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The Power of Digitization in International Trade Finance

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Abstract

Digital market platforms are used to facilitate exchanges and transactions. The digital transformation with a very high potential to upgrade the economic and financial system is blockchain. Blockchain is transparent and trackable, it encodes all transactions, it randomizes the process and ensures that no one can force the blockchain to accept a particular entry onto the ledger that others disagree with. Besides these advantages, blockchain will have a major impact on international trade finance because it will also eliminate intermediaries, thus reducing transaction costs.

Keywords: blockchain, digitization, international trade, trade finance

Introduction

As we are living in a technological era, we see that the environment goes through a lot of challenging times and people are willing to be part of it, innovation is an important factor nowadays. The manner in which people appreciate diversity is seen in their way of living

because they are more aware of the information received through all types of channels. Each and every day is simplified for people in general, due to a variety of benefits that improve the stability of society, which can speed up the people's choices.

All of these digital transformations that happen nowadays ensure a rapid way of solving people needs and desires. The world is going through a process which implies the tremendous improvement of each industry. These changes boost the efficiency and productivity considering that each sector is greatly stimulated by digitization, which brought numerous advantages that impacted clients' experiences.

Digitization is referring to the creation of a standard business model where all participants, markets and consumers, are part of a massive system. The literature makes a distinction between the terms 'digitization' and 'digitalization'. Digitization is considered a process of information management that is recognized by computers. Digitalization is perceived as the change induced by digital technologies (digitization) in society, business and economy (Pratap, 2019). Digital technologies help the economic and financial environment to accelerate and grow rapidly. For example, people have nowadays multiple and different accessible options to make their payments more easily, such as mobile banking apps, e-wallet or even mobile money. And this is not everything! Digital era brings other impressive and innovative discoveries to make the trade effortlessly and quickly.

Blockchain technology

What a Blockchain is and how will improve international trade?

Digital market platforms are used to facilitate exchanges and transactions. The digital transformation with a very high potential to upgrade the economic and financial system is blockchain.

According to Dao (2018), blockchain is transparent (anyone can see the transactions) and trackable (Dao, 2018). The system leverage is seen in the presence of cryptography that encodes all transactions and makes it transparent for each partner involved in the business deal. The concept of blockchain can be applied in corporations, in trading goods and services worldwide, including IT industries.

By using blockchain technology, organizations are able to simplify all trade processes and save time, that can be at the end directed to other transactions. Blockchain is a network of computers where all have the same history. Instead of being a single company with a database that possesses all the information, this system is designed so that all companies' computers are running the same software which may guarantee the transactions (Figure 1) (Rosic, 2016). Thus, whenever a deal is made, the information is verified and stored in the ledger, and while more data is added it will be impossible to erase it or change previous data within it. According to Tapscott & Tapscott (2018), blockchain represents a true revolution in business and economics, representing “an incorruptible digital ledger of economic transactions that can be programmed to record not just financial transactions but virtually everything of value” (Tapscott, D., Tapscott, A., 2018).

