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THE TRADE FINANCE EVOLUTION

Banking's agility test

INTRODUCTION

Corporate trade finance is on the cusp of significant evolution, prompted by increasing levels of digital disruption and globalization. COVID-19 has added to a climate that demands agility from all industries. The trade finance evolution will have significant knock-on effects for the vast trade ecosystem of banks, corporates, technology companies, transporters, government agencies and insurers. Accenture has identified four key drivers of the change:

- **The rise of new competition**—competitors from the technology, fintech and logistics industries pose a significant threat to existing trade finance banks.
- **SMEs are the new corporate customer**—small and medium-sized businesses are a rapidly growing segment of the changing trade finance market.
- **Agile business models**—the need for agility demands operational transformation by integrating siloed processes and using new technologies.
- **New market opportunities**—there's an estimated $1.5 trillion global trade finance gap up for grabs by suitably agile trade finance providers. We suggest three ways to capitalize on the opportunity.

It's vital to analyze the drivers of trade finance change, seek insights into how and why the disruption is occurring, how existing players are evolving, what opportunities these trends will create, and how to capitalize on them. We'll start with the emerging challenge to incumbents.

THE RISE OF NEW COMPETITION

The threat posed by technology giants, fintechs and even logistics providers is considerable. Their growing presence in the trade, supply chain and working capital finance space is increasingly apparent as they overcome traditional barriers to entry. Their strong capabilities in data processing and technology enable them to offer a range of competitive financial products, predominantly in previously underserved market segments.

Why are new competitors emerging?

The financial services industry has shifted away from pure financial plays. This is illustrated by the continued prominence of fintech companies who offer innovative new products that, first and foremost, have a strong technology base. Since the late 1990s, supply chain finance companies have connected corporates with funders by providing product support, reporting and payment services, and have licensed their platforms to banks and financial institutions. This serves demand from both ends of the market—corporates who are looking for funding and banks who want to provide that funding. Now, technology companies or companies with the relevant technology infrastructure are competing for the business. The key attributes enabling these new competitors to offer competitive products in trade, supply chain and working capital finance are:

1. Technology giants enter financing

Emerging competitors with strong links to corporate customers have immediate access to a large potential client base via other services they provide. A prime example of this is Amazon,1 which accounts for 38 percent of all e-commerce conducted in the US. According to its 2018 financial report, third-party sellers in that year made up 58 percent of all its sales—demonstrating the influence of its platform and the level of buy-in from third parties. Players like Amazon that run a marketplace are strongly placed to offer additional services (including finance) to create a seamless, convenient customer experience.

2. Enriched customer data

Access to high quality, verifiable and readily available data is a crucial risk management lever. By collating alternative datasets such as order volumes, website traffic and product reviews, providers like tech marketplaces and logistics companies can create reliable risk profiles of potential corporate customers. Enriching customer data sets is increasingly important in the difficult COVID-19 climate, for SMEs and corporates alike. Coupled with the large number of stimulus packages available, and with several industries strapped for cash, lenders must use new data vectors to assess affordability for borrowers more accurately. Ant Financial2 is a great example of using algorithms to look at transaction data and assess how well a business is doing, based on offering competitiveness and whether its partners have high credit ratings, among other metrics. This unprecedented access to quality data and the application of new technology enabled the lending of $13.4 billion to more than three million SMEs in its first seven years of operation.

3. Innovative supply chain technologies

As long as emerging competitors can couple the above areas with large balance sheets to meet capital requirements, or with platforms that simplify supply chain financing, they will be strongly positioned to offer competitive finance to corporates. Maersk,[3] for example, has invested in a technology platform called Modifi that allows SMEs to apply for financing digitally and raise working capital within 48 hours. SAP and Standard Chartered Merchant Bank (SCMB) have announced a "strategic collaboration aimed at making the bank's financial supply chain solutions easily accessible to businesses in the Asia Pacific region through Ariba Network."[4] In essence, the ability to leverage technology to build a global marketplace, combined with access to data and an aggressive approach to new market entry, has resulted in a ready-made platform to start offering financial services.

