Oracle Financial Services

Fostering Smarter Trade Finance Operations

Digital Engagement in Trade Finance

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INTRODUCTION

To stay competitive in today's ever-changing trade environment, both corporates and banks have to modernize their trade finance operations. According to the World Trade Organization, 80 to 90 percent of the world trade relies on trade finance (trade credit and bank financed trade). Banks need to transform themselves for efficiently meeting the growing trade finance demands of corporates. Corporates are looking for ways to improve their trade service quality levels, expand trade operations to a global scale and ensure compliance to regulatory bodies without incurring additional costs. The onus lies on the banks to ensure that corporates can achieve their trade goals without any friction. Banks need to offer solutions that automate the end-to-end lifecycle processing of trade finance operations thus satiating the corporates' trade needs with real-time visibility over their trade transactions.

The trade finance lifecycle is a very complex process when carried out manually. The processes involved are document intensive especially when corporates function their business from multiple location and the application has to go through multiple verifications, amendments, and approvals. Digital transformation in trade finance will play a very critical role in empowering banks to provide trade finance services at lower costs and at a higher efficiency level.

Banks need to gear up themselves to embrace automation that eliminates the manual labor and paper intensive trade operations, which are highly error prone. Leveraging trade finance solutions that have workflow automation for managing trade finance lifecycle in real-time will empower banks to carry out trade finance operations seamlessly with faster turnaround time and superior customer experience.

In this whitepaper, we will examine how digital transformation in trade finance drives banks to deliver a frictionless trade finance experience.

TRADE FINANCE GLOBAL MARKET OUTLOOK

According to the recent International Chamber of Commerce global trade report, the global trade market is witnessing a steady comeback from the global financial crisis and the world trade volumes are growing at a fast pace (Figure 1). 80 to 90 percent of the world trade relies on trade finance and this shows us how much dependency the trade market has on financial institutions. According to WTO and UNCTAD, the global trade flows are expected to grow from 2016 to 2020, reaching USD 18.7 trillion. The BCG Trade Finance Model estimates trade grew 8.7%, well outpacing global GDP growth.

The International Chamber of Commerce report also stated that the Middle East and non-EU Europe regions grew fastest at 16% and 13%. Asia-based corridors are expected to grow between 4% to 9% a year from 2017 to 2026 and US based corridors are expected to grow only 2% to 5%. Asia will represent 38% of global trade flows by 2020, up from 36% in 2016, while the US share will fall to 8.7% in 2020 from 9.2% in 2016.

