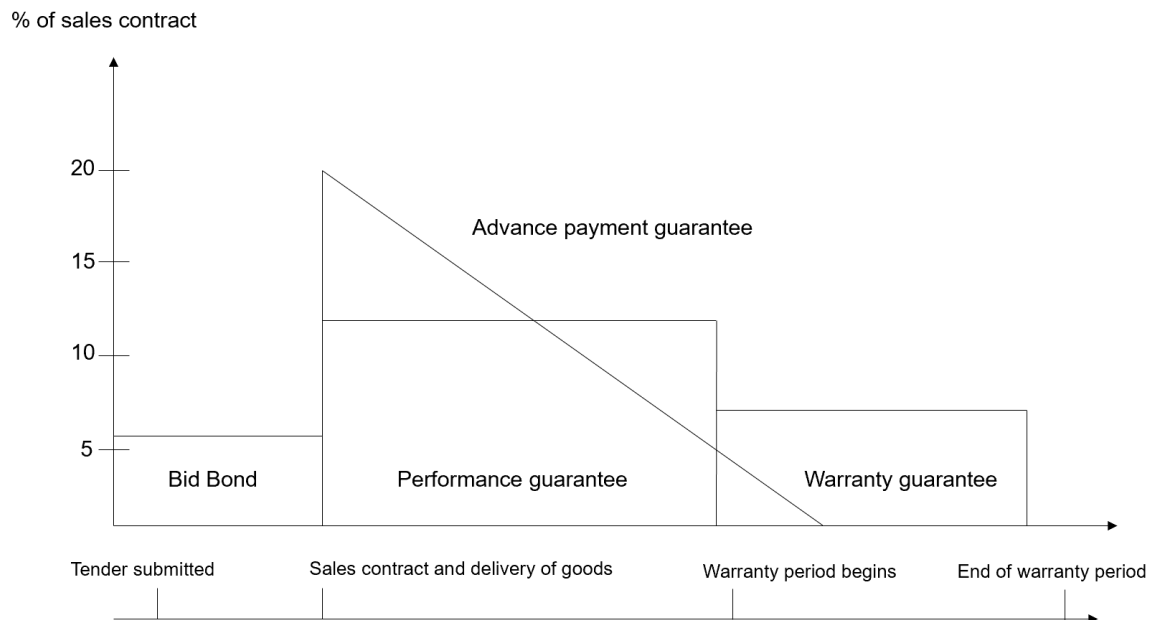


FIGURE 3. Types of export guarantees (Helppi & Paloheimo, 2005, 64.)

A Bid Bond is typically 5-10 per cent of the contract amount. Its purpose is to ensure the buyer will receive an agreed compensation if the seller does not fulfil its contractual obligations. Commonly the Bid Bond is required by the buyer, for the seller to enter the tender.

An Advance payment guarantee is primarily connected to the sales contract of larger value. The guarantees are typically 10-30 per cent of the contract value. It

ensures that the seller will refund the guarantee amount if failing to fulfil the contractual obligations.

Performance guarantees are issued to ensure the performance of the seller in regards of the sales contract. The guarantee amount is dependent of the term agreed in the sales contract between parties, commonly 5 – 10 per cent.

Warranty guarantees are issued once the performance guarantee's validity has been terminated, to ensure the seller's obligation towards the goods delivered for a certain period. Occasionally the warranty guarantee is included in the performance guarantee. Therefore, it is important to carefully review the guarantee wordings to avoid duplicate guarantee issuance. Commonly the guaranteed amount is 5 -10 per cent. (Nordea, 2020.)

3 RESEARCH

3.1 Qualitative research method

As the research in form of a case study has for aim to understand the current challenges in trade finance processes for export companies in Finland, a qualitative research method was chosen. According to Saldaña (2011, 3) the qualitative research method has for purpose to study natural social life, with a variety of different methods.

A case study has its main focus on a single unit, in this thesis the trade finance industry. It enables in-depth examination of the issues, instead of developing new arguments or theories (Saldaña 2011, 8). The research purpose of finding the prevailing challenges and what causes them, led to the decision of conducting a case study for this topic.

To gain deeper understanding of the industry and the instruments, the researcher held conversations with trade finance specialists before starting the research. These conversations helped to formulate the research questions. The questions focused specifically on one instrument, guarantees, and the its end-to-end process. The qualitative method enabled to gain deep data on the challenges regarding the instrument.

Another reason for choosing to conduct the research with the qualitative method was that the industry has companies that differ vastly in size, trade finance processes and challenges. Some companies are very advanced in their processes concerning digitalisation whereas others may still process everything manually. This method enabled the researcher to get as large of a perspective as possible of the industry's current status.

3.1.1 Sampling

For choosing the sample for the survey, the researcher discussed with the advisor during a meeting in March 2020 to help with the selection of possible exporters. The sample was chosen from exporters mentioned by the advisor as well as amongst members of Standardised Trust, a group of international trade finance specialists from corporates, financial institutions and fintechs (financial technology).

In order to get the most comprehensive view on the industry's current state, the sample varied largely in industry, size of the company as well as amount of transactions, which were some of the demographics in the survey. All of them export internationally as well.

Based on the members of Standardised Trust, a contact list was collected. A total of 40 specialists were listed and contacted via email.

3.1.2 The Survey

Organizing individual or group interviews with the sample would not have been possible due to challenges in timing, as most specialists are busy and need to book the meeting several weeks ahead of time. Moreover, the everchanging situation with the COVID-19 pandemic led to the decision of conducting the research online instead of interviews. Companies had restricted employees from meetings and remote work was recommended. Therefore, the research was decided to be conducted in form of a questionnaire. Reasoning behind this decision was that it was easily accessible and could be answered when best suitable within the scope of time given.

