Keynote Paper:
Revisit Quality Trade Finance

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ABSTRACT
Some 80% to 90% of world trade relies on trade finance (Trade credit and Insurance/guarantee) which is at the low risk, high collateral of credit spectrum. Recent worldwide trade finance shift of strategy from market share to increase focus on the specific clients, products and geographic regions that present the best profit potential. In terms of processing, trade finance is perhaps the most paper based and manual area in additional to complying to Custom Practices such as UCP500 of the financial services industry since it is sheer lack of automation. Fintech will drive efficiencies for trade finance processing including to apply Optical Character Recognition (OCR) and Machine Learning, Blockchain or Distributed Ledger Technology (DLT) for digitizing trade finance which has been attracted attention of many countries including Greater China, Australia. Western Australian SME trade finance case and experience will be discussed.

Keywords: Trade Finance, Fintech, efficiency, Blockchain, SME.

1. Introduction

International trade is important to enhance the world, countries, regional economy activities and job creation. Some 80% to 90% of the world trade relies on trade finance since it is at the low risk, convenience but high collateral of credit spectrum. There are still unresolved ways not just by technologies to expedite processing for issuing documents of Trade Finance since the process perhaps the most paper based and manual works in additional to complying to Custom Practices (UCP) by International Chambers of Commerce based in London and strict deadline to issue trade finance certificates for importers and/or exporters. This paper is to revisit trade finance processing to date so as summarizing processing application including credit analysis and approval. SMEs are always more difficult to access trade finance however it does provide lots of jobs which will be discussed. Driving Efficiencies of processing trade finance has been a major hurdle for exporter/importer to settle business deals which will be future discussed by using platforms and technologies Fintech such as Blockchain and/or distributed ledger technology (DLT) even Optical Character Recognition (OCR) and Machine Learning and Artificial Intelligence leading to benefits of digitizing trade finance. With regards to strategic shift of trade finance business in Asia by interviews Asian Global banks, many Asian bank re-evaluated their resource commitment to trade finance where some banks pull back from region altogether, most banks focus on client relationships they believe they have sustainable earning potential. The last part is sharing experience from a WA case by survey and analysis. This survey is to find out which are the trade financing instruments commonly used by enterprises within trade products and services provided by banks in the SW-WA.

2. Nature of Trade Finance

Trade financing (also known as supply chain and export finance) is an important huge driver of economic development and helps maintain the flow of credit in supply chains. It is predicted that 80-90% of global trade is reliant on trade and supply chain finance and is estimated to be worth around USD $10 trillion a year. As a result of the global economic crisis in 2008, export markets reduced in size by around 40-50%, SMEs being the hardest hit. As a result, lending decreased as investor's appetite for risk decreased, and banks had to reduce the sizes of their loan books. Financing of trade in a company life cycle, whether you're sending goods, services or commodities, a variety of financial instruments are used to structure this, under the umbrella term 'trade finance'. Trade finance includes Letters of Credit (LCs), export finance and credit agencies, receivables and invoice finance, Forfaiting, insurance (during delivery and shipping, also covers currency risk and exposure) as well as bank guarantees.

Providers of trade finance are Banks (Retail and commercial) and alternative Finance and Non-bank Funder: Some commercial banks have specialized trade finance divisions, which offer facilities to businesses. Commercial banks represent the majority share of financial institutions globally, although they range in size from small and niche banks to large multinational banks. The banking services offered by trade finance commercial banks include issuing letters of credit, accepting drafts and negotiating notes, bills of exchange and documentary collections. The advantage of larger commercial banks over smaller niche banks is twofold: their global presence (they may have foreign subsidiaries which makes L/C confirmation cost effective), and their credibility. Alternative Finance and Non-Bank Funders may not use public deposits as a funding resource. Funding sources include crowd-funded (pooled) investment, private investment and public market sourced capital. Traditional 'receivables-backed finance' has been disrupted by smaller finance platforms since the economic crisis. This has been driven by a decrease in appetite for risk by larger banks, which has opened the doors to agile smaller finance lenders, who can fill the gap. Private investment funds and larger banks provide capital to alternative trade financiers. Crowd-lending (peer to peer) finance has also entered the trade finance sector.