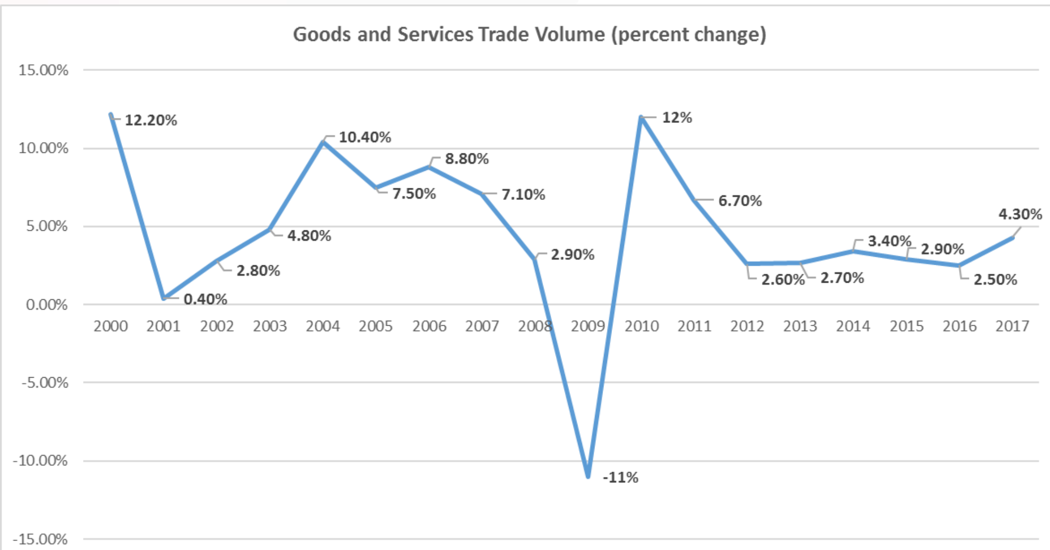

Figure 1. Global Trade Volumes Source: ICC Global Trade Report 2018

According to the analysis by the Boston Consulting Group, the global trade flows are estimated to hit a record US$24 trillion by 2026, and the trade finance revenues projected at US$48 billion in the next three years, with a growth rate exceeding at 6% a year. These statistics show us that the trade business is heading towards growth and banks need to pull up their socks and transform themselves to address the needs of trade market efficiently.

According to the International Chamber of Commerce Global Survey on Trade finance 2018, over 31 million trade finance transactions and over USD $9 trillion in trade finance were processed in 2017. Asia-Pacific region was about 36,000 transactions for the year, nearly double the level processed in North America, and about 10 times the median volume reported in Africa. North America ranks first for processing the highest value, double that of Asia-Pacific, which ranks third in value processed. Latin America and Central and Eastern Europe (CEE) rank sixth and seventh respectively in volume and value processed.

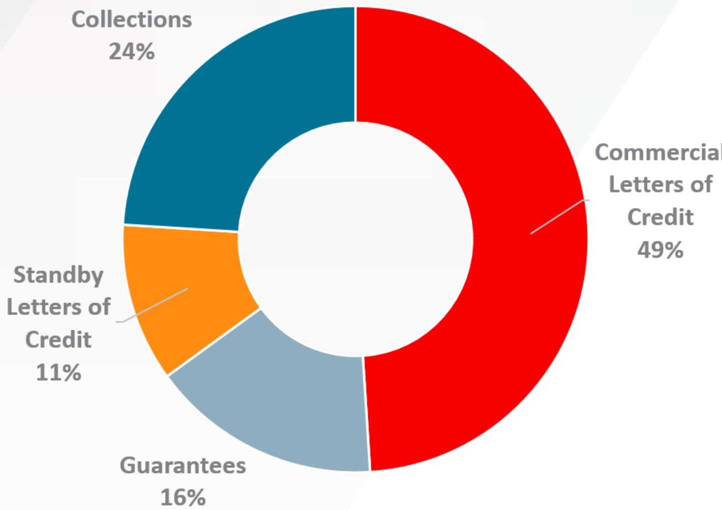

Figure 2. Trade Finance Product Mix Source: ICC Global Survey on Trade Finance 2018

The traditional trade finance product mix as per the 2018 survey conducted by ICC Global on Trade Finance (Figure 2) reveals that the commercial letters of credit is the most preferred trade finance instrument followed by guarantees and standby letters of credit. Traditional instrument usage is facing threats due to the current shift, which is taking place in the trade market due to supply chain finance.

Overall, the usage of the traditional trade finance instruments such as letter of credit and guarantees form the major chunk for trade finance operations, with 85% in traditional trade finance and about 15% in supply chain finance for the year 2017. (See figure 3)

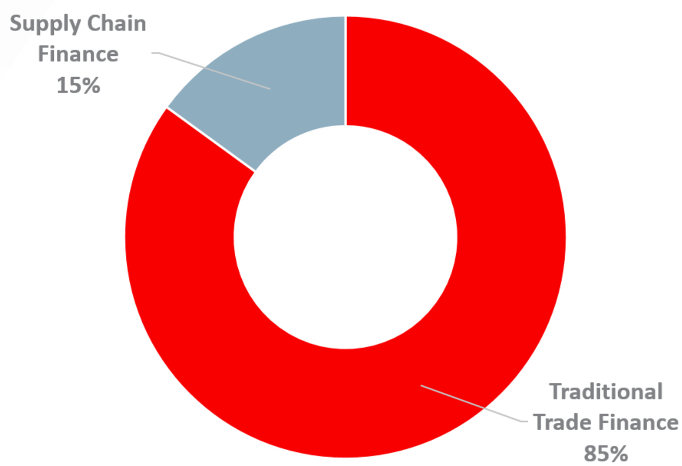

Figure 3. Traditional vs. Supply Chain Finance Source: ICC Global Survey on Trade Finance 2018