The questionnaire was made on SurveyPal, an online service provider, as it enables clear data collection and analysis throughout the process. The questions were formulated to be as clear and straightforward as possible, with various types of questions, that being multiple choice, single choice or open ended.

The questionnaire begins with the title and forewords, where the goal of the thesis and basic instructions are explained. In addition, the respondents are insured that all responses will be handled anonymously.

The first page of the survey consists of questions 1 – 8. Their purpose is to identify the basic demographics of the respondents, such as size of the company and industrial sectors as well as basic information of their trade finance processes.

The second page of the survey focuses on questions 9 – 21, that are more focused on the overall guarantee issuance process and steps before the issuance, e.g. general policies, facilities and pricing requests.

The third page, questions 22 – 27, focuses on the communication with financial institutions and the issues of the guarantee processes.

On the final page of the survey, the respondents are advised to leave their contact information and are kindly reminded of the anonymity of their responses. It also states that all responses will be deleted after completion of the research.

The survey in its entirety can be found as Appendix 1.

3.1.3 Distribution

The survey was distributed to the sample via email. As Standardised Trust is based on LinkedIn, an online networking platform, the researcher could find specialists' contact information there. In addition, the researcher had already met with some specialists for initial discussion in January and February 2020, a connection through email was already established.

The sample was contacted via email with an introductory message and a link to the survey. The emails were sent from the researcher's personal school email: katrin.vayrynen@tuni.fi.

The research included 3 messages, the initial message containing the link to the survey and two reminders.

3.1.4 The Research

The survey was launched on the 11th of March and an email containing the link to the survey was sent to 41 contacts. Four email addresses were not valid, therefore the survey did not reach them as messages were undeliverable. After the first week, there were 6 responses to the survey, and 12 had opened the link.

On 16th of March, the second email was sent as a reminder to the remaining sample who had not yet responded to the survey. After the first reminder, the survey had nine completed responses.

On the 23rd of March the third and last email was sent to the remaining sample that had not responded. By this date, 9 responses were received to the survey.

The survey was closed on the 25th of March. Out of the total 41 contacts, the total amount of respondents was 11, totalling 26,8 %. Undeliverable messages totalled 9,8 % of the contacts.

4 ANALYSIS

The research purpose is to examine the trade finance industry and the challenges that occur in the guarantee processes of medium-to-large sized exporters.

To retain the anonymity of the respondents, each company has been given a letter from A to K, used when referred to.

4.1 Demographics

In Figure 4 below, the division between medium and large companies can be observed. Large companies amount to 72,7 % of the total respondents and medium companies to 27,3 %.

Company size of respondents,
n=11

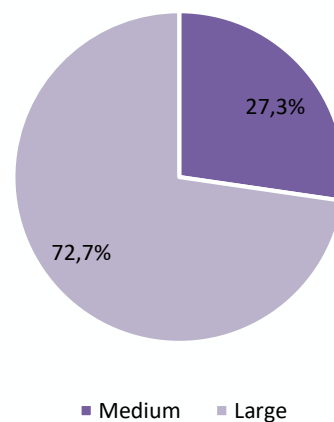


FIGURE 4. Company size of respondents

To gain the most comprehensive view of the challenges in guarantee processes, it was important to distribute the survey to companies from different industrial sectors. Below, one can observe the Industrial sectors of the companies and their distribution. As seen, several different sectors are represented. Three companies had only stated "industrial manufacturing" without any specific information.

Industrial manufacturing	3
Metal industry, lifting equipments and services	2
Mining	2
Pulp, paper and energy industries	1
Shipbuilding	1
Technical Engineering and services	1
Telecommunication	1

The amount of yearly new guarantee transactions, including both issued and received guarantees, is showed in Figure 5 below. Most of the respondents, 45,5 %, fell into the range of 101-1000 new guarantee transactions of a yearly basis. 36,4 % of the respondents have 1001-5000 new guarantee transactions and 18,2 % have between 0-100.

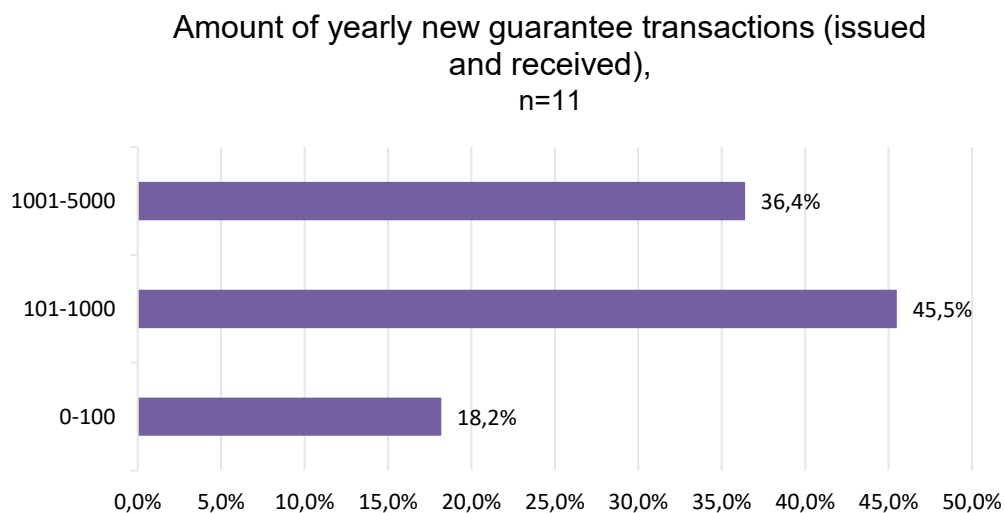


FIGURE 5. Amount of yearly new guarantee transactions

In Figure 6, shown below, one can observe the average current number of outstanding guarantees, including both issued and received. The largest number of more than 5001 outstanding guarantees totalled 9,1 % of the respondents. Most of the respondents, 45,5 %, have between 1001 and 5000 outstanding guarantees. Companies that have between 101-1000 outstanding guarantees totalled 36,4, %. Lastly, only 9,1 % of respondents had less than 100 outstanding guarantees.