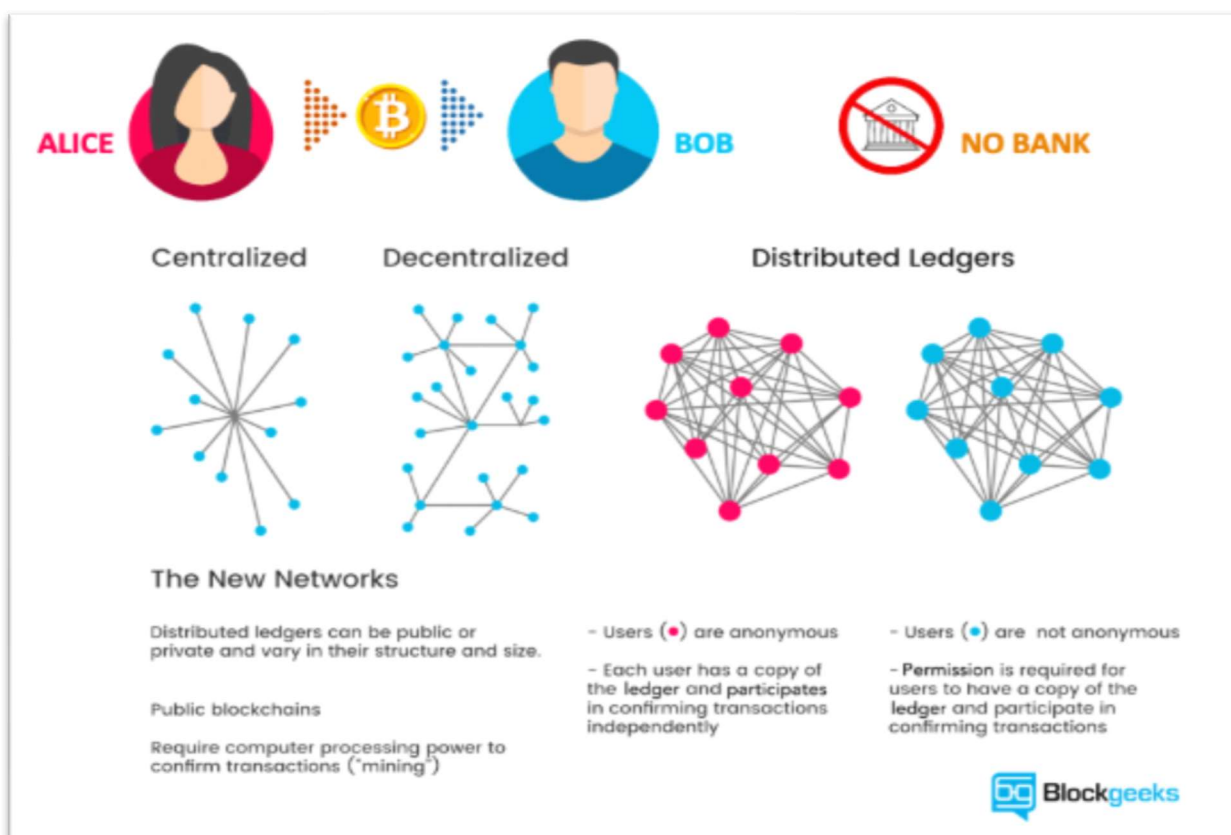


Figure 1. How blockchain technology works

(Source: (Rosic, 2016))

From a technical point of view, the system is designed as a decentralized network, transparent, and persistent, similar to the ideology that stands behind the Bitcoin. It creates a consensus between scattered or distributed parties that do not need to trust each other but to trust the mechanism. It randomizes the process and in theory, ensures that no one can force the blockchain to accept a particular entry onto the ledger that others disagree with. According to CB Insights, blockchain will have a major impact on international trade finance because it will eliminate intermediaries, thus reducing transaction costs (CB Insights, 2018).

Blockchain relies on the mechanism of a peer-to-peer network that can maintain updates to the ledger and then verify those updates in such a way that it is impossible to defraud and alter after the fact. Notably, the blockchain technology will increase the speed of trade and will automate compliance, which in turn will increase trade efficiency whilst reducing the risk of corruption or failure (Canavan, 2019) (Bauerle, 2019).

In addition, one of the most important advantages of digital technologies innovations is the reduced consumption of paper. In the future, the paper use will decrease and many industries will take steps to utilize digital technologies with the hope that the environment will be protected. Making the case for trade finance, the International Chamber of Commerce and the AmericanExpress Company recently stated that moving to paperless transactions proves to be not only environmentally friendly but also efficient by “reducing processing times by two hours per transaction and regulatory compliance costs by 30 percent” (Lynch, 2018). For many companies, using blockchain for different types of transactions proved to save a lot of time compared to traditional procedures. For example, a trade finance transaction carried out by HSBC and ING via blockchain technology took less than 24 hours compared to 5-10 days necessary for paper-based (letter of credit) alternative (Hegarty, K., McDonald, T., 2019).

Trade digitalization through blockchain

The creation of blockchain as a trading concept is considered a viable and effective monetization opportunity. The trade finance market went through hard times for many years because of old-fashioned, traditional, long-established economical documentation measures. Even though the classic form of Commercial Letter of Credit (LOC) and Bill of Lading are still used to guarantee that the goods are delivered and the payment is received, the adoption of

blockchain can increase the trust between the trade parties (CB Insights, 2018). If this innovation can empower organizations to safely and carefully demonstrate to each party involved all the details in terms of transportation, the authenticity of the country of origin and some other documentation, this could increase the confidence, straightforwardness and spread the idea of trust in the process. In the traditional system, some reports would lack in information because the mechanisms that are put into practice are moving slowly. For this reason, the blockchain is identified as a transparent platform, however, it must be made compliant with regulations such as anti-money-laundering (Canavan, 2019).

A significant aspect of the adoption of blockchain technology is training and education. Whether as employees or customers using blockchain technology, people should have the necessary knowledge and skills before they actually use the technology in a wider sense. To transition into the mainstream and make it useful for average people to use it, a lot of measures should be taken into consideration in terms of education, standards and probably hard work with enterprises to create a user experience and ensuring that the technology is safe, feasible and understandable.

Conclusion

The blockchain technology will be applied in many areas and fields, not only trade. Blockchain may sound complicated, but at its core, it is just another tool for humans and eventually robots and other kinds of identities to trade at a big scale and make the trade more decentralized, transparent and secure.

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