3. Processing for Applying for Trade Finance

3.1 Application

The initial 'credit' application drives the process when applying for credit. A trade finance application will require provision of the following: (i)Thorough introduction to the business, including a future vision (business plan), goals of the business and any significant accomplishments to date.(ii)Information on the key stakeholders/ directors including past experience and equity make-up of the company.(iii)Introduction and an analysis of the product or service offered. (iv)Overview of the sector/ competitor landscape. (v)Summary of anticipated results, including financial forecasts. Lenders will often ask for information on current assets or collateral that the business owns, including debt and overdrafts, assets that the company or directors own (property, equipment, invoices).

3.2 Evaluating the Application

The lender will undertake a full credit risk assessment of the documents that have been received. The credit analysis will usually involve inputting figures from the applicant's income statement, balance sheet and cash flow documents. It will also take into consideration the collateral the SME can provide, and the quality of this. The evaluation process will normally involve some kind of credit scoring process, taking into account any vulnerabilities such as the market the business is entering, probability of default and even the integrity and quality of management.

3.3 Negotiation

Eligible SMEs applying for trade finance can negotiate terms with lenders. An SME's aim with a lender is to secure finance on the most favourable terms and price. Some of the terms that can be negotiated can include fees and fixed charges, as well as interest rates. If you're prepared and understand the structure of fees and charges, it can help you negotiate terms that are in your favor. Sometimes it may be a good idea to seek advice from your local trade body to avoid any risks, understand the charges and the structure of the loan and insurance.

4. The Approval Process and Documentation of a Loan: Typically, the account officer who initially deals with the applicant and collects all of the documentation will do an initial credit and risk analysis. This then goes to a specific committee or the next level of credit authority for approval. If the loan is agreed (on a preliminary basis) it goes to the legal team to ensure that collateral can be secured/ protected and to mitigate any risks in the case of default. The loan document is a legally signed contract from both parties that consists of definitions, a full description of the finance facility that has been agreed (amount, duration, interest rates, currency and payment terms – both interest and non-interest charges). The conditions of a loan will also be included, which will state any obligations of the buyer and the lender, as well as what would happen in the case of any disputes or a default.

4. Driving Efficiencies by Technology

From the banks perspective, as the regulation burden (i.e., Basel III) has become heavier, SMEs often don't fulfil certain criteria for banks to justify lending to. As lending money has an associated transaction cost, it is more costly to assess and monitor loans to a smaller, riskier company where profit is less certain, relative to a larger, more profitable and stable business.Banks will often ask for the following from any company when filling out an application for any type of business finance:(i)Audited financial statements,(ii) Full business plans, (iii) Financial forecasts, (iv) Credit reports,(v) Details and references of the directors,(vi)Information on assets and liabilities. As well as the cost of lending to SMEs being less profitable for banks, there is a much higher default risk and chance of bankruptcies with SMEs in comparison to larger firms. The other challenge banks have in lending to SMEs is the lack of security and collateral an SME can provide. SMEs also face challenges in accessing finance from banks. In a recent survey by the British Business Bank, 46 percent of SMEs were looking to grow in the next 6 months, yet awareness of types of finance available and finding sources of finance (especially after being rejected from a bank) are major concerns amongst SMEs. The perceived high cost of borrowing, lengthy procedures for securing a loan and also the amount of paperwork and documentation required is often off-putting and cumbersome to SMEs.