Examples of such services include:

- **Alibaba's** personal credit lines[5]—the finance which Ant Micro Loan provides to Alibaba- and TaoBao-registered vendors. The product serves SMEs and sole proprietors that are struggling to get loans from banks. It allows all transactions to be done online and provides flexible repayment terms.
- **Amazon's** B2B e-commerce platform[6] reached $1 billion in sales within a year of operation.
- **PayPal**[7] has been offering loans to small businesses via PayPal Working Capital since 2013. In total, it has lent over $10 billion.
- **Tencent**[8] recently launched a new credit card service, Fenfu, which allows users who cannot get a credit card from a bank to own a virtual one via WeChat. In addition, it will grant loans (which can be interest-free) for about a month, along with other micro-credit options and long-term financial services.

Along with financing via debt-based products like those above, new entrants are preparing to enter supply chain finance by offering limited-liquidity-based products. One example is Ant Financial's new blockchain supply chain finance subsidiary, Ant Duo-Chain, which aims to provide financing by using accounts payables for SMEs who have large corporate customers.[9]

What could the impact be on incumbents?

For now, new players are targeting and winning business in underserved areas of the market, such as small and medium-sized enterprise finance. There has been a significant rise in trade finance rejection rates under the established trade system, predominantly due to applicants' risk profiles or a prohibitive cost to serve. According to a 2019 BNY survey, 60 percent of trade finance requests by SMEs are currently rejected.[10] This has resulted in significant unserved finance demand for these new players to address.

New entrants are disrupting the marketplace by remediating user pain points and providing easier access to a variety of financing options. Ultimately these improvements will be beneficial to larger corporates, which may currently be served by incumbents. The efficiencies achieved by these new competitors will potentially mean cheaper finance offerings which can be widely marketed at speed to the provider's existing network of corporates.

Traditionally, trade has been heavily bank-centric, and corporates have been contacted by banks for their financing needs. With the proliferation of corporate financing platforms, the reverse is now occurring. Banks are pushing to get closer to their customers, and may be slowly crowded out of the financing process by tech giants that can offer lower rates and have access to more corporate customers. Tencent's SCF program, for example, offers supplier rates that are 33 percent lower than the average factoring cost.[11] These improved rates can be realized as a result of a lower regulatory compliance burden and the strengths in data access, utilization and processing.

All of this is a call to action for the incumbents—they will have to adapt to this change if they are to maintain their prominence in the market. The threat posed by new entrants is significant. But new competition isn't the only thing making life more complex for incumbent trade finance providers. As innovation pervades the market and entry barriers fall, it is important to remember that customer profiles and needs are at the heart of the market's evolution.

SMEs ARE THE NEW CORPORATE CUSTOMER

Among the most underserved customers in trade finance are small and medium enterprises (SMEs). However, according to the World Bank, SMEs make up about 90 percent of global businesses and more than 50 percent of employment worldwide.[12] The demand for SME funding has increased significantly in recent years. In the UK, for example, a £22 billion (US$28.5 billion) SME funding gap has emerged due to a surge in demand and limited supply.[13] In the current and post-COVID-19 climate, this demand will escalate because the underserved SME market is likely to grow. One out of four SMEs report that they have cash reserves to last only one month without additional financing.[14]

The growing demand for financing among SMEs can be attributed to the growing importance of cashflow. The 2008 financial crisis, coupled with lengthening supply chains, led banks to adopt more rigorous lending policies. It forced corporates to develop working capital strategies that provided quick access to cash. As a result, corporates are no longer solely reliant on traditional sources of finance.

The crisis not only shed light on the importance of managing liquidity and credit risk, but also brought with it more stringent regulation such as Dodd Frank and Basel III.[15] This meant there was a lack of funding available for corporates due to lending restrictions on banks, and a reduction in the issuance of certain assets, such as commercial paper.

