The Imperatives of Financial Instruments to Addressing the Working Capital Challenges of Businesses in the Global Value Chains Trades: The New World Trading Currency

Adedeji Richard Adeshile

Open Learning Campus: The World Bank Group

ARTICLE INFO

Keywords:
Contract Enforcement
Economic Shared Prosperity
SDG-17
Emerging Market
Productivity

ABSTRACT

The study was carried out to examine the level of awareness on financial instruments and familiarization with any other financial instruments apart from the Letter of Credit (L/C) and Bank Guarantee (BG). Furthermore, it examined the impacts of COVID-19 on business working capital and the level of readiness of the business to take advantage of financial instruments when fully innovated and globally acceptable. The study used primary data obtained through experience, observation, and opinion sampling from thirty businesses in Nigeria with a digital market presence. Data were analyzed using a descriptive statistical method of measures of frequency. From the study, an average respondent is aware of financial instruments application for financing their business working capital. However, very few are familiar with other financial instruments apart from L/C and BG. Unarguably, COVID-19 has impacted business working capital and many respondents are willing to take advantage of financial instruments when fully innovated and globally acceptable based on the principle of good faith amongst all actors in the GVCs trades. The recommendations include the need to embrace the Global Registry of Financial Instruments (GRoFI) and encourage in-country and regional domestication by the Central Banks and Multilateral Development Banks. Furthermore, the global and national leaders may embrace the Multilateral Committee on Financial Instruments (MultiCoFI) to work out the fine details to innovate financial instruments facilitating trade for development.

1. Introduction

The world is a global place where economic actors and activities are interlinked. Hardly will one see a national economy in the world that does not trade with foreign partners. Over the years, trading activities have faced challenges ranging from contract enforcement to shortfall in financing and delays in making final investment decisions. As the global and national economies grappled with these trading challenges, the global pandemic set in unexpectedly and causing economies to shut down--revenues and jobs are lost. Businesses are tensed and yet to figure out the appropriate direction and waiting for the implementation of market reinforcement

* Corresponding author E-mail address: deji.adeshile@gmail.com

Cite this article as:
Adeshile, A. R. (2021). The Imperatives of Financial Instruments to Addressing the Working Capital Challenges of Businesses in the Global Value Chains Trades: The New World Trading Currency. *International Journal of Applied Research in Management and Economics, 4*(1), 50-59. https://doi.org/10.33422/ijarme.v4i1.618

strategies—will this be a game of survival of the fittest—business as usual? Or will there be a game-changer of collaboration—as a paradigm shift?
The key questions are, will the world trade ever recover from the setback occasioned by COVID-19 lockdowns? If yes, for how long is the recovery process considering the need to meeting the global goals by the year 2030? Of course, achieving the global goals by 2030 is not a mirage if the framework for collaboration and mobilization of finances and investments from all sources are fully harnessed-- and global leaders must act now.

1.1. Statement of the Problem

The United Nations (UN) estimated the gap in financing to achieve the Sustainable Development Goals (SDGs) at $2.5 trillion per year in developing countries alone (United Nations Conference on Trade and Development, 2014). This estimation was before the emergence of the COVID-19 pandemic and its devastating impact on a fragile financing framework in developing economies.
COVID-19 pandemic has threatened both developing and developed economies in the world. There was an unprecedented fall in OCED[1] GDP by 9.8% experienced in the second quarter of 2020 due to COVID (Organisation for Economic Co-operation and Development (OECD), 2020a). This signalled a major concern to the World considering the active role OECD countries perform in the GVCs trade. Therefore, there is an urgent need to innovate appropriate frameworks for mobilizing finance and investment for GVCs trades.

1.2. Objective of the Study

The study was carried out to find solutions or explanations of the research problem. Below are the specific objectives of the study:
1) To examine the level of awareness of financial instruments.
2) To examine the level of familiarization with any other financial instruments apart from Letter of Credit (L/C) and Bank Guarantee (BG).
3) To examine the impacts of COVID-19 on business working capital.
4) To examine the level of readiness of the business to take advantage of Financial Instruments when fully innovated and globally acceptable.