Trade finance is perhaps the most paper-based and manual area of the financial services industry. "In terms of sheer lack of automation, trade finance can actually be considered an outlier," (OECD) estimates that 15% of the overall value of traded goods around the world is comprised of hidden costs, much of it a result of the manual processes underlying most transactions. This translates into losses of $100 billion per year. Actual costs could be much higher, because these OECD numbers do not take into account the impact of the opacity inherent in these manual systems. With transaction histories stored on paper, it is difficult for banks to access information needed to assess companies' risk and credit histories, making bank capital more expensive and less available to companies looking to finance transactions. The lack of automation in trade finance is due primarily to the business involving companies of varying sizes and a wide array of entities—including not only banks, but also carriers, freight forwarders, ports, authorities, and other players. These participants differ widely in terms of available resources/budgets and levels of sophistication with regard to technology. As a result, harmonizing all parties onto a single technology platform has proved difficult. Banks achieve the promise of an effective cost-saving measure through automation which is a combined outcome of various Machine Learning Technology and OCR (Optical Character Recognition) Technology. OCR Technology is used to convert virtually any kind of images containing written text (Typed, handwritten, or printed) into machine-readable text data. OCR implemented with Machine Learning, a subfield of computer science that evolved from study of pattern recognition and computational learning theory in artificial intelligence.

5. Using Platforms and New Technologies

In the U.S. and Europe, where roughly half of trade finance business is executed electronically on bank platforms, relatively few companies say they are using in-house or vendor-provided platforms that could link the various parts of the trade finance value chain. Only 29% of European trade finance customers use a proprietary or third-party platform to manage transactions. In the U.S. and Asia, the share is roughly half that amount. Change is certainly anticipated in the form of new technologies—including, and perhaps most importantly, blockchain or distributed ledger technology (DLT). But despite a stream of exciting headlines about blockchain advances and ventures around the world, the industry still hasn't figured out exactly how DLT will function as a common process (versus separate pools of banks) in trade finance, and significant challenges remain ahead for developers. However, the financial services and tech sectors are committing vast resources to apply DLT to corporate finance. Given the fact that the transactional nature of trade finance makes it perhaps the best and easiest fit for this technology, it seems inevitable that the blockchain will have a material impact on the business eventually. In all likelihood, that impact will take the form of some type of "smart contracts" that digitize the letter of credit process. Going forward, using DLT to capture transaction-level details on shipment, payment and financial information could allow for much faster and easier matching. A blockchain-enhanced exchange of trade data and auditability of a participant's credit history would help increase speed, efficiency, and security in financing between buyers, sellers, and their banks. Finally, expanded access to transaction/business history within the digital chain would provide greater transparency to banks with regard to small and medium-sized enterprises (SMEs), enlarging input into bank credit risk models and potentially lowering credit costs/expanding availability.

5.1 Key benefits of digitizing trade finance

(i) Reduction in operating costs.
(ii) Records of processing, storage of data securely, and non-paper records might be more accurate and reliable.
(iii) Overall speed of transaction is reduced.
(iv) Lower overall costs for issuing a trade finance related loan.
(v) Solid KYC / AML checks which are digitized and more instant.

In addition to these, new technologies to disrupt the somewhat lengthy application process for certain types of trade finance make it easier to assess risk, supply credit and documentation to importers and exporters.

5.2 Strategic Shift of Trade Finance Business in Asian Banks

Based on 578 interviews with corporates with annual revenues of $500 million or more, across China, Hong Kong, India, Indonesia, Malaysia, the Philippines, Singapore, South Korea, Taiwan, Thailand, and Vietnam (Greenwich Associates/Consultants). Trade finance interview topics included product demand, quality of coverage and capabilities in specific product areas.