Consequently, larger corporates have placed greater pressure on their treasuries to provide real-time visibility across the whole supply chain, with the agility to move cash around in order to mitigate risk and improve efficiency. Treasurers have turned to the likes of invoice discounting and supply chain finance innovators such as C2FO, Greensill, Demica and Orbian, and to financing platforms like TradeIX that integrate with traditional ERP systems, to realize the benefits of releasing locked capital from their value chains.

Basically, players seeking finance can be split into two categories: SMEs, whose demand for immediate finance is growing, and larger corporates which require more bespoke financing solutions. Here are some examples of strategic adaptations to serve these changing needs:

- **SME financing strategies now have the ability to serve vast numbers of SMEs**: Square Capital,[16] for example, has financed more than $5 billion across 800,000 loans since its inception in 2014; DBS Bank has created a special financing package around the micro-loan, specifically targeted at SMEs, with reduced capital requirements and rapid approval time.[17] The emergence (and success) of these initiatives is reflected in Stripe's decision to launch Stripe Capital, a service to advance cash to customers that gets repaid out of future sales which they make through Stripe's payment platform.

- **Service-oriented financing strategies that are tailored towards large corporates:** Standard Chartered has completed its first deep-tier SCF transaction with Chinese tech firm Linklogis. This allows large buyers on the Linklogis blockchain platform to have their confirmed invoices or accounts payable digitized on the chain as an e-voucher. Top-grade suppliers can finance these e-vouchers in similar ways to reverse factoring, and can then divide these vouchers and transfer a portion of them to lower-tier suppliers. Each holder of an e-voucher can present it on the platform and can be pre-paid based on its value.[18]

It's not only the corporate customer that is driving change. Consumers in general are increasingly conscious of the way in which goods they purchase are produced. According to a global 2018 Nielsen report,[19] 81 percent of respondents think that companies should be doing more to improve their sustainability practices. Millennials, at 85 percent, came out ahead as the generation that said it was 'extremely' or 'very' important that companies work to improve the environment.

Several companies are making great strides in this space. Their transparency, traceability across the supply chain, and positive social and environmental impact have resonated with consumers globally. Patagonia, for example, has allowed its customers to see every step in its manufacturing process via its Footprint Chronicles.[20]

Banks and fintechs are beginning to react to this change too by offering 'sustainable financing strategies'. HSBC, for example, has introduced a scheme whereby suppliers get discounts on their financing if they meet set sustainability goals.[21]

Finance providers across the ecosystem are under pressure to evolve their practices—driven by rapidly changing customer expectations, pressure from executives to maintain profit margins, and the threat of new entrants. Financial institutions that want to remain competitive must design a roadmap that utilizes digital capabilities to enhance corporate customer experiences.

AGILE BUSINESS MODELS

New competitors and the changing nature of corporate customers will require operational reinvention by finance providers, which are embarking on journeys to redefine their operations by integrating siloed processes and using new technologies. We have identified four major areas of operational change:

1. Multi-bank platforms are the new normal

Traditional financing is made up of thousands of credit lines and guarantees, formed across multiple banks. Maintaining these banking relationships requires considerable effort and resources from corporates as they have to interact with several different providers, each with its own separate systems and processes.

Corporates are increasingly eyeing multi-bank platforms to consolidate these processes—and the benefits are obvious. Platforms such as Trafec and PrimeRevenue provide increased visibility and a direct line of access to corporates' banking partners. This results in reduced costs, easy communication, more efficient use of credit lines and fewer human resources required to complete these processes.

2. Borrowers and banks come closer together

Borrowers are not the only beneficiaries of multi-bank platforms. Banks are using them as convenient new digital origination channels to deploy innovative lending solutions that dramatically reduce application times and time-to-cash.

For example, leading digital providers like Kabbage now use machine learning algorithms to provide quick assessments of companies. Kabbage uses sources such as banking data, accounting information and social media to speed up the loan underwriting process for SMEs. This provides real-time, bespoke solutions and addresses the historical inefficiencies associated with trade finance's legacy systems and paper-based processes.