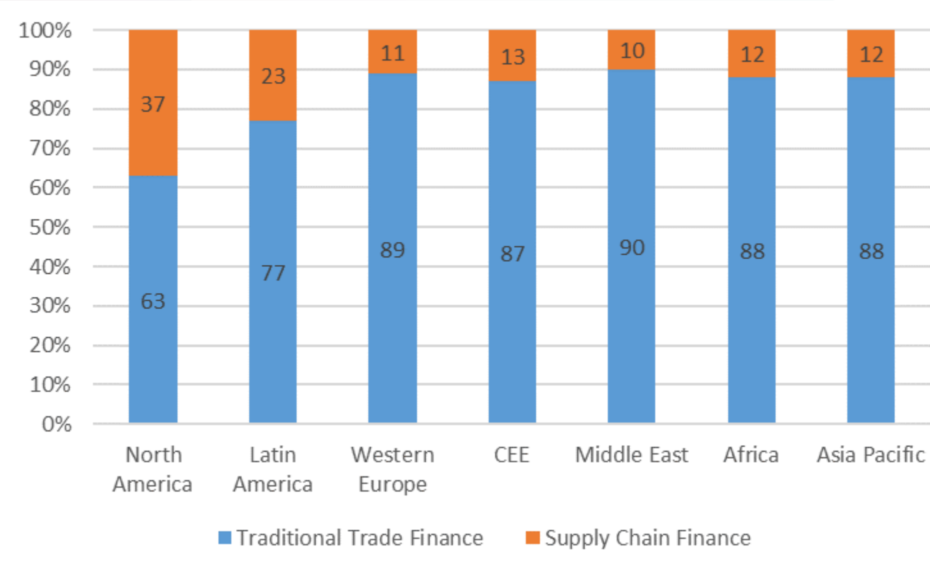

Figure 4. Traditional vs. Supply Chain Finance by Region Source: ICC Global Survey on Trade Finance 2018

As mentioned earlier that a gradual shift is taking place from using the trade finance traditional instruments to supply chain finance. However, traditional trade finance instruments dominated the year 2017 in almost every region (See figure 4). The 2018 survey conducted by ICC Banking Commission, the value of traditional trade finance respondents provided in 2017 was over US$4.6 trillion, and US$813 billion in supply chain finance.

KEY CHALLENGES IN THE TRADE FINANCE LIFECYCLE

Corporates are looking for ways to reduce costs and banks should step in to offer efficient and cost effective trade finance solutions. The current trade finance processes are heavily dependent of manual and document based processes. This not only adds to high costs and revenue loss for both corporates and banks but also causes delay in the entire trade finance lifecycle. The banks also have to fulfill the stringent compliance, KYC verification and AML requirements for processing the trade finance applications.

The entire trade finance lifecycle is bogged down with labor-intensive processes that drive the productivity level across the trade lifecycle to a very low level. The growth of trade is moving in the positive direction and the need to the hour is to meet the growing demands of corporates by overcoming the challenges faced by banks throughout the trade finance lifecycle and thereby equip them to serve their customers efficiently.

Table 1 highlights the critical trade finance challenges banks face and the operational impact they have on the trade finance lifecycle. The optimal way to curb these challenges is by moving the trade finance operations into the digital realm. We will be discussing on how digital transformation can affect the trade finance gamut in the latter sections.