In Asia, the strategic shift on the part of global banks has been twofold. At the most basic level, many banks re-evaluated their resource commitment to the Asian trade finance business as part of their broad strategic response to crisis-era reserve requirements and balance sheet pressures. While some banks pulled back from the region altogether, most banks changed strategy by growing more selective in which client relationships they saw the most sustainable earnings potential. That shift in focus gives rise to the second major element of their strategic shift: Global banks are concentrating their resources on the higher-value aspects of the trade finance cycle. In particular, they are focusing on cash flow management and supply-chain financing, businesses with profit margins much higher than those associated with letters of credit and other more traditional trade finance products.
Japanese banks and other local Asian banks have found a wide-open playing field for trade finance 'flow' products (Gaurav Arora, 2017). They have just become more selective in the plain vanilla aspects of the business, as they shift the attention to working capital advisory solutions and complex supply chain needs. The list of 2017 Greenwich Share and Quality Leaders reflects this fast evolution of the marketplace. In terms of market penetration across Asia, the top four spots are held by global banks: HSBC at 38%, Standard Chartered at 33% and BNP Paribas and Citi, which are statistically tied for third with 28% and 26% respectively. But at 23%, DBS Bank ranks fifth and is closing in on the global leaders. DBS Bank is the top trade finance provider in its home market of Singapore, as are Bank of China in China, State Bank of India in India, and KEB Hana Bank in South Korea.

In terms of quality, local providers have not yet caught the global leaders. The 2017 Greenwich Quality Leader in Asian Large Corporate Trade Finance is BNP Paribas. The accompanying table presents the complete list of Greenwich Share and Quality Leaders in each of the major country markets of Asia.

5.3 Trade Finance: A South West - Western Australian (SW-WA) Case

Background, location, industries, trade finance applied, case analysis are concluded in the following paragraphs: **South West Region's production:** South West Region of Western Australia is situated in the South West Corner of WA covers the area of 23,998 square kilometers with the population of 132,026 (2016). The region has the most diverse regional economy of Western Australia. There are about 2,500 SMEs involving in most production of most industries to less extent mineral resources industries. The major production for international exports and some imports are listed in the following, most productions were growing for the past few years and continue to grow in the future: *Mineral Resources, Agriculture, Fishing and Acqua-culture* (South West Development Commission, 2016).

Most small businesses tend not to export directly to overseas markets but they choose to sell their products to largest exporters who export directly to overseas.

5.4 International Trade Financing Solutions

Those instruments or methods of payments are arranged from the most risk for importers but the least risk for exporters to the most risk for exporters but the least risk to importers in the following: prepayment, documentary credit or letter of credit (LC) (usually irrevocable, confirmed or unconfirmed, and issuance of sight or term), documentary collection (sight, D/P or term, D/A) and open account (with credit or without credit term). LC almost provides a definite commitment of payment to the beneficiary with the complying all terms and conditions and governing under Uniform Customs and Practice for Documentary Credits (UCP) 500. LC may be replaced once good relationships have been established between importers and exporters since LCs incur higher cost and slower. Additional clauses can be added to LCs in order to suit needs of marketplaces which are irrevocable/revocable, sight or term, confirmed, back to back, standby, transferable, red clause and revolving (Chase bank 1982/3). Global trade financing require to be adjust according to evolution of global trade such as linkage to supply chain, creation of virtual trading partners and growth of contract manufacture relationships in many situations which are relevant to application of technologies.

Empirical Study Objectives and Methodology: The objectives of this study are to reveal common types of methods for international trade settlement adopted by exporters and importers, trade financing services provided by local bankers and its practices in the South West, Western Australia region. The methodology is by interviewing ten bankers from four major banks and Bank West which are the population of banks providing comprehensive trade finance services in the region. Bendigo community bank based at Donnybrooks has no direct exporters since it's clients are all small business. A relationships manager based at Bunbury and a trade finance manager with bills processing background based at Perth from each of sampling banks were interviewed by using structured questionnaires with some unstructured/exploratory questions. Applying inference statistical techniques to analyze small sampling size may not be proved worthwhile. Descriptive statistical techniques and qualitative method were therefore being used.