3. End-to-end trade finance solutions

In response to trade finance evolution, incumbent banks have started to use third parties to integrate digital solutions and rapidly strengthen their origination channels. Banks such as Santander and AIB have started to use fintechs like nCino, which integrates its Customer Onboarding System solution with the banks' origination channels. The solution enhances digital customer experiences, processes loans more quickly and improves regulatory compliance through automated reporting, digitization of processes and integration with core accounting systems.[22]

Regtechs, like fintechs, are also making their presence known throughout trade finance. Their total market value is expected to reach $55 billion by 2025, at a compound annual growth rate of 53 percent.[23] This highlights the appetite for corporates to cut the cost of compliance and generate insight that can deliver additional value. Westpac, for example, has worked with Red Marker to use a real-time compliance tool for its credit card advertisements,[24] while HSBC has integrated Quantexa's AI technology in order to combat money laundering.[25]

4. Trade consortia in the ecosystem are maturing

New ways of operating—established by platformization, blockchain consortia and APIs—are inherently reliant on the network effect of an ecosystem. An ecosystem allows incumbent financial institutions to pool resources and share data stacks with other organizations in that ecosystem, helping them defend against the technological strengths of new entrants.

To create an interoperable trade ecosystem, it is necessary to collaborate with like-minded institutions throughout the value chain, and also to build a foundation of shared data, trust and transparency. There is a marked increase in the maturity of these consortia, with examples such as Marco Polo for trade finance and Finacle for digital corporate identity both moving towards production. New consortia have also involved larger incumbents partnering with new industry entrants to spur innovation, reduce costs and improve customer service. Banks like Commerzbank, Standard Bank and SMBC, among others, are working with fintechs to upgrade their trade and supply chain finance capabilities.

The value in an ecosystem lies in achieving a critical mass of participants—the larger the number, the greater the benefits that it provides to each of them. Only in an ecosystem will these institutions realize the benefits that accrue: streamlined processes, reduced cost-to-serve and improved origination efforts. If consortium participants continue to collaborate and bring significant volumes of corporate customers to a shared platform, they will experience similar gains in efficiency to those enjoyed by the big technology marketplaces—while maintaining their own direct relationships with corporate clients.

