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POV

Digitalizing Global Trade Financing





Abstract

Global trade is the backbone of the most economies, however, most of the banks do not see financing trades as a profit-making business. Banks have been relying on manual processes for trade financing resulting in higher cost and increased processing time. Traditionally, banks looked at the trade finance business as steppingstone to newer business opportunities with corporate clients, further fading its importance. This also provided more power to relationship managers in terms of setting the pricing resulting in further reduced margins in an already competitive business resulting in banks viewing trade finance as a less prominent business area.

There have been multiple efforts by trade organizations, regulators, and governments to increase interoperability and digitalization. It is estimated that more than 200,000 correspondent banking relationships have been disappeared, therefore unmet demand of trade financing has increased.

In this POV, we will dive into key trends driving the demand of trade finance across organizations, key challenges faced by banks in meeting the changing demand and expectations of customers towards trade financing. We will also understand the various solution offerings of Tech Mahindra in digitalizing trade finance, that can help banks transform their trade finance ecosystem to help achieve continued and sustainable growth.

Key Takeaways

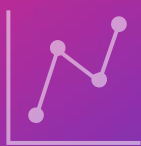
- Introduction
- Key trends in Trade Finance
- Challenges Faced by Banks
- Tech Mahindra's Point of View
- Tech Mahindra Offerings

Introduction

Conventional trade finance products include letter of credit (LC), bank guarantee (BG), supply chain finance, buyer side finance and supplier side finance which also covers discounting and factoring. Even in today's digital world, trade finance remains a largely paper-based and laborious business. While tighter regulations are being imposed, most of the banks are unable to cope up with the increased volume of global trade. Margins are shrinking not only due to increased compliance but mostly due to inability to digitize and automate operations. A recent Asian Development Bank study estimated that the gap in trade finance availability reached \$1.7 trillion in 2020, representing 10 percent of global trade. This estimate is 15% higher than that of 2019 which stood at \$1.5 trillion.ⁱ

Most of the banks still rely on their core banking system to cater to trade financing. With complex processes and checks involved, relying on manual process has led banks to be seen as document processors rather than service partners by their clients. Having a robust digital ecosystem with customer facing digital channels can not only change the perception but also increase competitiveness in the trade finance industry.

Key Trends



Global Trade Outlook: According to World Trade Organization (WTO), the value of world merchandise trade grew by 27% in 2021 and 12% in 2022 to reach the height of 25.3 trillion USD. Furthermore, few countries saw up to 49% growth in their trade volumes.ⁱⁱ The global trade finance revenue was valued at 45 billion in 2022 and is expected to reach 90.21 billion by 2030.ⁱⁱⁱ Asian region alone accounts for 55% of global trade finance revenue followed by EMEA and Americas with 30% and 15% respectively.^{iv}

Developing countries facing the heat: Up to 80% of trade is financed by credit or credit insurance but availability of finance varies across regions.^v Small and medium enterprises in poor countries face highest challenges while accessing trade finance. A lack of trade finance is a significant barrier to trade, particularly in developing countries. Africa, the Caribbean, Central and Eastern Europe and the Pacific Islands are the regions most affected by the termination of correspondent banking relationships affecting flows of trade finance.

According to McKinsey 85% of trade finance volumes are represented by documentary trade finance, including letter of credit and guarantees.^{vi}

Digitalization: Many of the financial institutions rely on their core banking systems or legacy systems to cater to trade financing needs which provides limited extensibility to adapt to the changing landscape of trade finance. Generally, large global banks have been able to use modern technologies, while regional banks become laggards resulting in customer attrition. Many efforts have been made to ensure smooth interoperability within the banking network for smooth functioning of trade finance but has yielded limited results. In some of the geographies we are seeing digital trade finance product offerings including e-LC, e-BG, digital buyer, and supplier finance which do not require lengthy paper trail. Governments and central banks are playing a critical role in uplifting the trade finance ecosystem. As part of the recent initiative, SWIFT has set out the transition of MT messages to ISO 20022 compliant MX messages by November 2022.