Challenges	Description	Operational Impact
Paper Heavy Processes	Flow of physical paper documents like Purchase Orders, Invoices, Bill of Lading (BOL) etc. across borders throughout the transaction cycle	Increase in transaction turnaround time Handling & storage costs Risk of losing or tampering important documents
Labor Intensive	Authenticity of paper documents like BOL, signatures, address is verified manually‘ Manual handoffs across fragmented operational processes and IT systems	Manual checking is subjective & error prone Lack of standardization across geographies makes it difficult to scale operations Staff development is critical which may take as many as 6 months to 7 years High staff turnover and relative inexperience increases operational risks and leads to client dissatisfaction
Stringent Regulatory & Financial Crime Compliance	Basel III, Dodd Frank, Foreign Account Tax Compliance Act (FATCA) and AML require banks to invest heavily in systems and procedures to deter, detect and protect from money laundering. This one of the significant cost drivers in the industry.	Enhanced due diligence, KYC compliance, Sanctions screening has introduced costly manual checks Reliance on 3rd party providers like World Check, Sea Searcher, Blacklist check, Defaulters list check increases manual handoffs and turnaround time Nonstandard reporting processes and formats for adhoc transaction reporting to regulators
Legacy IT Systems	Fragmented and outdated legacy systems are integrated in an ad-hoc manner with manual processes by staff	Manual handoffs increase complexity in tracking and limit efficiency improvement by automation Low paced adoption of operationally efficient technological innovations like Bank Payment Obligation (BPOs)
Funding	The absence of guaranteed payment due to little or no clarity on the counterparty and absence of payment default rules	Delayed or no payment

Table 1: Challenges in the Trade Finance Lifecycle Source: Deloitte Report

TRADE FINANCE OPERATIONAL CHALLENGES FACED BY BANKS

The trade finance operational processes that are carried out today by banks are burdened with low efficiency resulting in loss of revenue and low customer loyalty by corporates towards their banks. Figure 6 shows us the operational challenges that banks are face because of lack of automation and digital engagement in today's trade finance scenario.

Figure 6: Trade Finance Operational Challenges Faced by Banks

Labor and Paper Flow Intensive Processes for Trade Contract Creation and Review: The current process of contract creation is a very tedious process wherein a paper format of the trade contract document is drafted and send back and forth multiple times by the parties involved until a consensus arrives. This is followed by amendments and reviews, which are carried out by the parties involved. According to the ICC global trade report, 2018, an estimated four billion pages of documents circulate in documentary trade. Trade finance processes with heavy paper copies such as bill of lading, purchase orders, invoices, etc. across multiple parties and across borders create a huge operational chaotic situation.

AML Implementation: Carrying out trade based AML checks for the trade finance applications is complex for banks to handle if the corporate is doing a high value and multi-location trade transaction. Banks face difficulties to establish the genuine identity of the customer, understand the nature of the customer's trade activities and access the AML risk of the corporate.

Slow Documentation and Verification Checks: The checking and approving contract documents in paper format is very tedious process and is carried out by multiple stakeholders. There are high risks of the documents being misplaced in the process which in turn cause severe delays in the shipment of goods. Also the pain staking limit checks and verifications with AML and credit bureaus lead to delays the payment process.

Manual and Expensive Reconciliation: Banks should ensure that their account report should not have errors during the matching process. A huge disadvantage with manual bank reconciliation is that it is prone to human errors and a very costly process. Such reconciliation errors can increase the risks to loss of revenue and frauds.

Multiple Trade Systems and Poor Visibility into Trade Transactions: As corporates venture into global markets to expand their business, it becomes increasingly critical for banks to help themselves and their corporate clients have clear visibility of their trade finance transactions and a clear view of their credit position. Banks use multiple systems to handle the different activities of the trade lifecycle. This creates a major disconnect in the flow of critical trade data such as letter of credit value, dates, payment terms and contract amendments which increases the risk of trade finance fraud and regulatory non-compliance.

No Standardization of Processes and Documentation: Banks face multiple formats of Letter of credit and guarantee applications and it becomes very difficult for banks to manage them due to non-standardization of the processes and documentation. Manual and Labor Intensive Processes for trade document creation, review, authentication of paper documents, confirmations, handoffs, etc. This results in errors during data entry, inconsistencies across the trade finance lifecycle, losses and delays in shipment, approval, verification and non-compliance.