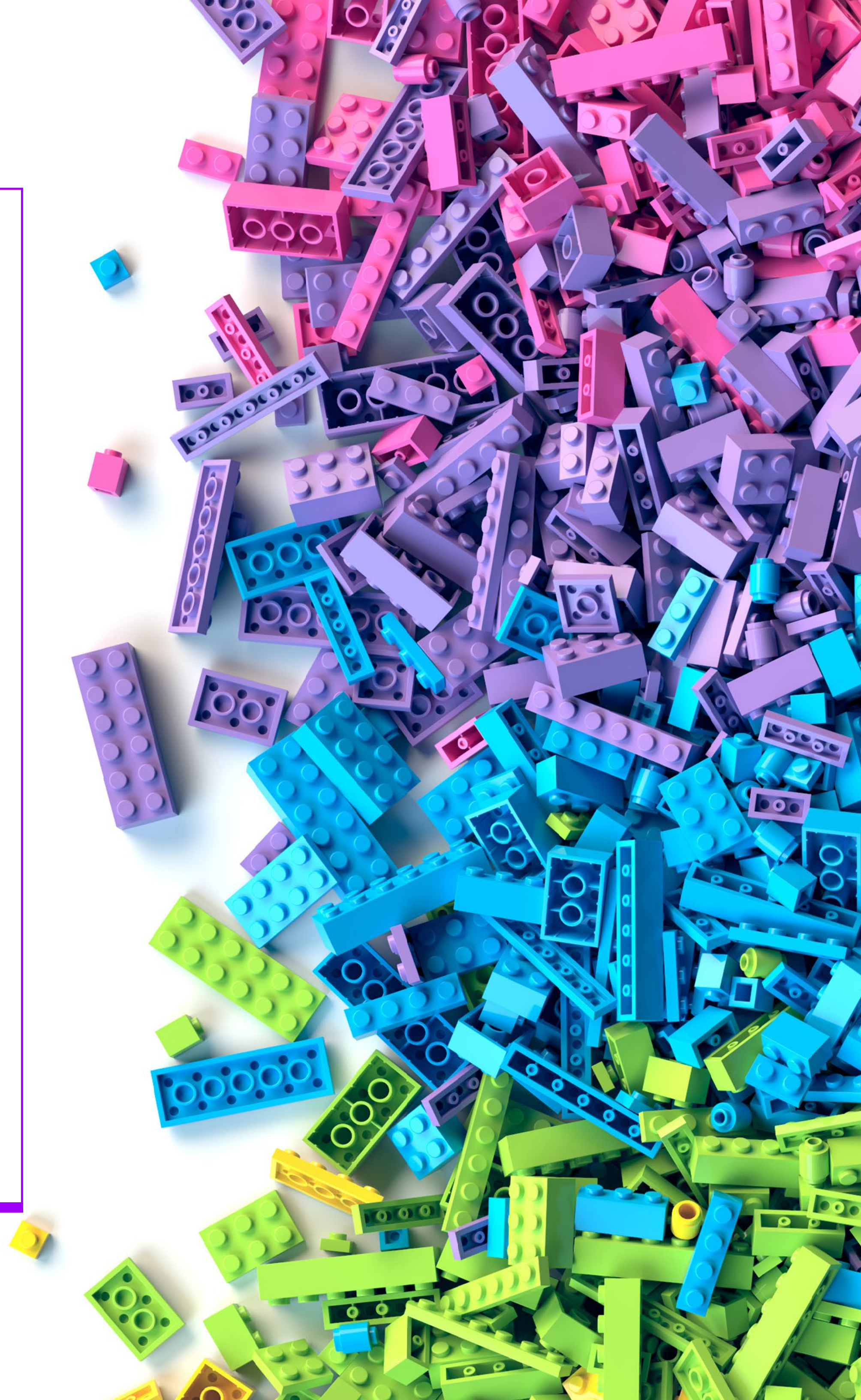
Once banks have prepared to deal with the rise of new competitors and positioned themselves to meet the needs of changing customers by establishing new ways of operating, they'll be ready to take advantage of new market opportunities.

NEW MARKET OPPORTUNITIES

First, it's vital to outline what these opportunities are, and then evaluate how financial institutions can leverage new technologies to access them. We've established how finance providers are rapidly adopting new ways of operating to develop more bespoke client services. The rise of multi-bank platforms and digital origination channels has opened up a multitude of new opportunities in trade finance.

The global working capital finance market is worth approximately $43 trillion—the amount vendors around the world have tied up in accounts receivable on any given day.[26] The global trade finance gap is estimated to be $1.5 trillion[27] —the amount of world trade that cannot access traditional trade finance products (historically, mostly comprising SMEs that are too expensive and risky for incumbent banks to finance).

So how can corporates and banks unlock this huge amount of trapped capital? We have three recommendations.



1. Reach further and wider for new customers

Marketplaces for working capital (like Demica), for trade credit insurance (like LiquidX's Trade Credit Insurance Marketplace[28]), and for digitization across the trade finance value chain (like Bolero[29]), are growing in popularity. These solutions enable banks and corporates to reduce the cost to serve and access these previously out-of-reach markets. Santander, for example, automated and digitized the main steps of its SME customer onboarding process by using AI, OCR, biometric recognition and digital signatures, and reduced the time taken to open new accounts from an average of seven days to just 15 minutes.[30] The emergence of these new entities will speed trade finance acquisition for new-to-bank SMEs—a growing priority in light of the COVID-19 pandemic.

2. Engage with fintechs to optimize balance sheets

Basel III regulation heralded a number of emerging fintechs that enable banks and corporates to optimize their balance sheets and better deploy assets to meet regulatory requirements, increase profitability, and retain working capital flexibility. Companies like Apruve and Greensill offer APIs that plug into ERP systems to track accounts receivable. These new insights clarify the risk profiles of the companies that banks lend to, increasing confidence and enabling financing for previously underserved SMEs.