1.3. Research Questions

This study examined relevant questions as the basis for evaluating the imperatives of financial instruments capable of providing unsecured import and export financing-- post-COVID-19 pandemic lockdown. Below are the research questions:
1) Are businesses aware of financial instruments?
2) Are businesses familiar with any other financial instruments apart from L/C and BG?
3) Has the COVID-19 impacts business working capital?
4) Will businesses take advantage of Financial Instruments when fully innovated and globally acceptable?

1.4. *Scope of the Study*

The study is limited to businesses in Nigeria with working experience in GVCs trades. Also, their working capitals have been affected by the COVID-19 pandemic lockdown.

1.5. *Significance of the Study*

1) To add to the body of knowledge and broaden the knowledge of scholars who are interested in understanding the impacts of COVID-19 pandemic lockdowns on businesses in GVCs trades.

[1] https://www.oecd.org/about/document/list-oecd-member-countries.htm

2) To give insight to business owners both (local and international) on leveraging financial instruments to bridge working capital gaps—post COVID-19 lockdown.
3) To serve as financing and investment blueprint to government ministries, departments, and agencies (both nationally and globally) charged with economic planning and development.

2. Literature Review

2.1. Overview of Conceptual Framework

The research on the imperatives of financial instruments to addressing the working capital challenges of businesses in the global value chains trades premised on various concepts and theories. These concepts and theories include the concept of global value chains and the factors of production. Others are the concept of financial instruments and the working capital management concept.

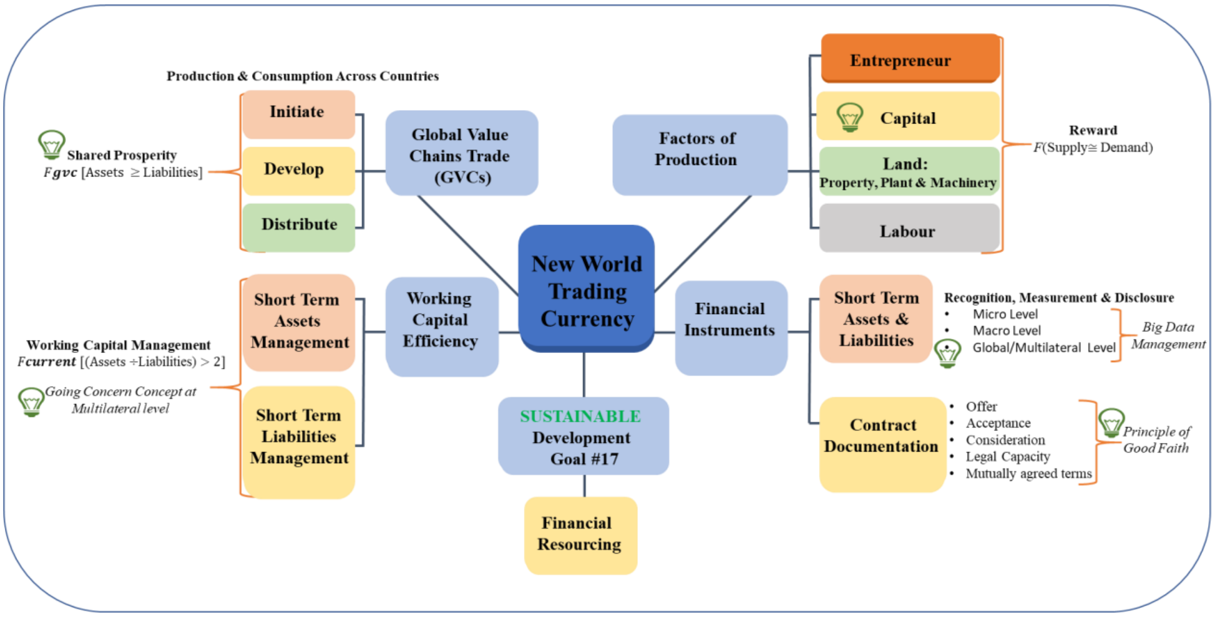

Figure 1. Conceptual Overview of Financial Instruments Supporting the New World Trading Currency
Source. Literature Review, 2015- 2020