Geographical Distribution: According to McKinsey's Global Banking Pools, the global trade finance market covered a value of approximately \$5.2 trillion in 2020, amounting to roughly 6 percent of global GDP. 56% growth of Trade finance in Asia pacific region is anticipated. Majority of trade finance volume for APAC region are documentary business consisting about 90% of the total volume, EMEA and Americas have somewhat lower mix of 80% to 85% thereby indicating more adoption of buyer-led and supplier-side finance.^{vii} Market dominance of APAC region is fueled by increasing global and regional trade flows, and continued dependence of large corporates on supply chains in the region.



Challenges Faced by Banks

Limited offerings and services: Many financial institutions find it difficult to expand their trade finance offerings and service coverage due to legacy systems and manual process. The technical debt has accumulated over a period and the systems do not fit into the modern digital ecosystem. The fragmented technology landscape within the bank blocks the way for innovative offerings, enhanced customer servicing and support for higher volumes.

Complexity and Transparency: A single trade finance transaction often requires interaction between at least 20 entities from two countries, involves 10 to 20 paper documents and about 5000 data field exchanges. Moreover, country specific regulations add more complexity to already complex transactions. The fragmentation in the trade finance landscape reduces the transparency contrary to customers' demand and prone to frauds.

Increased costs: Banks typically spend about 25-30% processing time in compliance checks and approximately 60% of transaction processing cost results from compliance. Most of the banks are concerned with keeping up-to-date and implementing changes in compliance, regulations and subsequently managing operational costs.

Widening demand gap: Gaps in trade finance provision are widest in developing countries, where opportunities to trade are increasing as global production patterns evolve. Non-availability of adequate risk management mechanisms stops them from serving smaller traders who need it most. In two-thirds of cases, traders whose requests for trade finance have been rejected, do not attempt to seek alternative financing.

Evolving Financing Needs: More than half of the global banks claim that their trade finance customers are requesting innovative financing mechanisms and personalization for them to implement more sustainable strategies and operations. The clients' requirements have also been changing to respond to the changing dynamics of the market which goes beyond the personalization in pricing. Most often, banks struggle to meet this demand due to limitations in their technology systems.

Low Penetration of Digital Channels: Many banks do not have digital channels to service trade financing leaving them with in-person or email-based interactions thereby increasing operational costs. Even banks with digital channels have low utilization due to unavailability of harmonic front to back trade finance systems, further creating a gap due to manual processes.





Tech Mahindra's POV

Our vision for trade finance business of the bank is better, faster, efficient, simple and most of all, digital experience for the financial institutions and banks. Connected digital systems, platforms and channels leveraged by best-in-class workflow and approval provide smooth journey to trade finance. Adding flavors of AI/ML, OCR, RPA, and digital documents further speed up the operations in a paperwork centric business line.

Tech Mahindra has helped various global banks to grow and evolve their trade finance offerings by deploying bespoke and partner solutions throughout the trade finance lifecycle. Tech Mahindra has significant experience from its client engagements in transforming the issuing as well as presenting side of business with global processing capabilities. Tech Mahindra's engagement has not only helped financial institutions to automate and streamline their mostly manual processes, but also helped to efficiently utilize digital channels. Enhanced transparency, reduced TAT, personalized pricing, enhanced evaluation of risk, compliance to regulatory norms, increased efficiency and automated collections are the key features of the Tech Mahindra solutions.



Corporate Channels for Digital Experience

- Digital Application for Trade Finance
- Digital Onboarding of Corporates
- Online Document Exchange
- Digital Claims Submission and Real-time Tracking
- Collaboration with Financials Institution



Front to Back Digital Trade Finance

- Core Trade Finance Platform Handling the Complete Lifecycle
- Centralized Operations with Global Processing and Multi-Region and FX
- Departmental Limits and Sub-Limits
- Regulatory Compliance and Wide Range of Third-Party Integrations



