Innovation in trade finance
Large scale digitalisation necessary

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There is a huge gap in access to trade finance for SMEs globally. Well connected digital supply chains could give banks unprecedented access to data on the movement of goods, allowing finance to be structured as the risk and ownership of goods change.

Global trade is expected to grow at a moderate pace in 2017. The Society for Worldwide Interbank Financial Telecommunication, the messaging service provider to over 12,000 banks and large companies, has reported a sixth consecutive year of lower volumes for documentary trade finance for 2016, with worldwide trade finance volumes declining 4.7% from 2015.

While it is estimated that up to 80% of global trade is supported by credit or credit insurance, more than half the trade finance requests from small and medium-sized enterprises globally are declined. The same figure stands at a mere 7% for large corporates. There is a huge gap in access to finance for SMEs globally, and it is especially pronounced in emerging markets.

Banks are contending with tougher regulations, primarily due to the implementation of Basel III regulations, and anti-money laundering and 'know your customer' rules. According to the International Chamber of Commerce Global Trade Finance Survey 2016, more than 90% of the banks surveyed see AML and KYC requirements as impediments to trade finance.

The survey also showed that 65% of respondent banks experienced termination of correspondent banking relationships, primarily as a result of challenges in maintaining strong KYC standards across a global client base. This is problematic for smaller banks, whose access to trade finance will be limited as international banks cannot justify maintaining these relationships in the light of high compliance costs.

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Benefits of technological innovation

Experts agree that technological innovation can help resolve at least some of these problems and stimulate global trade finance growth. Well connected digital supply chains could give banks unprecedented access to data on the movement of goods, allowing finance to be structured as the risk and ownership of goods change. A well maintained KYC database for smaller local and regional banks could result in less onerous correspondent banking requirements.

In the payments industry there has been a significant technological shift, with the development of faster processing, better connectivity and lower costs. On one side, there are banks and fintech companies in the retail payments space that are innovating real time payments. On the other, established service providers like Swift are working to make cross-border payments faster, more transparent and cheaper. Key reasons for these improvements in the payments space include higher levels of standardisation and a relatively less complex industry network. Similar initiatives ought to be implemented in the trade finance sector.

The digitalisation of trade finance would require the inclusion of exporters, importers, shipping companies, ports and customs authorities, industry associations and banks. The scale of this network presents the greatest challenge. While there have been technological advances in each of these industries, they are still not consistent and there is heavy dependence on paper-driven processes.

Several banks involved in trade finance have developed a strong digital front-end for clients to access services. Larger companies that can afford it have their enterprise resource planning systems integrated with their key banks for trade finance needs. However, penetration remains low beyond the top-tier businesses. Moreover, the back-end processes of banks are still catered by paper-based processes, taking away potential benefits in efficiency and cost that could be passed on to clients.

Automation of processes

KYC is one process which is repeated for the same client by multiple entities and in multiple countries, and is therefore suitable for automation. This can help stem the tide of large scale closure of relationships and provide a boost to smaller banks which rely on correspondent banks to confirm their letters of credits or provide funding against them.

Most banks are comfortable providing trade finance through low-risk trade products that include documentary credits and collections. However, it is estimated that more than 80% of world trade is

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done on an open account basis, which banks are less comfortable financing unless it is backed by credit insurance or some other form of security like physical collateral. Both documentary trade and open account systems, therefore, ought to become digitised.

Bank payment obligation was invented to digitalise trade flows beyond the traditional documentary sphere. It not only offered a solution for the digitalisation of trade finance processes compared to documentary trade, but also provided a safer way of trading compared to higher risk open account processes. Uniform rules for BPO followed a few years later to support the legal framework behind the new method of payment. This solution has been slowly gaining momentum, with 18 of the top 20 banking groups capable of sending and receiving BPO.

A standard for digitalising trade flows

From a corporate perspective, large businesses that are willing to digitalise their trade processes often have to deal with multiple banks with differing level of automation in their back-end processes. Swift MT798, which provides corporates a multibank standard to digitalise their trade flows, is becoming increasingly popular.

These standards are being further updated next year to allow improved flow of messaging for an expanded set of services. Of the top 20 trade finance banks, 13 support MT798, and some of the largest corporates are benefiting from these capabilities, with 36% year-on-year growth in transaction volumes in 2016.

The emergence of new technologies like blockchain and the proliferation of fintech companies in the field of trade finance attract much attention. However, most of the solutions proposed so far solve only a small part of a very large puzzle. The ability of the whole trade network to collaborate and find interoperable technology solutions is key to making a success of future developments.

To flourish, the solutions that emerge will need to take into account the shifting patterns of trade, needs of underserved businesses, and challenges in compliance. ■

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