2.2. Concept of Global Value Chains (GVCs)

GVCs conceptual framework is principled on the international division of labour. It encompasses nontrivial matching between importers and exporters, relationship-specific investments by all parties, inter-firm, and intra-firm flows of goods. Furthermore, it factored in technology and credit in environments with limited contractual security and governed by incomplete contracts enforcement. By implication, GVC consists of a series of stages involved in producing a product or service that is sold to consumers, with each stage adding value, and at least two stages being produced in different countries (Antras, 2020).

The GVCs is pivoted on the drivers of participation. GVCs participation is determined by fundamentals such as factor endowments (such as availability of labour in the host country and foreign capital for both efficiency and resource seeking actors), market size, geography (such as improved remote areas connectivity through apt logistics), and institutional quality (such as entering deep preferential trade agreements to cover legal and regulatory frameworks, synchronize customs procedures and set rules on intellectual property rights). However, these fundamentals need not dictate destiny (World Bank, 2020b).

2.1.1. Impacts of COVID-19 on GVCs

The effects of COVID-19 on economic activities cannot be overemphasized—this worsens trading considering the surmounting trade challenges pre- COVID-19 lockdowns. Of course, the COVID-19 impacts are huge, but trade actors must not lose sight of solutions that will reinforce the market in terms of demand and supply.

The impact of COVID-19 on GVCs can be both direct and indirect. The direct impact is when companies operating in GVCs stop producing due to health precautions. While the indirect impact is linked to supply chain risk which occurs when there is a disruption in production and logistics due to restrictions in another location/ jurisdiction. There can be a demand impact, whereby production continues but fewer consumers are willing to buy the products due to shifting in demand. Furthermore, there is trade and investment policy risk whereby countries impose sanctions and policies to protect the national economy – which further exacerbates world trade tension (Organisation for Economic Co-operation and Development (OECD), 2020b)

2.1.2. GVC Macroeconomic Implications and Consequences for Development

GVCs are a powerful driver of productivity growth, job creation, and increased living standards due to the inherent GVCs macroeconomic implication. One of the key macroeconomic implications of GVCs is the ability to create greater synchronization of economic activity across countries and aid strong links in price formation. This implies that inflation in one country is likely to impact its trading partners. Furthermore, export growth in GVCs countries are linked with import growth—this implies that the consequences of currency movements for export and import volumes are likely to be dampened. GVC amplifies the cost of protectionism for trade and growth and GVCs trade agreements have the potential to reshape the geography of production across countries—this poses new challenges for governments and policymakers (Francois de Soyres, 2020).

GVCs consequences for development is spot-on considering the hyper-specialization, and durable firm-to-firm relationships of GVC. This promotes efficient production and diffusion of technology—including access to capital and inputs long value chains. GVCs also deliver more productive jobs through scale effects resulting from increased productivity and expanded output. On the flip side, the expansion of GVCs has magnified the challenges facing the international tax system (World Bank, 2020a).

2.1.3. Policy and Institutional Framework for GVC Operationality

The question is-- why should a business link up with another if the business environment discourages trading activities? Of course, there is a need for policy synchronization for GVCs trade to thrive. Policymakers must ensure the full implementation of proactive policies that enhances participation. The Key Performance Indicators (KPIs) of such policies must be the elimination of restrictions in factor markets that enables countries to exploit their comparative advantages and liberalizing trade expands access to markets and inputs.

Furthermore, KPIs must be to eliminate market remoteness by improving connectivity and lowering trade costs. No doubt, all policies framework must be pivoted on strengthened contract enforcement, protecting intellectual property rights, and improving standards regimes (World Bank, 2020d).