Non-Compliance: Conforming to external regulatory bodies and internal compliance checks can be a daunting task for banks if the trade lifecycle processes lack transparency. Being non-compliance can result in heavy losses for the bank and damage their relationship with their corporate clients. Time-consuming compliance checks can cause delays for letters of credit and guarantee issuance thereby leading to friction in the entire trade finance lifecycle.

Lack of Collaboration: Banks are facing issues when collaborating with their counterparties to process the trade finance applications in an efficient manner. Lack of collaboration can result the application to be a part of a vicious cycle wherein the trade document moves back and forth to the same parties during drafting, amendments, verification, approval, etc.

TRADE FINANCE CHALLENGES FACED BY BUYERS AND SELLERS

The buyers and sellers also face complex challenges during the trade finance lifecycle. The challenges faced by the buyers and sellers are described in table 2 below. The pain points caused by paper based manual processes; delayed payments and delay in the receipt of goods are some of the critical challenges faced both the parties.

Buyer Side	Seller Side
• No clear understanding on the counterparty • Shipment delays – Many touchpoints, increased & time consuming paperwork • Possibility of fraud due to multiple touchpoints • Possibility of damaged goods on receipt and inspection	• No clear understanding on the counterparty's credibility • Increased paperwork • No assurance of payment at the time of shipment • Possibility of delayed payment/no payment • Delay in receiving acknowledgement of receipt of goods

Table 2: Trade Finance Challenges faced by Buyers and Sellers Source: Deloitte Report

Banks should take the onus of helping both the buyers and sellers in overcoming their challenges. Digitization of trade finance processes and real-time collaboration are the key element that can help all the three parties involved i.e. buyers, sellers and banks to conduct trade transactions in a frictionless and timely manner.

DIGITAL TRANSFORMATION IN BANK'S TRADE FINANCE OPERATIONS

The financial world is riding high on with drastic changes happening in the technological realm. Banks in particular are leveraging technologies such as Artificial intelligence, Blockchain, Internet of things and Machine learning to solve banking business challenges. Digital transformation has also started happening in the space of trade finance along with major digital transformation happening in the retail and customer experience space.

Banks can overcome the trade finance lifecycle and operational challenges faced by banks as noted in the previous segments by imbibing digital restructuring into their trade finance operations. According to BCG, an integrated digital solution having functions like intelligent automation, collaborative digitization and other advanced technology solutions would help global trade banks save US$2.5 billion and US$6.0 billion on a cost base of US$12 billion to US$16 billion, with the potential to increase revenue by 20% up to 35% over 3 to 5 years. (See figure 7).

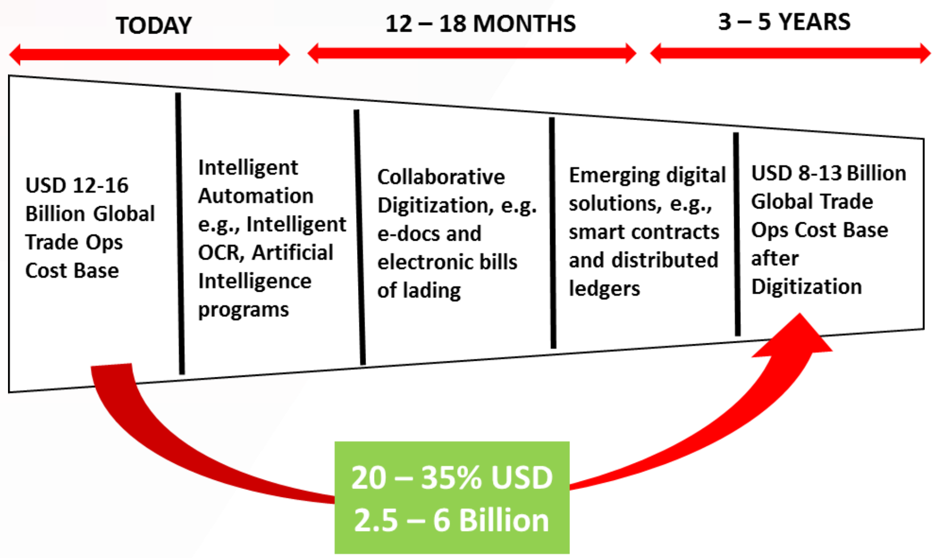

Figure 7: Savings Opportunities During Digital Transformation in Trade Finance Source: BCG Analysis