Claims & Doc Presentation using AI/ML & OCR

- Auto-Identification and Categorization of Docs
- OCR and AI based Automated Data Population from Docs with Discrepancy Checks
- Automated Compliance Checks from Documents
- Auto-Creation of Issuance and Claim Requests



Open APIs and Marketplace Solutions

- FinTech Ecosystem for OOB Add-On Solution
- Open APIs for Third-Party Solutions and Bespoke Capability Development
- Shared Digital Network Environment Linking Banks, and Businesses Globally
- Omni-Channel for Corporates

Figure 1: Key solution areas of Tech Mahindra offerings

Digital Corporate Channels: TechM's corporate channel solutions aim to provide unified digital experience to corporate clients across different product offerings. The solution enables omni-channel experience for the corporate clients across different type of devices thereby reducing complexity and friction. Solution enables corporate onboarding, counterparty onboarding, finance request initiation, amendments to presentation/claim request submissions digitally. Modular architecture and open APIs enable banks to integrate with any system and bring new products and services with self-service capabilities while driving operational efficiencies.



Solution puts the end user at the core while improving customer stickiness, increasing cross-sell opportunities, and reducing cost to service. It also comes with integrated software development toolkit providing flexibility to customize the system without impacting the core code base, therefore future-proofing upgrade path.

Front-to-Back Digital Trade Finance: Front-to-back digital trade finance solutions from Tech Mahindra eliminates the shortcomings of disparate and legacy systems which prevents banks from innovating with the offerings, providing consistent experience and delivering new capabilities at the required pace. Moreover, integration with digital channels ensures seamless flow of the request and data without requiring manual intervention, thus reducing errors. The solution supports all types of trade financing products, global processing capabilities across different regions, SWIFT and bureau integrations, flexible charge, and interest capabilities along with customized workflows and user interfaces. The core solution also provides extensibility while linking external applications and processes with flexible data models. Integrated document management, accounting, settlement, automated compliance checks and reporting functions further enable seamless trade finance lifecycle management in the solution.

AI/ML and OCR Powered Presentation and Claims: Document presentation and claims in trade financing involve huge number of documents with a wide array of data points which can be digitalized using TechM's AI/ML enabled automated presentation and claims module. It reduces the burden of manual document and compliance checking by automatically identifying documents, categorizing them, and performing automated compliance checks on the document data. It also has OCR capabilities allowing it to extract unstructured data from scanned documents. The data is then analyzed using rules and advanced analytics to enable business to make informed decisions. It is compliant with major global regulations and performs all necessary compliance checks for a trade transaction.

Marketplace Offerings: Open API and marketplace solutions from Tech Mahindra enables business to leverage FinTech ecosystem for extending existing solution capabilities. Tech Mahindra has partner led ecosystem of various OEMs to choose from with capabilities around regulatory compliance, onboarding, omni-channel experience. TechM also offers Open APIs for third party solution integration and bespoke development capabilities. A shared digital network environment links various member banks and businesses globally while reducing friction and improving overall efficiency in trade transactions.

Summary

Lack of technological advancement in trade finance has been a major bottleneck for the growth of this specialized business. With increased digitalization, banks and financial institutions can do away with the inefficient manual and paper-based processes, further enhancing the prospects of the trade finance business. Having a robust risk assessment framework for a wider customer base will certainly enable them to come out strong while tapping the underutilized market. Various regulatory bodies and agencies need to come together to ensure interoperability in the trade finance value chain.

Tech Mahindra, with its strong domain expertise, consulting and technological expertise and partner relationships in trade finance can help banks in identifying gaps and inefficiencies within their current trade finance ecosystem and processes and provide valuable insight and recommendations to transform them, thereby enabling rapid leverage on the market potential.

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Rahul Nemiwal is SME at Tech Mahindra's lending practice. Rahul brings his lending knowledge to design and market compelling solutions for financing organizations globally, leveraging Tech Mahindra's state-of-the-art lending projects and partnerships with innovative software product vendors. Rahul has more than a decade of experience in banking technology area and has worked in solution sales, consulting and strategy, product development and management in IT organizations while helping banking clients across the globe.