Beyond policies that drive participation, there is a need for policymakers to implement those that drives inclusivity and sustainability. By implication, developing countries would benefit from policies that spread the jobs and earnings gains from GVCs participation across society. While industrial countries would benefit from adjustment policies for workers displaced by technology, trade and the expansion of GVCs, policies should mitigate negative environmental consequences and promote the adoption of environmentally friendly technologies. These national measures must be complemented by global cooperation on the environment and working conditions (World Bank, 2020c).

2.3. Factors of Production
The GVC concept thrives on the production theory considering that goods and services are initiated, developed and distributed across many participating countries for shared prosperity.
Factors of production include entrepreneurs, capital, land and labour. The research focused on capital as the much-needed driver of other factors of production. Capital is either needed on a short- or long-term basis. However, the seamless flow of short-term capital facilitates business sustainability.

2.4. Working Capital Management
The working capital requirement of businesses is attributed to their current assets and liabilities. This implies that the current assets and liabilities must be properly managed to ensure that businesses meet financial obligations as and when due. At all times, current assets must be higher than current liabilities to indicate the sustainability of the business. Otherwise, it is a threat to business continuity which may lead to its liquidation.

2.5. Concept of Financial Instrument
Financial Instruments are alternatives to fiat money which facilitates business transactions and reinforces the market through the ignition of demand and supply. In the face of financial pressure occasioned by COVID-19 pandemic lockdowns, it is imperative to innovate financial instruments that will bring about desired sustainable investment towards achieving the global goals by the year 2030.
Financial instruments are contracts that give rise to a financial asset of one entity and a financial liability or equity instrument of another entity (Code of Practice on Local Authority Accounting in the United Kingdom Guidance Notes for Practitioners 2014/15 Accounts, 2015).

2.5.1. Principle of Good Faith
The word "faith" has both sectional and universal application amongst all walks of life. It has been established by scholars that nothing happens without faith. The fiat money, despite being established by government regulation, still relies on faith that the market conditions will continue to be favourable to enhance its currency value. Good faith must be exercised in every circumstance whether implied or expressed.
Good faith requires contracting parties to deliver reasonable contractual expectations. This implies that each party's good faith is the agreed purpose memorialized in the contract—meaning the legitimate contractual expectation of the other. Good faith is not a principle of substantive fairness in the face of new contingencies. A party may not use unanticipated contingencies to deprive his counterparty of a benefit that the contract allocated to each party. It is important to always consider the arms-length nature of good faith (Markovits, 2014).

3. Methods
This chapter discusses the research design, source and method of data collection and method of data analysis.

3.1.Research Design
The study is both exploratory and descriptive. It explored literature to provide insights on the financial instruments and their application to bridge the working capital gaps, post COVID-19 lockdown. Furthermore, the researcher uses a descriptive research design by obtaining sampled opinion data from experience and observation on the level of awareness and imperatives of financial instruments in the GVCs trades.

3.2.Sources and Method of Data Collection
The study used primary data obtained through experience, observation, and opinion sampling from thirty (30) businesses in Nigeria with a digital market presence.

3.3.Method of Data Analysis
Data were analyzed using the descriptive statistical method. Measures of the frequency with percentage distribution technique was adopted, and data are presented in tables and charts. Responses to the research questions were categorized into three- viz, Yes, No and Not responsive. The total number of responses and the total number of respondents that were contacted formed the research data that were analyzed.

4. Results
This chapter covers the presentation of the collected data, data analysis and interpretation. Primary data through opinion sampling were generated – these data are in line with the objectives and the scope of the study. The data provided the answer to the research questions and conclude the study. The data are analyzed, presented, and interpreted below.

4.1. Respondent's Sector

Table 1. *Respondent's Sector*

S/N	Description	Total Responses	Percentage of Responses
1	Construction	5	17%
2	Agriculture	3	10%
3	Logistics	9	30%
4	Printing	1	3%
5	ICT	4	14%
6	Health Care	2	7%
7	Power & Energy	4	13%
8	Food Processing	1	3%
9	Extractive	1	3%
	Total	30	100

Source. Survey 2020

The chart shows the Sectors of the respondents in the survey. 30% are into logistics, 17% in construction, 13% in power & energy and 10% in agriculture sector. Others include Food processing 3%, Extractive 3%, Healthcare 7%, ICT 14%, and Printing 3%.