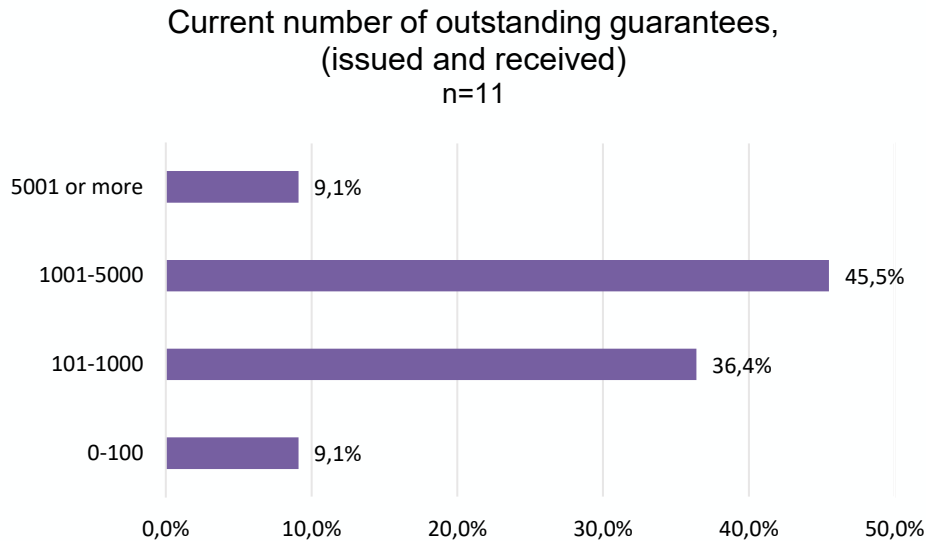


FIGURE 6. Current number of outstanding guarantees

Figure 7 below, shows the distribution between types of business the companies export. The majority, 55 %, of the companies do both projects and bulk products. Companies with solely projects totalled 27 % and the rest 18 %, consist of bulk products, such as spare parts, components and equipment.

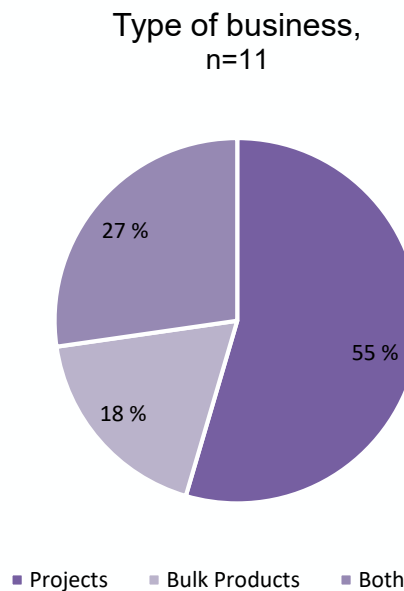


FIGURE 7. Type of business

The overall satisfaction of the guarantee processes was also questioned. In Figure 8 below, one can observe that 72,7 % of respondents were satisfied with the current processes. Only 27,3 % stated their feeling as neutral.

Overall satisfaction with current guarantee process,
n=11

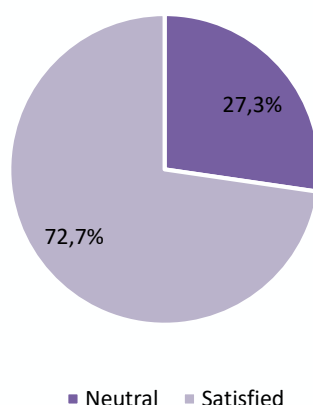


FIGURE 8. Overall satisfaction with current guarantee process

4.2 Current challenges in guarantee processes

The sample were asked to state their current challenges in the guarantee process in an open ended questions. In the table below, the themes of the responses are listed as well as times mentioned. The most frequently mentioned challenge was issues with systems.

	Times mentioned
Issues with systems	5
Paper documents	2
Lack of knowledge and guidance	2
Manual work	2
Guarantee wording requirements	2
Country-specific requirements	1

4.2.1 Issues with systems

From the respondents, 72,7 % use a multibank platform to handle guarantee administration processes. The rest, 27,3 % of respondents, who handle processes manually were all medium sized exporters. Manual work affects the efficiency of the processes largely as it requires more time from the team and the time used per guarantee increases.

As there are several service providers with different tools and systems, there is a large variety of tools used in the industry. Company B stated that it is hard to have the systems integrated into their internal reporting system, which is why they will eventually switch to another service provider. Company C stated that their issues with the integration of the current system into the company's ERP.

Company F found issues in the interconnections of subsidiaries in their system, affecting the overall efficiency of the trade finance processes of the company. Additionally, Company K does not find the systems user-friendly.

Another challenge common between companies were the issues within the system between banks and corporates. Some smaller financial institutions might not have the same systems or accesses, resulting in issues to operate with these banks. Smaller banks for example outside Europe, are a vital part of guarantee processes when issuing guarantees internationally. Often the connection with these smaller banks goes through another financial institutions, making the guarantee indirect and thus more expensive for the applicant.

Especially when having de-centralized or partially de-centralized teams across the world, as does 56,4% of respondents, the importance of an integrated system that is operable for all is emphasized. Having de-centralized operations brings some challenges itself, as the teams can be located in different time zones and speak different languages. The need to have a common understanding of processes and guidelines is emphasised. To combat these challenges, most companies have a general policy regarding the trade finance processes.