6. Findings of the Survey

6.1 International Trade Settlement Methods

6.1.1 Exports:

For larger firms usually in industries such mineral and wool, many transactions were by open account with credit since they dealt with larger overseas buyers with established relationships and trust. However, they also used LC to settle the trade because of large amount, smaller firm buyers with unknown credit worthiness or country risk such as China and Indonesia. They are also having some shifting to documentary collection after a few deals compromising with their overseas buyers. Some large firms or cooperatives such as BHP and Wheat Board require LC, but Woodside asks for open account after a few deals. Industries such as mineral exporting handled by larger firms have a smaller number of transactions per week say one or twice transactions but each transaction has larger value say AUD 4 to 5 million under possible lower risk categories since buyers are always established larger buyer leading to use opened accounts.

For smaller firms, they prefer to use LC whereas after some trust being established collection is a method to use since it could save cost for transactions. Practicing settlements in India, China, Indonesia exporting non-manufacturing goods: food stuff, wine and wool tend to use LC unless strong links have been established. However, popular methods for trading with Japan are either collections or open accounts. Furthermore, in many situations, which are the methods to use are also decided by matching with competitors' methods of payments such as iron ore industry moves away from LC. Industries such as food stuff exporting handled by smaller firms have higher volume or more number of transactions per week say fifteen to twenty and a value of each transaction was usually smaller. Collections may be the way to save costs. Most small businesses in South West do not export directly because they do not have the volume. They sell their products to cooperatives or larger buyers exporting directly.

6.1.2 Import:

For larger firms, the settlement method is mostly by open accounts, however, some firms did these transactions by themselves, sample banks had therefore no records. For small firms, most trading through

LC or collections by D/P or D/A. Generally, importing goods were television and electrical & electronics appliances, furniture, toys and papers from Asian countries preferring to use collections because of lower costs and open account with credit after trust has been built. LC is still one of common methods of payments.

6.1.3 Standby LC and Banker Guarantee (BG):

Importers and exporters expect to be protected by their country legal systems both prefer to use BG under their country own laws. At once stage, it was due to BG attracting stamp duty, most guarantees were therefore in the form of standby LC. Although BGs do not attract stamp duty now, standby LC is still the most common one since it is structured under UCP 500 for protecting importers and exporters of international trades at any location. Currently, BG applies for internal trading transactions.

6.2 Common Problems Exporters facing related to Trade Finance

For exporters, small firms have more problems than larger firms. Problems include cash flow to finance production of goods, recent high Australian Dollars affected sales, discrepancies on LC documents, not adequate experience and knowledge in trade finance. For importers, similar smaller firms have more problems which include lack of banking facilities for trade finance involving securities provided to banks, insufficient knowledge and/or experience to deal with trade financing such as available finance from banks, EFIC and Atradius.

6.3 Trade Solutions Functions in Banks

6.3.1 Strength of trade finance functions

All sample banks have about 5 to 7 staffers for their trade bills processing functions and 1 to 3 trade finance managers. The strength is much smaller than their head office in Sydney and Melbourne except the Perth based bank.

6.3.2 Trade finance specialist based

All specialist trade finance managers within trade services or solutions functions from all (five) sample banks are based in their Perth regional head offices or head office for a bank. These trade finance managers provide specialist supports to their regional relationships' managers and market their trade finance services. They apparently work together with regional managers to cater for full international trade services to their regional clients.

6.3.3 Centralized bills processing

All the major banks have centralized all or majority of import bills to their Sydney or Melbourne offices for processing in order to achieve economies of scales, however, Perth offices only or mainly process export bills except the Perth based bank had processed all import and export bills at Perth which in fact creates some extra import bills business for the Perth based bank. Few foreign bank branches did process import bills at Perth. All head office of sample major banks in Melbourne or Sydney had three shifts trade bills functions operating for 22 hours and plan to have 24 hours.

6.3.4 A leader of trade finance

One of the major banks considered itself was the leader of trade finance in general although the Perth's based bank can be ranked the leader of import bills in Western Australia. No bank can certain whether they are a leader of trade finance services in specific industries, however, difference banks seems to specialize in specific industries.