78% percent of banks surveyed in the ICC global trade report 2018, have implemented, or are in the process of implementing technology solutions to digitalize their trade finance operations. The report also states that banks are moving towards greater digitalization with a strong interest of investing in evolutionary technology such as digital trade and online trade platforms, digital ledgers and supply chain finance. BCG states that methods such as Robotic Process Automation (RPA) and Machine Learning (ML) can help in the digitization of trade finance operations such as sanctions screening and compliance checks.

Let us now discuss on the three pillars (see figure 8) that will enable banks to drive digital transformation in their trade finance operations.

Figure 8: Three Pillars That Drive Digital Transformation In Trade Finance Operations

Automation: According to the report, Role of Trade Finance for Inclusive Growth, Deloitte 2018, trade activities require an average of 36 original documents, 240 copies, and the involvement of 27 entities and the Fortune 500 companies spend over USD 81 billion annually on unnecessary working capital, and supply chain costs.

The documentation intensive manual work contributes to the majority of the trade finance related costs. Banks have to adopt trade finance solutions that drive automation throughout the entire trade finance lifecycle that is burdened with labor-intensive paperwork and documentation processes. For banks to dominate the trade finance space in these challenging conditions and also taking into consideration the drastically changing financial landscape, their trade finance offerings and operations must take the digital route to be more flexible and agile.

Speed: According to ICC global trade report, 2018, the automation of trade finance operations such as Letter of credit issuance, drastically reduced the end-to-end human involvement to final validation and authorization, cut processing times by 60%, and reduced full-time employee headcount needed for data entry and scrutiny by 70%. Banks need to be agile and speed up the trade processes with efficient workflows to streamline the trade finance operational processes end to end. With the advent of digital innovations happening in the trade finance space, banks have to start digitizing their trade processes to speed up trade finance operations throughout the lifecycle.

Technologies such as e-documentation can help banks replace paper processes and enable real time transaction tracking. Adoption of such technologies will help banks increase trade visibility, prevent duplication of work across the trade lifecycle, reduce paper footprints and ensure banks remain compliant to all the trade processes.

Banks use Optical character recognition (OCR) technology to convert documents into e-documents without any human intervention. This can be used in speed up trade finance operations and reduce costs. Banks have also started utilizing automated templates solutions in their trade finance operations to reduce the time taken for trade documentation creation and to maintain document consistency across the entire trade finance lifecycle.

Collaboration: According to ICC Global Trade Report, 2018, all trade parties (importers, exporters, banks, customs and logistics institutions) collaborate with each other and collectively end up creating a huge amount of data during the transaction (about 5,000 data fields) which varies across the trade finance instruments. The report also regarded the letters of credit as the most complex trade finance instrument with its end-to-end lifecycle involving more than 20 players, more than 100 pages across 10 to 20 documents with duplicated information transmitted multiple times.

Banks need to collaborate with corporates and other counterparties for real-time visibility and quicker processing of their trade finance services with the technological trade finance innovations such as e-documentation and e-bill of lading, Such technology-based collaboration will empower banks and other trade entities to make quicker decisions and complete trade finance services in a shorter processing time.

Trade finance instruments such as e-bill of lading facilitate faster transfer of shipping documents between entities thereby reducing the payment cycle. It also helps improve the working capital position of exporters. E-bill of lading are gaining popularity because they are digitally processed which saves a ton of money, they provide real-time end-to-end transaction visibility and are highly secure.