4.2.2 Documents originality and manual work

The respondents were asked how they ensure documents originality in the guarantee process. 63,6 % of respondents stated that documents' originality is mostly checked manually. Only 36,4 % have entirely electronic checking.

Those who check their documents electronically, most often through a SWIFT advise from the bank, can trust the documents' originality as it comes through a secured network. SWIFT is short for Society of Worldwide Interbank Financial

Telecommunication. It is a secure network used world widely by financial institutions as well as corporates to communicate about transactions (TransferWise, 2018).

Many challenges are compounded from manual document checking. Firstly, it is fairly old fashioned, as it is paper based. These documents are shipped via courier to the beneficiary, which causes additional costs. The documents have an authorized signature that one must trust. These original documents are circulating around, and the ownership and location of the documents is unclear.

Currently, the originality of documents relies vastly on trust between business partners. Company G stated that if the document arrives from the named guarantor, then it is trusted. Nevertheless, Company G prefers SWIFT advices instead of paper documents. Additionally, Company J trusts that a document that looks original, is original.

4.2.3 Paper documents and sustainability

As seen previously in Figure 5, most of the respondents, 45,5 %, issue and receive between 100-1001 new guarantee per year. Some companies have more than 5000 transactions a year. Guarantee related paper documents, that being the original guarantee, any amendments or cancellations commonly consist of several sheets of paper.

In this example the estimate is given with the largest group of respondents, having new transactions between 100-1001 on a yearly basis, and having an average of 2 sheets. This means that guarantee transactions require 200 - 2 000 sheets of paper yearly per company. Naturally all guarantees are different and require different amounts of paper documents, which is why these numbers are given only as an example. In addition to this, utilizing a courier service to ship the documents adds to the sustainability and cost factor for its part.

After their shipment, the documents are often archived into folders, from where they can be retrieved when amendments or cancellations are needed.

Company I stated that one of the main issues in the guarantee processes is in fact these paper documents. In case an original document is lost, the cancellation process is arduous and might generate additional fees for the company.

The respondents had an undivided opinion on the effects of electronic documents and their benefits. All of them agreed that electronic documents would minimize risks related to documents' originality as well as the efficiency of processes. The benefits of electronic documents will be discussed later in Chapter 6.

4.2.4 General policies and guarantee wordings

One of the main issues stated by the respondents was the lack of knowledge and guidance. Trade Finance processes are complex, involving several aspects of business, which is why clear guidelines and operating policies would be recommendable.

Interestingly, 66,7 % of those who stated their feeling as "Neutral" in Figure 8, were the once who had no general policy regarding the trade finance processes. Company B thought that not having a general policy has no effect on processes, whereas Company H thinks not having a general policy results in lack of consistence in the operations.

Out of all respondents, 81,8 % have a general policy on trade finance processes. According to the respondents, the policy gives guidance, clear roles and responsibilities as well as structure to the personnel handling trade finance processes. Additionally, it helps decision making and management control. Not having general policies causes challenges especially in those areas mentioned earlier. 66,7 % of medium sized exporters rely vastly on the banks' knowledge and wordings in their guarantee operations as they lack knowledge and guidance in that sector.

More than half of the respondents, 54,5 %, use mainly the company's own standard guarantee wordings. The remaining respondents, 45,5 % use either banks' standard wordings, beneficiary's requested wording or a combination agreed in negotiations.

According to Company I, many beneficiaries request their own guarantee wordings to be used, however the issues arise if the minimum requirements of a guarantee wording should be met: the maximum guarantee amount, expiry date and the reasons for the claim. Having these in the wordings minimizes the risks of fraudulent misuse of the guarantee by the parties involved.

4.2.5 Communication with financial institutions

According to the survey, 72,8 % of respondents request pricing quotations from banks, equally through platform or by email. 27,3 % of respondents do not request quotations. The respondents that do not request quotation were surprisingly all medium sized exporters.

For other communication than pricing requests, the most used tool by the respondents was email, with 63,6 % as visible in Figure 9 below. The two second most used tools were multibank platforms, with 36,4 % each. SWIFT was used by 27,3 % of respondents. In option “Something else”, with 18,2 %, respondents used other platforms such as Mitigram. Mitigram is an online platform for securely interacting with parties involved in trade finance negotiations and risk mitigation (Mitigram, 2020).

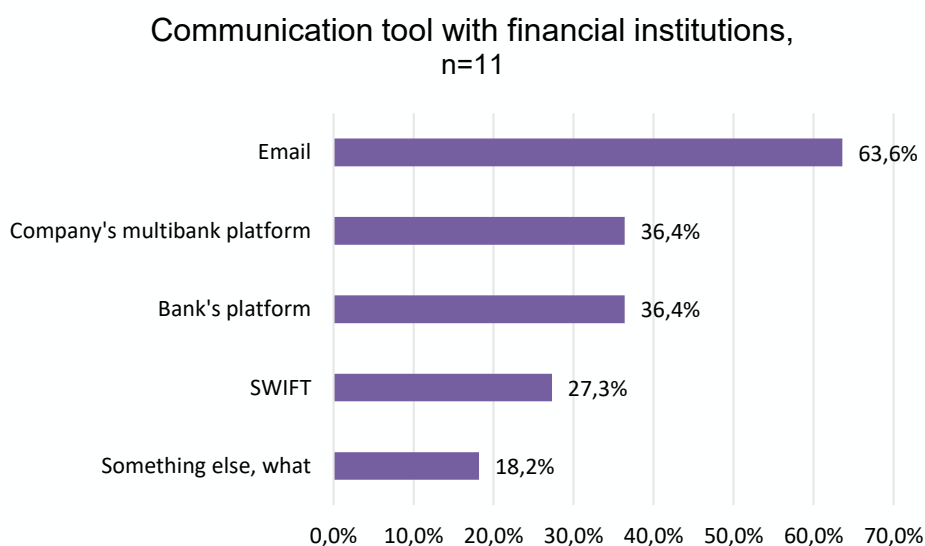


FIGURE 9. Communication tool with financial institutions

From the respondents, 27,3 % stated that the tool had not worked well for their companies needs. These included companies that used different tools including email or a multibank platform. Company J found some issues with the system being used by only a certain selection of financial institutions, resulting in having to use another tool to communicate with others.