6.3.5 Trade finance products and services

All sample banks provide comprehensive range of trade products and services including documentary credits (import and export) with additional conditions such as confirmation, back to back and transferable, documentary collections (import and export) as well as direct collection to be handled by clients directly. Open account administration, short term trade finance up to 180 days and longer term finance for more than 180 days. Foreign currency overdraft and accounts, telegraphic transfer (outward and inward) and draft, forward exchange contracts and so on.

6.3.6 Outsource trade finance services

All the major banks do not outsource their trade finance functions, but they have tried to in-source their services to other banks. A major bank forms a company providing its trade finance expertise to small banks in Asia. The Perth's based bank ever outsource but it has failed to deliver efficient production.

6.3.7 Trade finance training provided by banks

All sample banks do provide some training programs and seminars to their clients and public although some are active than others.

6.3.8 Trade finance information in bank's websites

All banks have comprehensive information on trade finance in their banks' websites. Two major banks even publish guide books for international trade on line as well as in hard copy forms for their clients and public.

6.4 Risk Management

6.4.1 *Awareness of risk.* Many smaller firms involving in international trade do not aware of trade risks such as credit risk, transfer risk, foreign exchange risk, transport risk and so on. In the South West, there are still exporters using open accounts for trade until a deal incurs loss to those firms.

6.4.2 *Managing risk.* Many smaller firms have little or no knowledge about the trade risk as well as trade finance products including trade insurance products provided by Atradius and EFIC. All sample banks do have their trade clients assessed by their credit analysts or relationships managers with opinions providing by trade finance managers.

6.5 Relationships Management

All sample banks do have their relationships managers stationed at individual business centers at populated towns in the South West. They also use Bunbury or Perth as a regional support center. Again, trade finance expertise always provided by Perth bank trade services units.

7. Conclusion for the SW-WA Case

Precise Statistics of export/import types and quantities of goods from/to the South West were not available. Estimated export data are therefore by studying statistics of produces and manufacturing goods provided by the South West Development Commission data base. Many SMEs did not export or import directly but depending on larger exporters and importers to serve for their needs. It is not realistic to generalize a single type of trade finance instruments used by the exporters and importers to suit all situations in the South West based on the survey. LC remain as the most reliable international trade finance instrument to protect exporters and importers from trade loss. Exporters/importers can pick one or more than one settlement instruments from a risk spectrum of instruments: LC to open accounts depending on counter parties they are dealing regarding risk, time and cost. Risk should always be the priority for consideration and decision. Once importers and exporters have established trust and good relationships, they tend to move away from LC which is more costly and slower. Open account or pre-payment is too risky, but they are cheapest and quicker. Therefore, in many situation, both parties may be compromised by using collections or even direct collections. In the South West, the local relationships managers worked together with specialist trade finance managers based in Perth providing comprehensive trade services to regional clients. Many clients in the region relied on their relationship's managers for trade finance advices. They did not have good knowledge on trade finance arrangements and protection against risk. Although risk rating for importing or exporting clients were complied by relationships managers, trade finance performance inputs are from the concerned who are the relationships managers and trade finance managers.

8. Overall Conclusion

International trade has existed few thousand years therefore certainly there is a need to have trade finance to facilitate international trade. Improving rules, ways to process trade finance documents are always ongoing processes. Current technologies moving towards direction to automate by Learning Machine even to Artificial Intelligence is still not mature and uncertain in order to reduce manual and paper works becoming paperless and, hence speeding the process. In business side, business credit analysis for granting loans still needs time for approval it is a big challenge to cut down process time. SME trade finance is specifically critical for SME or micro enterprises to survive. Public assistance scheme for SME will improve survival rate for SME.

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Professor of Finance/Economics and Accounting, US Bryant University Zhuhai, & Honors College, BITZH, Prior to became a full time academic for More than 20 years with universities at ECU, WU, USQ & QUT, in UAE, HK, China and Malaysia. he was a senior banker to the rank of Vice President of a Chinese Major bank and specializing in Loan and International Trade, a senior Accountant and valuer. His research interest in the areas of credit risk management, trade Finance, international banking, bank management, investment and corporate finance.