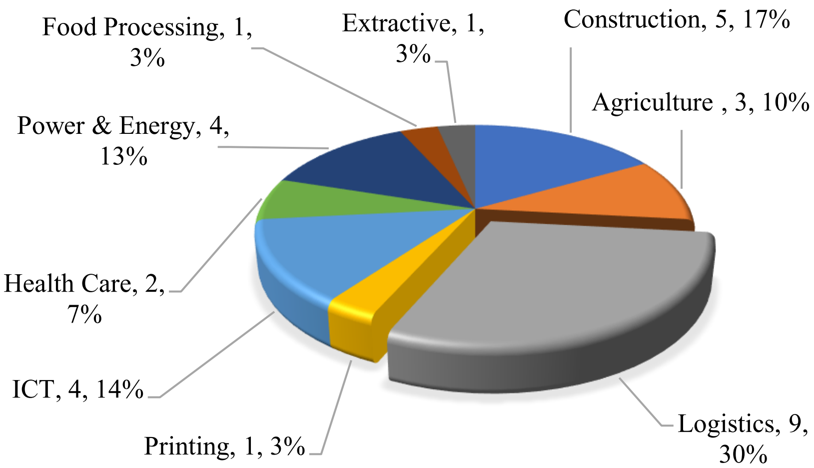

Figure 2. Respondent's Sector
Source. Survey 2020

4.2. Are Businesses Aware of Financial Instruments?

Table 2.
Level of Awareness of Financial Instruments

Description	Responses		
	Yes	**No**	**Not Responsive**
Total Responses	16	10	4
Percentage of Responses	54%	33%	13%
Total Respondents		30	

Source. Survey 2020

The chart shows the level of awareness of financial instruments application. 54% are aware of financial instruments application, 33% are not aware and 13% were not responsive.

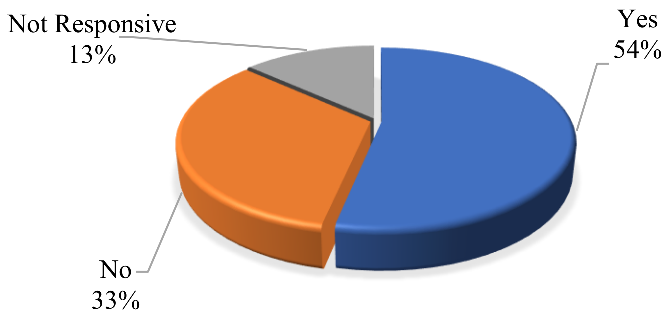

Figure 3. Level of Awareness of Financial Instruments
Source. Survey 2020

4.3. Are Businesses Familiar with any Other Financial Instruments Apart From L/C And BG?

Table 3.
Level of familiarization with any other financial instruments apart from L/C and BG

Description	Responses		
	Yes	**No**	**Not Responsive**
Total Responses	7	20	3
Percentage of Responses	23%	67%	10%
Total Respondents		30	

Source. Survey 2020

The chart shows the level of familiarization with any other financial instruments apart from L/C and BG applications. 23% are familiar with other financial instruments apart from L/C and BG, 67% are not familiar and 10% were not responsive.

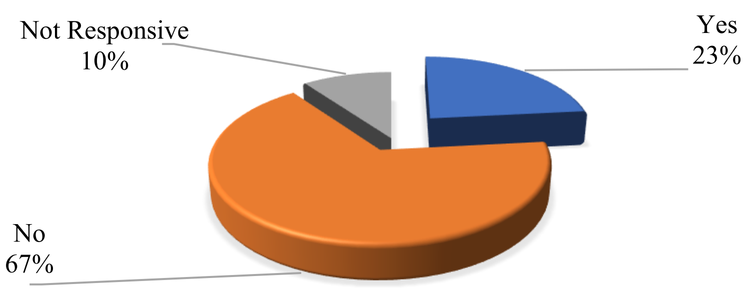

Figure 4. Level of familiarization with any other financial instruments apart from L/C and BG
Source. Survey 2020