4.2.6 Development processes

Trade finance is in an emerging state of digitalization. New systems and services are introduced on a regular basis. In Figure 10 below, one can observe the biggest issues preventing development in processes stated by the respondents.

The largest issue preventing development in this sector, with 36,4 % is the lack of resources. Only 33,4 % of medium sized exporters chose this option. It was more chosen as an issue amongst large exporters. The systems, such as multi-bank portals or other, can be costly. A company with lower volumes might not find a costly system as a necessary part of handling the guarantee processes, and therefore chooses to handle processes manually.

Developing processes also require time form both the corporation as well as the service provider, as they often work together in pilots and projects to modify the systems to meet the needs of customers.

Some respondents, 18,2 %, found that the unawareness of options stand on the way of their development. The abundance of services providers and different tools and features can be overwhelming for exporters looking to develop their processes.

18,2 % of respondents chose the option "Something else" explaining that local regulations stand on the way of the development. Lack of co-operation between parties involved in the development processes was chosen by 18,2 % of the respondents as well. In order to create the most efficient and best service possible, parties are required to co-operate. Only 9,1 % of respondents thought that no desire for change was the biggest issue preventing development in the processes.

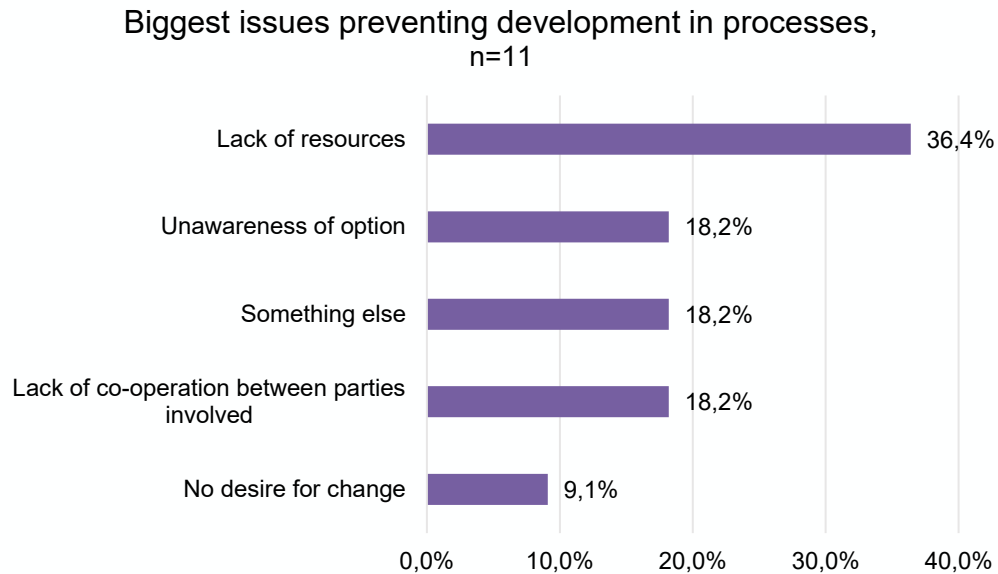


FIGURE 10. Biggest issues preventing development in processes

Respondents were also asked to select the key drivers for changing the guarantee processes. As visible in Figure 11 below, the biggest driver was process efficiency with 41 %.

Out of the respondents who chose process efficiency as one of the top drivers, 77,8 % were large companies. The remaining part 22,2% were medium companies. As mentioned in previous chapters, the efficiency of guarantee processes is found to be one of the main challenges, with need for improvements. Improvements in several parts of the processes would increase the process efficiency.

Improving process efficiency will consequently also result in cost savings. Cost savings was the one of the top drivers for change, with 23 %. Cost efficiency was chosen as one of the top drivers by 62,5 % of the large companies.

The third key driver was improving risk protection with 18 %. Improving quality totalled 9 % and the final two, data security and improving audit trail were 5 % each. These minor drivers are however important as well for any company, being important part of a company's general operations.