Banks should also digitize their reconciliation process in order to optimize their staff's efforts in managing and matching exceptions manually. Digitization the reconciliation process reduces the risk by eliminates transaction errors and reduces the possibility of fraud. Lastly, seamless customer experiences in trade finance with intuitive customer interfaces empowers frictionless collaboration between banks and other trade counterparties.

HOW CAN BANKS DELIVER A FRICTIONLESS TRADE FINANCE EXPERIENCE?

The trade market is very competitive and banks need to transform themselves for efficiently meeting the growing trade finance demands of corporates. Banks have to go digital to drive their customer's trade finance operations at a higher efficiency and this is where trade finance technology steps in. Banks need to have the right set of trade finance systems in their banking IT infrastructure to meet not only their current trade finance requirements but also keeping in mind the ever-changing trade finance landscape. Figure 8 highlights six key trade finance functionalities, which banks have to look out for when deploying their trade finance systems to deliver a frictionless trade finance experience to their customers.

Figure 9: Key Trade Finance System Functionalities

Table 4 below shows the benefits that banks can gain from each of the key trade finance system functionalities as shown in figure 9.

Trade Finance System Functionalities	Benefits for Banks
• Automated Workflows	Automated process workflows improve task management and increases productivity • Ensures Straight Through Processing to reduce operational cost • Eliminates redundant manual processes • Maximizes automation and enables faster fulfillment • Enables visibility into real-time status of application
• Seamless Experience across Multiple Channels	Seamless multi-channel experience removes all channel barriers impacting customer satisfaction • Allows use of different access points to begin & complete process • Enables consistency of experience across touch-points • Ensures frequent in-person branch visits are no longer required
• Centralized Trade Finance Operations	Centralized operations capability enables reuse of customer data & application services • 360 degree view of customer relationship • Ensures capturing only the required data 'one time' • Ensures faster turnaround time • Complete reuse of customer information such as customer, trade and import licenses and preferences such as currency, branch and tenor • Reuse Application Services for fulfillment of different Trade Finance processes
• Paperless Processing	Enhances operational efficiency and reduces manual errors • Enables faster processing • Provides greater convenience • Reduces cost and improves the speed of communication
• Seamless Third Party Integration	Seamless third-party integration for quicker turnaround and collaboration between parties • Enables faster credit decisions • Ensures meeting ever-increasing regulatory requirements • Enables parallel processing • Enables Integration with external vendors and credit bureaus to perform customer identification, AML and KYC checks • Eliminates manual transfer of data between stakeholders • Enables Integration with participating banks (issuing bank, advising bank, etc.), importer, exporter and service providers

• Flexible Product Attributes	Flexible options to define wide range of product attributes enables banks to enhance customer experience • Enables faster credit decisions • Enables banks to create different trade finance Products with several Variations • Enables banks to define product attributes such as Currency, Branch, Tenor, Charges and Collection terms specific to Customer Requirements • Faster time-to-market and thus faster realization of revenue with high degree of configurability that adapts to business and regulatory environment with a shorter development time • Enhances customer experience as customer preferences are met

Table 4: Benefits of the Key Trade Finance System Functionalities

CONCLUSION

With the global trade flows showing a rapid growth, trade finance is proving to be a highly profitable business entity for banks. Banks need to play a critical role in facilitating trade finance operations end-to-end such as financing, payment processing and risk management through different trade finance instruments. Banks need strive to deliver a seamless trade finance experience by leveraging technologies such as Machine learning, Artificial intelligence, Optical character recognisation (OCR), e-documentation and e-bill of lading and advancements in customer interfaces.

Digitization is the driver for trade finance and the onus lies on the banks to provide innovative trade finance solutions to their clients. Banks have to pull their socks understanding that the trade finance landscape is changing drastically and most of the trade interaction between banks, corporates and other counterparties is happening through digital channels. Banks have to deliver digital trade finance services to eliminate heavy paper flows operations, provide rapid processing, enable real-time transaction visibility and enhance collaboration.

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