4.4. Has the COVID-19 Impacts Business Working Capital?

Table 4.
COVID-19 impacts on business working capital

Description	Responses		
	Yes	**No**	**Not Responsive**
Total Responses	27	0	3
Percentage of Responses	90%	0%	10%
Total Respondents		30	

Source. Survey 2020

The chart shows the COVID-19 impacts on business working capital. 90% acknowledged that COVID-19 has impacted their business working capital exposure and 10% were not responsive.

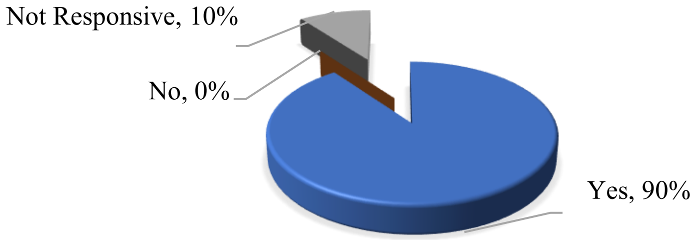

Figure 5. COVID-19 impacts on business working capital
Source. Survey 2020

4.5. Will Businesses Take Advantage of Financial Instruments When Fully Innovated and Globally Acceptable?

Table 5.
Readiness to take advantage of FI when fully innovated and globally acceptable

Description	Responses		
	Yes	**No**	**Not Responsive**
Total Responses	27	0	3
Percentage of Responses	90%	0%	10%
Total Respondents		30	

Source. Survey 2020

The chart shows the level of readiness to take advantage of Financial instruments when fully innovated and globally acceptable. 90% affirmed its adoption when fully innovated and globally acceptable and 10% were not responsive.

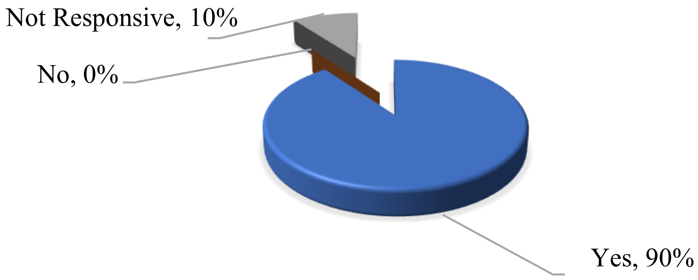

Figure 6. Readiness to take advantage of FI when fully innovated and globally acceptable
Source. Survey 2020

5. Discussion

5.1. Summary and Discussion of Findings

From the study, an average respondent is aware of the Financial Instruments application for financing their business working capital. However, very few are familiar with any other financial instruments apart from L/C and BG. This implied that if L/C and BG are scarce, businesses might not be fully aware of other financial instruments if there is no sensitization. This will pose a high risk on business working capital management, post COVID-19 lockdown. Unarguably, COVID-19 has impacted business working capital. Financial instruments must be fully innovated and globally acceptable based on the principle of good faith amongst all actors in the GVCs trades. Consequently, this will aid business leverage for working capital management.

5.2. Limitations of the Study and Directions for Future Study

The scope of the research study is limited to businesses in Nigeria with working experience in GVCs trades—upon which inferred conclusion is drawn for the study. The study did not consider businesses with no digital presence due to COVID-19 pandemic social distancing protocols. The scope of the future study can cover businesses with no digital presence and those outside Nigeria.

5.3. Recommendations

The COVID-19 pandemic lockdown has impacted businesses and therefore, posed a major setback on GVCs trade with consequential ripple effects on the global goals targeted for 2030. Global leaders could embrace innovative financial instruments that will reinforce the market and cause a quick economic rebound.

The study has identified some recommendations for considerations based on focus reviews, findings, and conclusions. Below are the recommendations that will further reinforce the economic rebound plans of the global and national leaders.