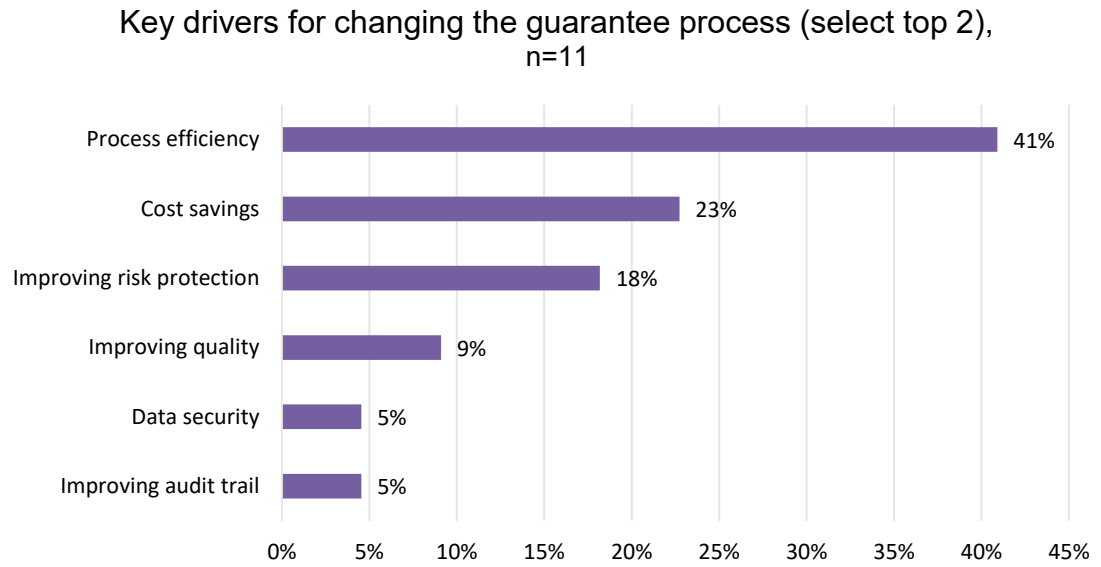


FIGURE 11. Key drivers for changing the guarantee processes

5 DISCUSSION

5.1 General observations of the research

Based on the conducted research, there are several challenges companies encounter in their trade finance guarantee processes currently. Overall, respondents are satisfied with their current processes. However, medium sized exporters felt neutral towards their current process. According to them it is caused by lack of knowledge and guidance in trade finance processes, resulting in challenges with processes. Due to this, some of the exporters rely vastly on financial institutions' knowledge.

Given the complex nature of guarantee processes, most of the respondents felt that having a general policy gives guidance and structure to the guarantee processes. The respondents without a general policy, felt that it did not have an effect or that it caused lack of consistence in operations. Those who had a general policy stated that the benefits of having one are guidance, clear roles and responsibilities as well as structure. Additionally, it helps decision making and management control.

The most significant challenge according to the respondents was issues with systems. The majority of respondents utilized a multibank platform for handling their guarantee processes. As there are several service providers in the industry currently, finding the one that works can be a challenge. Some respondents found issues in the integration of the systems to their other systems used internally.

The interconnection of systems between subsidiaries was another challenge respondents had. In addition, having de-centralized teams, in different geographical locations and time zones, increases the importance of having a system that can smoothly connect and work.

Another challenge respondents had with these systems was the connection between banks and corporates. Not all financial institutions have the access to the systems corporates use or have access to different systems. This results in issue

to conduct business with some banks, especially whilst doing business internationally. In addition, the issues with the systems affect the communication between financial institutions and corporates.

Respondents found challenges in original documents' checking as well. Most of them check the originality manually, commonly having an authorized signature and approval. Currently, the checking relies vastly on trust between business partners. Some respondents prefer receiving guarantee related documents through SWIFT advice, as a secure network provides confirmation of the originality.

That brought up the challenges related to paper documents. Guarantee processes involve a large amount of paper documents, that affect the process efficiency, sustainability and risk mitigation. Handling and archiving these documents take up resources that could be utilized for other tasks. One big risk that was brought up by a respondent was the issues if and when a paper original document is lost.

All respondents agreed on the need and benefits of electronic documents in guarantee processes. The benefits of having electronic documents were clearly minimizing risks and improving process efficiency.

Conveniently, whilst conducting the research, the COVID-19 pandemic outbreak took place in Finland. Companies switched to remote work and social distancing, meaning that all work was to be done digitally, naturally meaning guarantee processes as well. This pandemic pushes companies to digitize their processes, not only in trade finance, but many operations that were not digital before.

According to the research results, there are several factors preventing development in the guarantee processes of corporations. The main factor is the lack of resources. Systems are costly and might not be seen as necessary for a corporation with lower volumes. Another factor was the unawareness of option. New systems and tools are launched regularly and finding the suitable option for one's needs can require many resources.

The top two key driver for changing the processes were process efficiency and cost savings. To improve process efficiency, many changes would have to be made in the end-to-end process. The improvements would in the long run then benefit the companies in form of, for instance, cost savings and quality.

5.2 Limitations of the research

It can be argued that the research did not reach an expected response rate. Having a fairly large sample, it would have been ideal to have at least half of the sample respond to the survey. The larger the response rate, the more comprehensive the analysis would have been, as it was industry-wide. However, all three email messages were sent out successfully to the sample, whose contact information were known.

Nevertheless, the research was conducted successfully with the responses collected. The researcher did benefit of conducting the preliminary interviews with the trade finance specialists as it was convenient to communicate with them and they confirmed responding to the research.

Finally, one factor limiting the research was timing. The research was conducted in March 2020, and during the exact week of the pandemic outbreak. One could speculate, that responding to a survey was not a top priority at that time for specialists, as companies were going through various changes in their processes and work environment. This could have affected the response rate of the survey.

6 SOLUTIONS

There are several aspect of trade finance that could be developed to optimize the processes. According to the research, the top two key drivers for changing the processes were process efficiency and cost savings. The two can be increased by developing the end-to-end processes.

6.1 Increased knowledge and guidance

One of the prevailing challenges in the trade finance industry is the lack of knowledge and guidance. Although financial institutions and corporates co-operate tightly, the industry could benefit from an increase knowledge in all aspects.

To start with, trade finance would benefit largely of increase education of the subject in universities. Currently, only few courses are thought on the topic, or have courses that briefly include it, most often resulting in unawareness and lack of interest of the industry amongst students and new graduates. With this corporates could inspire more young professionals into the world of trade finance.

Increasing the knowledge of the topic, could result in corporations being able to recruit graduates, with knowledge of the industry and operations, for practical training and possible a full-time position. The obtain this, corporates and universities should work in close co-operation, shaping the course content, offering professional experience and other resources.

