Modernizing Trade Finance
Trade Finance: The Opportunity for a New Trajectory

Trade Finance products and services have served as a critical enabler of global trade growth and economic development. The business has developed from a simple financial instrument that facilitates trade to a span of corporate offerings including finance (trade loans, discounting loans, and supply chain finance) and services (letter of credit, performance guarantees, and documentary collections). In line with the expected long-term growth in overall trade, the size of the trade finance market is expected to grow at a CAGR of 3.2% from $63.5 Billion in 2019 to $79.4 Billion in 2026.¹

Inherent Characteristics of Trade Finance Products

- **Paper-Intensive**: Trade finance products are highly paper-intensive and involve the processing of financial and non-financial documents that contribute significantly to total costs.
- **Manual Processes**: Trade finance processes are labor-intensive, which creates operational inefficiencies, process errors, and longer turnaround times.
- **Regulatory Compliance**: Trade finance requires strict compliance with multiple regulatory requirements including Basel III, Dodd Frank, AML, and CFT. This pushes banks to make continuous investments in systems and processes to avoid potential financial and reputational losses.
- **Client Onboarding**: Banks need to conduct strict KYC while onboarding new clients and updating ongoing relationships. The lack of transparency in data, including funding, can result in significant monetary losses and the loss of clientele.
- **Legacy IT Systems**: Most banks operate through their legacy IT systems, and these systems are poorly integrated with manual processes, which can result in errors and reconciliations.

Shifting patterns of trade finance uptake

Recently there has been a shift in the uptake of trade finance from traditional products toward supply chain finance and open accounts. This shift is largely driven by globalization and technology, including seamless communication and access to near real-time data, providing opportunities to unlock liquidity early in the supply chain. In comparison, it is more difficult for SMEs to access the trade finance market due to insufficient risk assessments, lower credit ratings, and KYC limitations – potentially creating a trade finance gap of $1.4 trillion to $1.6 trillion.² This gap indicates that there is significant latent demand for more traditional finance products and, therefore, an enormous opportunity for banks. However, to tap this demand, banks must address significant structural and operating impediments. We believe judicious use of digitization is the way forward for banks to modernize their traditional trade finance offerings, including operations and transaction processing.

Potential digitization opportunities revolve around the inherent characteristics of traditional trade finance products. These products have been slow to modernize due to the involvement of multiple parties in the transaction, the requirement of physical movement and paper-based processing, manual processes, and legacy technology systems. Other major challenges facing businesses today include regulatory compliance, limited technical and development. These challenges drive up costs for multiple reasons -- including and development. These challenges drive up costs for multiple reasons -- including fragmented processes and the physical handling and checking of documents – and make it difficult to manage customer experience and expectations.

1. [https://reports.valuates.com/request/sample/QYRE-Auto-6X849/Global_Trade_Finance](https://reports.valuates.com/request/sample/QYRE-Auto-6X849/Global_Trade_Finance)
Intelligent Automation

Artificial Intelligence (AI) and Machine Learning (ML) leverage predictive analytics to drive intelligent automation and pattern recognition. A combination of AI/ML with RPA/OCR can help automate the transaction process, enable the conversion of paper documents into a selected electronic format, and ensure that electronic forms are delivered to stakeholders at appropriate times during the trading process.

Collaboration & APIs

The industry is moving toward a collaborative model, and the implementation of APIs enables the integration of a bank’s siloed legacy IT systems with third parties. This leads to a single-window transaction as it interconnects trade finance products across the ecosystem. Banks are extensively leveraging the potential of external service providers through APIs, creating an improved customer experience.

DLT & Smart Contracts

The integration of Distributed Ledge Technology (DLT) with trade finance products is likely to support efficient, cost effective, and secure transactions. Smart contracts running on DLT provide a single and immutable record. DLT also prevents duplicate financing and enhances the credit quality of corporations. The industry is heavily investing in DLT because it has the potential to provide end-to-end digitalization of trade finance.

Embedded & IoT

The Internet of Things (IoT) interconnects smart devices and supports real-time tracking of shipments. The technology is useful in a closed-trade transaction and could enable the instant payment and release of invoices. Shipping companies are investing in IoT to improve transparency, efficiency, and the safety of goods.

Digitization

Robotic Process Automation (RPA) enables the digitization of transactions and is extremely beneficial in curtailing inefficiencies existing in manual and rule-based processes. The technology, when combined with Optical Character Recognition (OCR), further helps in converting paper documents into data, allowing seamless transactions.

Potential Digital and Technology Levers that Could Accelerate Adoption

Explore and Experiment to Shape Your Trade Finance Digital Strategy

There are clear signs that momentum is growing in the trade finance industry. The structural marketplace-led innovation, business models, standards, collaboration, and legal frameworks are being deliberated but are still evolving. While these marketplace shifts take more definitive and decisive shape, banks need to explore different new-age technology interventions available today to experiment and test solution possibilities to start shaping their trade finance digitization journeys. This process will help them reinvent and refresh their business capabilities underpinned by innovative digital solutions that can help deliver instant stimulus to manage costs, efficiency, and experiences. This will also help banks align and be better prepared to embrace ongoing structural and marketplace shifts by uplifting their digital capabilities.

The current market environment has accelerated digital adoption in silos across the value chain, including order management, invoicing, inventory management, transportation, documentation, payments, and financing. We believe financial institutions need to test, qualify, and implement these new-age digital interventions and fintech solutions within their own environment to alleviate immediate internal pains and customer experience issues. The images below outline some of the digital/technology levers that could act as catalysts to accelerating and adopting innovative solutions in trade finance by shifting from paper-based and labor-intensive models to a more modern digital and dematerialized world.
We acknowledge that trade finance is a difficult and complex business to digitize due to the involvement of a number of participants across the physical and financial supply chains. The opportunity to convert the exchange of data and documents from analogue to digital is fundamental to transforming underlying business processes across the value chain. Because trade digitization is such a vast undertaking, it presents multiple challenges for banks. They need to invest resources into implementing digital solutions in a manner that can maximize their return-on-investment in the short-term while laying the right foundational digital capabilities for the structural changes that are inevitable.

Based on our global experiences and deliberations with clients and extended trade finance eco-system players, we have devised the following framework that can help prioritize the trade finance digitization journey for banks.

The pace of digital adoption will depend on the intent and level of investment from banks, corporations, and other third parties, but this journey also requires a cultural change because new technologies and processes require renewed learnings and a shift in business trajectory to offer value-added services to strengthen revenue streams.

We intend to expand on these three pillars in upcoming paper, covering digital solutions, emerging fintech players, and how banks are managing the change from internal processes to ecosystem-led evolution.
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