Banks and corporates have also begun to use fintech solutions to access the burgeoning secondary market for trade and supply chain finance. The secondary market presents a range of additional benefits to banks. It lets them meet the increased capital requirements under Basel III; decrease their risk-weighted assets (RWA) by deferring risk to third parties; and expand their capacity to bring in revenue.

The increasing popularity of this market is reflected in HSBC distributing $20 billion of assets in 2018—a seven-fold increase since 2016,[31] while TradeAssets (a platform for the trade finance secondary market) estimates the size of this market at $1 trillion—seven percent of the value of global trade.[32]

3. Diversify the service portfolio

The emergence of digital platforms like CCRManager, CRX Markets and Tradeteq has introduced a variety of new services (like portfolio management, reporting, credit scoring, insurance and compliance) into the secondary trade finance market. These platforms allow investors to interact with each other directly, in one marketplace, to buy and sell trade finance assets. Investors, as a result, can grow, monitor and manage their portfolios to suit their risk appetites.

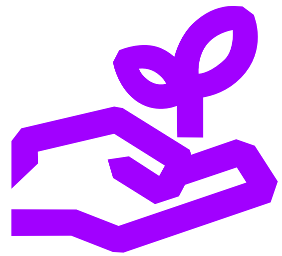
Since trade finance assets have differing risk profiles to traditional assets, they can be ideal tools for investor portfolio diversification and alternative asset class access. The growing prevalence of these platforms can allow investors to acquire trade finance assets more easily. This has the potential to open a traditionally illiquid market and unlock new working capital.

Another way of increasing diversification is the securitization of assets. This happens where assets with different risk ratings are bundled together in order to create a single diversified product. HSBC and Allianz Global Investors, for example, recognized the need to increase access to liquidity for trade finance assets. HSBC thus packaged (securitized) European trade finance assets into securitized pools for investors, allowing institutional investors access to shorter-term and higher-quality trade finance assets.

This type of securitization has also been extended to sustainability finance, where RBS is using securitization to increase its lending to the sustainable energy market in the UK. The bank is packaging together (securitizing) loans that are currently on its books, selling that package to Macquarie Infrastructure Debt Investment Solutions (MIDIS), and using the capital gained from the sale to make more loans.[33] This allows more companies to obtain financing and offers the lender increased flexibility to manage risk profiles.

SEIZING THE TRADE FINANCE OPPORTUNITY

It's an interesting time for incumbents—an inflection point in the trade finance market. New entrants are challenging established trade finance norms and opening finance to a wider audience. The efficient, low cost offerings that they have developed, coupled with their extensive reach, represent a threat to the way incumbents currently operate. The increased competition will provide customers with far more options, and place pressure on banks to differentiate their offerings to remain competitive. Corporates expect services provided by their finance providers (incumbents or emerging competitors) to be more personalized than ever.



While the changing market does create a new threat, it also provides a significant opportunity for incumbents. They can leverage their customer data to engage with the SME market and grow revenues. While new competitors currently face a lower regulatory compliance burden, adapting now will allow banks (largely) to maintain their market foothold while positioning them to recapture lost market share when new competitors face regulation in the near future.

The banking industry needs to pivot to a platform-based strategy and democratize the trade finance market to include more SMEs. Agile platforms and increasingly digitized value chains will reduce incumbents' cost-to-serve—and SMEs' barriers to entry. Ultimately, unlocking the trade finance market to SMEs and secondary lenders, and providing new services, will allow banks to grow their lending book and reduce their risk exposure through the distribution of diverse new asset classes to the market.

Market-wide innovation often leads to winners and losers—and trade finance is no exception. However, players that weigh technology adoption risk and reward, and are agile enough to evolve their operating model to embrace these ecosystems, will be able to realize the inevitable new market opportunities.

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