In addition, increasing the knowledge and guidance of employees and businesses of trade finance could benefit the corporates at large. Due to the complex nature of the trade finance industry and processes, gaining a wholesome understanding the industry and the processes takes years, according to the specialists interviewed before the research. This could be supported by the employer by investing in the education and qualification of the team members, increasing and supporting the knowledge gained in practice.

For qualification certificates and online learning:

- The International Chamber of Commerce (ICC) provides global rules and guidelines for trade finance, such as the Uniform Rules for Demand Guarantees (URDG), as well as its own academy with online learning for qualification. There are currently seven courses on global trade finance essentials. (ICC, 2020.)
- The London Institute of Banking and Finance (LIBF) provides professional qualifications on different areas on finance. The LIBF offers currently seven different certificates specializing on various areas of trade finance in addition to several other qualifications in various areas of finance. Some of their courses are designed in partnership with the ICC. (LIBF, 2019.)

Moreover, corporates would benefit from increasing the overall knowledge of trade finance processes in the company, especially department involved in the processes, such as sales and logistics.

A solution to increase the knowledge internally could be solved by having a general policy on trade finance processes, accessible for all employees through the intranet. A general policy is not an educational material but would help support the understanding of processes of a company.

Financial institutions also support exporters with knowledge and guidance in trade finance issues. Additionally, several other communities offer articles, videos and other materials to support the learning and increased knowledge of the trade finance industry.

6.2 Standardization

Although the International Chamber of Commerce is providing rules and guidelines on trade finance, there are still many challenges faced within the industry. Reducing the complexity of trade finance through standardization would benefit the industry at large.

With having standardized documents, instruments and processes, it would benefit in the overall process efficiency while reducing time used per guarantee end-to-end process. Additionally, one benefit of standardization would be to minimize the risk related to interpretation by human.

Standardizing the trade documents in content is needed before any electronic form of trade document can be adopted. Simple as it may sound, there are issues that lay in the process as financial institutions and corporates seem to have different views. Therefore, it is all the more important for parties to collaborate and advance the development of the industry.

6.2.1 Standardised Trust

One main actor in the industry is Standardised Trust (ST). It is an independent and global community, with a goal to digitalize global trade through active cooperation. It consists of more than 300 members representing various corporates, financial institutions and fintechs. The community has working groups, that focus on specific topics of the trade finance industry and its development. (Standardised Trust, 2020.)

According to Harri Rantanen, Business Developer at SEB and founding member of ST, the goal for the community is to improve the status quo by creating a common semantic model for Trade Finance. This model could then be used by solutions, while being affordable and tangible for the trade community, increasing participation of smaller actors and strengthening trust. (Patel, 2019.)

Standardization requires collaboration between all parties involved. Export companies and their specialists can join the community and even working groups and contribute to the digital development and standardization of the industry. Being part of the active community would also increase one's knowledge of current trade finance matters.

6.3 Electronic documents

Trade finance industry has been slow digitalize its processes. The research showed that there is a coherent opinion on the effect of electronic documents to improve process efficiency and cost efficiency in the long-run.

Many parts of the processes are handled with digital solutions such as multibank platforms, that enable the communication with financial institutions as well as the administration of the guarantees. Nevertheless, there are still many steps in the process that are handled manually in an old-fashioned paper-based way, being very inconvenient. Especially when handling business internationally, not all parties may accept electronic documents due to different reasons. Therefore, one cannot expect all paper documents to be replaced by electronic substitutes directly.

Certainly, the pandemic outbreak of 2020 indicates the pain points of each organizations processes as well of the trade finance industry as a whole. It pushes companies to work remotely, relying on digital tools and solutions, which might not have been utilized before. Export companies and financial institutions have had to adapt to the situation in a matter of weeks, to ensure the continuity of business. (White, 2020)

6.3.1 Positive impact on sustainability

A major concern in the business world is sustainability and climate change. Many businesses try to reduce their impact on the environment with different solutions to reduce their carbon footprint.

Switching to electronic documents in trade finance processes would also have a positive impact on companies' sustainability, as unnecessary paper consumption is minimized. Minimizing the use of paper documents, would in its part reduce the need for courier services and reduce the overall emissions caused by the end-to-end process.

6.3.2 Authenticity of documents

From a risk management point of view, there are still steps that need to be taken whilst processing digital documents. As an internal control tool, the 4 Eyes Principle should still be implemented to all documents. Additionally, in order to authenticate original documents, authentication measure must be taken.

One way of authenticating a documents is with digital signatures. Instead of having to process physical papers, the same paperwork could be handled digitally, adding an electronic signature to the original document. They are widely recognised in advanced jurisdictions (Edwards, 2020).

Companies often have tools enabling this, such as Adobe Acrobat. The pdf documents could then be shared with trade parties as wanted, eliminating the need for paper copies. This, however, still relies vastly on trust between trading parties.

However, this solution does not solve the challenges with the ownerships of documents. The original documents and the copies could be marked with water stamps, stating the originality. For extra protection, a password can be created to protect the document. Regardless, the documents can still be shared freely between trade parties.

Additionally, the research indicated that one of the key drivers for changing the current processes was data security. Having a password to a document could also protect it from misuse. One main concern with electronic documents is data protection. The World Economic Forum (2020, 61) stated in their annual Global Risk Report 2020, that one of the main threats of trade is in fact cyberattacks. This is caused by the lack of technology governance in general.

6.4 Innovation in trade finance

Digitalisation as a solutions to many of the challenges faced currently throughout the processes. The main challenge currently is the issues with systems. There are several to choose from, offering different services and tools for the exporters.

These systems are not used by all financial institutions, resulting in having to then switch to another tool for other parts of the process. As a result, exporters wish the interoperability of systems between all parties involved would be developed. The process could be streamlined, and all parties would have the same status with the guarantee.