1) Embrace Multilateral Committee on Financial Instruments (MultiCoFI), amongst others, carry-out the following functions:
   a. Work out the fine details to innovate Financial Instruments that will facilitate trade for development in the age of GVCs-- consequently creating at least a $2.5 trillion trade portfolio on an annual scalable basis over the next ten (10) years and beyond.
   b. Organize global and national advocacy and training programs on the application of Financial Instruments. Also, to reawaken the need for actors in the GVCs trade to adhere to the principle of "good faith" in contract execution.
2) Embrace the Global Registry of Financial Instruments (GRoFI) and encourage in-country and regional domestication by the Central Banks and Multilateral Development Banks.

Barring the global darkness on GVCs trades occasioned by the COVID-19 pandemic, there is light at the end of the tunnel if GVCs trade actors can leverage financial instruments to bridge working capital gaps. No doubt, Financial Instruments are pivoted on the principle of "good faith" to harness its full benefit. Every actor in the GVCs trade should stay positive and have "faith" that good things will happen.

6. Conclusion

The objectives of the study have been examined as well as the research questions. It can be deduced that COVID-19 has impacted the working capital financing of businesses in the GVCs trades. Furthermore, financial instruments are the financing innovation that will bridge the gaps of working capital--post-COVID-19 pandemic lockdown. This will accelerate the growth of global and national economies as well as enhanced shared prosperities amongst actors in the GVCs trades.

Acknowledgement
This paper is an output of the science project of the course entitled Trading for Development in the Age of Global Value Chains -- of the Open Learning Campus (OLC): The World Bank Group (WBG). I acknowledge my mentors, friends and colleagues who have inspired and keep supporting me. To my family, I sincerely appreciate all the emotional supports given to me during this study.

References

Antras, P. (2020). *Conceptual Aspects of Global Value Chains* (No. WPS9114). https://doi.org/541931579622262085

Code of Practice on Local Authority Accounting in the United Kingdom Guidance Notes for Practitioners 2014/15 Accounts, 767 (2015). https://publications.cipfa.org/publications/code-of-practice/module_07.pdf

De Soyres, F. (2020). *What are the Effects of Global Value Chains? Macro Implications* (pp. 1–5).

Markovits, D. (2014). Good Faith as Contract's Core Value. In *Philosophical Foundations of Contract Law*. Oxford University Press. https://doi.org/10.1093/acprof:oso/9780198713012.003.0014

Organisation for Economic Co-operation and Development (OECD). (2020a). *OECD GDP growth: Quarterly National Accounts*. https://www.oecd.org/sdd/na/GDP-Growth-Q220.pdf

Organisation for Economic Co-operation and Development (OECD). (2020b). COVID-19 and Global Value Chains : Policy Options to Build More Resilient Production Networks. In *Oecd* (Issue June). https://read.oecd-ilibrary.org/view/?ref=134_134302-ocsbti4mh1&title=COVID-19-and-Global-Value-Chains-Chains-Policy-Options-to-Build-More-Resilient-Production-Networks

United Nations Conference on Trade and Development. (2014). *World Investment Report 2014: Investing in the SDGs: An Action Plan*. https://unctad.org/system/files/official-document/wir2014_en.pdf

World Bank. (2020a). *World Development Report 2020: Trading for Development in the Age of Global Value Chains: Consequences for development*. Washington, DC: World Bank. https://doi.org/10.1596/978-1-4648-1457-0

World Bank. (2020b). *World Development Report 2020: Trading for Development in the Age of Global Value Chains: Drivers of Participation*. https://doi.org/10.1596/978-1-4648-1457-0

World Bank. (2020c). *World Development Report 2020: Trading for Development in the Age of Global Value Chains: Policies for Inclusive and Sustainability*. Washington, DC: World Bank. https://doi.org/10.1596/978-1-4648-1457-0

World Bank. (2020d). *World Development Report 2020: Trading for Development in the Age of Global Value Chains: Policies to Enhance Participation*. Washington, DC: World Bank. https://doi.org/10.1596/978-1-4648-1457-0