The hot-topic currently is blockchain technology. Blockchain is a decentralized and distributed ledger technology, that enables the recording of the origin of a digital asset, in this case particularly: guarantee documents. (Built In, 2019.)

Inevitably, the benefits of blockchain for trade finance processes are glorious. Its ability to increase process efficiency, while reducing paper consumption and saving money are solutions to the current challenges in the industry. In addition, blockchain technology enables increased transparency, security and trust. (TradeIX, 2019.)

6.4.1 EnigioTime

One possible solution for ensuring documents' originality could be EnigioTime, with a blockchain innovation that replaces paper documents. Their invention enables creation and handling digital original documents. (EnigioTime, 2020.)

According to their website (2020), the documents would be secured by a pair of cryptographic keys, one public and a private one. The private key enables modifications to the documents as well as states the ownership. Their solution would combat several challenges states by the research sample, such as the documents' originality and ownership, would decrease paper and manual work, resulting in increased process efficiency.

6.4.2 Marco Polo

Another blockchain solution is Marco Polo. It is a project involving numerous financial institutions together with TradeIX and R3. It is the largest and fastest growing finance network in the world for trade and working capital finance. (TradeIX, 2019.)

The benefits of the network are to enable communication between parties, end-to-end automation all while being secured and accessible through permission. In addition, the network would reduce issues with compliance and audit visibility. (Marco Polo, 2019.)

Marco Polo offers several way for corporates to access the system. According to their website, it can be embedded into the corporate's current ERP, resulting in having only one interface. In addition, it can be provided as a separate system, with managed access. For exporters with less volume, Marco Polo offers a simpler lightweight solution. The solutions seem to respond to the needs and challenges currently faced in the industry. (Marco Polo, 2019.)

7 CONCLUSIONS

Although the overall satisfaction towards the guarantee processes is good amongst exporters in Finland, the medium-to-large sized exporters in the trade finance industry are currently facing some challenges. The main challenges are the issues with systems, that are detached and not operable for all.

Process efficiency and cost saving were the top drivers for developing current processes. It is ever more important for companies to optimize and digitize their processes to enable lasting, sustainable, efficient and profitable business.

Innovations utilizing blockchain technology seem to provide possible solutions to the current challenges, increasing overall process efficiency, as well as being entirely digital.

The industry is largely still paper-reliant, with numerous documents and manual work needed. Corporates feel coherently that paper documents should be substituted for electronic documents, increasing the corporation's sustainability as well as efficiency.

Innovation, together with standardization, will better the processes for all parties involved. Therefore, collaboration between parties has to be emphasized. Additionally, companies should collaborate with fintechs, in form of pilots, to together improve and develop the tools.

There are already solutions to the current challenges, utilizing blockchain technology. However, digitalization requires time as well as resources from all parties involved in trade finance. Before full digitization, the pain points of current processes need to be identified and developed.

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APPENDICES

Appendix 1. The Survey

Challenges in Trade Finance guarantee processes

This survey is part of my final thesis project at Tampere University of Applied Sciences. It has for purpose to study the current challenges in the trade finance industry. The main focus is on guarantee processes.

Only one answer per company is needed.

All responses will be handled anonymously. Thank you very much in advance!

Company size?*

Small

Medium

Large

Industrial sector?*

Type of business?*

- Bulk products
- Projects
- Something else, what

Type of guarantees?*

- Guarantees issued
- Guarantees received

Amount of yearly new guarantee transaction (both issued and received)?*

- 0-100
- 101-1000
- 1001-5000
- 5001 or more

Number of outstanding guarantees (current average, both issued and received)?*

- 0-100
- 101-1000
- 1001-5000
- 5001 or more

Are your trade finance activities*

- Centralized
- De-centralized
- Something else, what?

In your company, who handles guarantee issuance processes?*

- Sales Team
- Corporate Finance Local
- Treasury
- Other, who?

How satisfied are you with your current guarantee process overall?*



How are guarantee administration processes handled?*

- Manually
- Multibank platform/Treasury Platform

Does your company have a general policy regarding trade finance processes?*

- Yes
- No

Do you think it has an effect on your processes?*

- No
- Yes, what

Have you established bank guarantee limits with your partner banks?*

- Yes, global facilities
- Yes, local facilities
- No
- Not applicable

If yes, what are the benefits?

- Documentation harmonization
- Pricing benefit
- Efficiency in guarantee processing
- Something else, what

Do you request guarantee pricing quotations from banks?*

- Yes, through platform
- Yes, by email
- No
- Not applicable

How does your company ensure guarantee documents' originality?*

Do you think electronic documents would minimize risks related to documents' originality?*

Yes

No

If no, please explain why?

Do you think electronic documents would help with efficiency of processes?*

Yes

No

Does your company use mainly its own standard guarantee wordings?*

Yes

No

Not applicable

If no, what are the wordings used and has it caused issues with guarantors or beneficiaries/applicants?

Which communication tool do you use when communicating with banks?*

- SWIFT
- Bank's platform
- Company's multibank platform
- Email
- Something else, what

Do you think it has worked well for your company's needs?*

- Yes
- No, why

What are the biggest issues in your current guarantee process?*

What are the biggest issues preventing development in the guarantee processes?*

- Lack of resources
- Lack of co-operation between parties involved
- Unawareness of option
- Too many options
- No desire for change
- Something else, what

What are the key drivers for changing the guarantee processes (select top 2)?*

- Data security
- Cost savings
- Process efficiency
- Improving risk protection
- Improving quality
- Improving audit trail
- Something else, what

How do you think guarantee processes could be developed?

Thank you for taking the time to respond to this survey!

Kindly leave your contact information below. Company name and email sufficient.

This is a kind reminder that all information will only used for research purposes and data will be deleted after completion of research.

Contact information:
