Cashing in on Trade

Post Covid - 19

What a world to look forward to!

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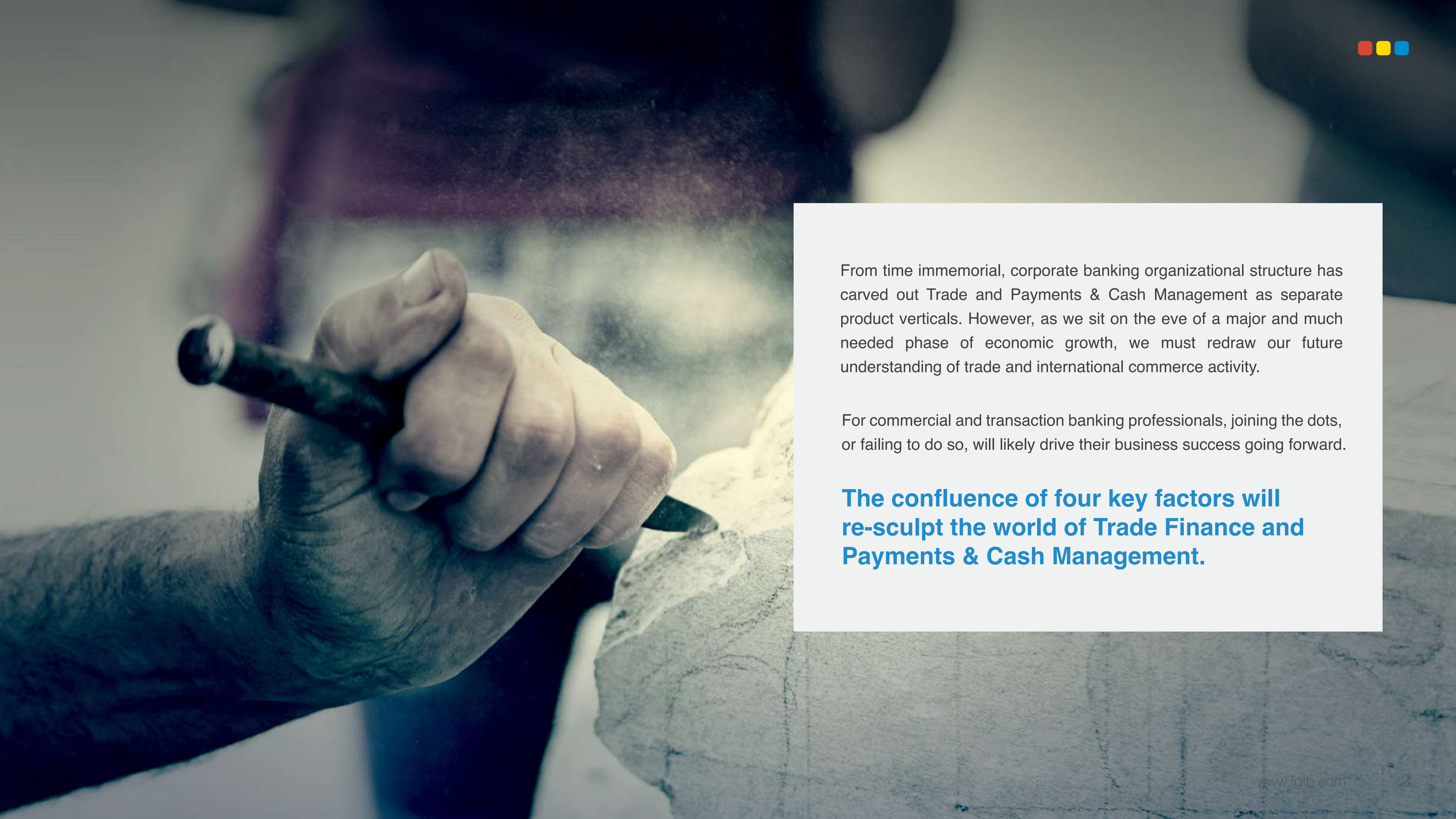


From time immemorial, corporate banking organizational structure has carved out Trade and Payments & Cash Management as separate product verticals. However, as we sit on the eve of a major and much needed phase of economic growth, we must redraw our future understanding of trade and international commerce activity.

For commercial and transaction banking professionals, joining the dots, or failing to do so, will likely drive their business success going forward.

The confluence of four key factors will re-sculpt the world of Trade Finance and Payments & Cash Management.

Key Factor #1

Cross Border 'Services'

During the last ten years the finance industry has watched the shrinking relevance of traditional trade finance – the 7x and 4x series message types – with annual volume statistics ranging from flat to -5%*. Last year, although atypical, saw a drop of 11.8% of those messages, against an increase of SWIFT message traffic overall.

Optimists continue to anchor their belief that Letter of Credit business is relatively stable and that there will 'always be a market' – but problematically there has been little commentary on how underlying trade is being dissected with the growing relevance of 'international services'.

This value added trade component supports not only the trade of goods and merchandise but is also a major driver of economic activity in its own right. And, of course, the resulting income stream is settled through open account cross-border payments which, according to analysts, is growing at twice the rate of physical goods.

From 2008 to 2017, growth estimates in pure-play international services were 5-6% per annum totaling a value of USD 13.3 trillion. These figures will have changed in relative significance since then, creating a larger moat between stagnating traditional trade and new age service industry development.

*Source: SWIFT

So what are these emerging international service businesses?

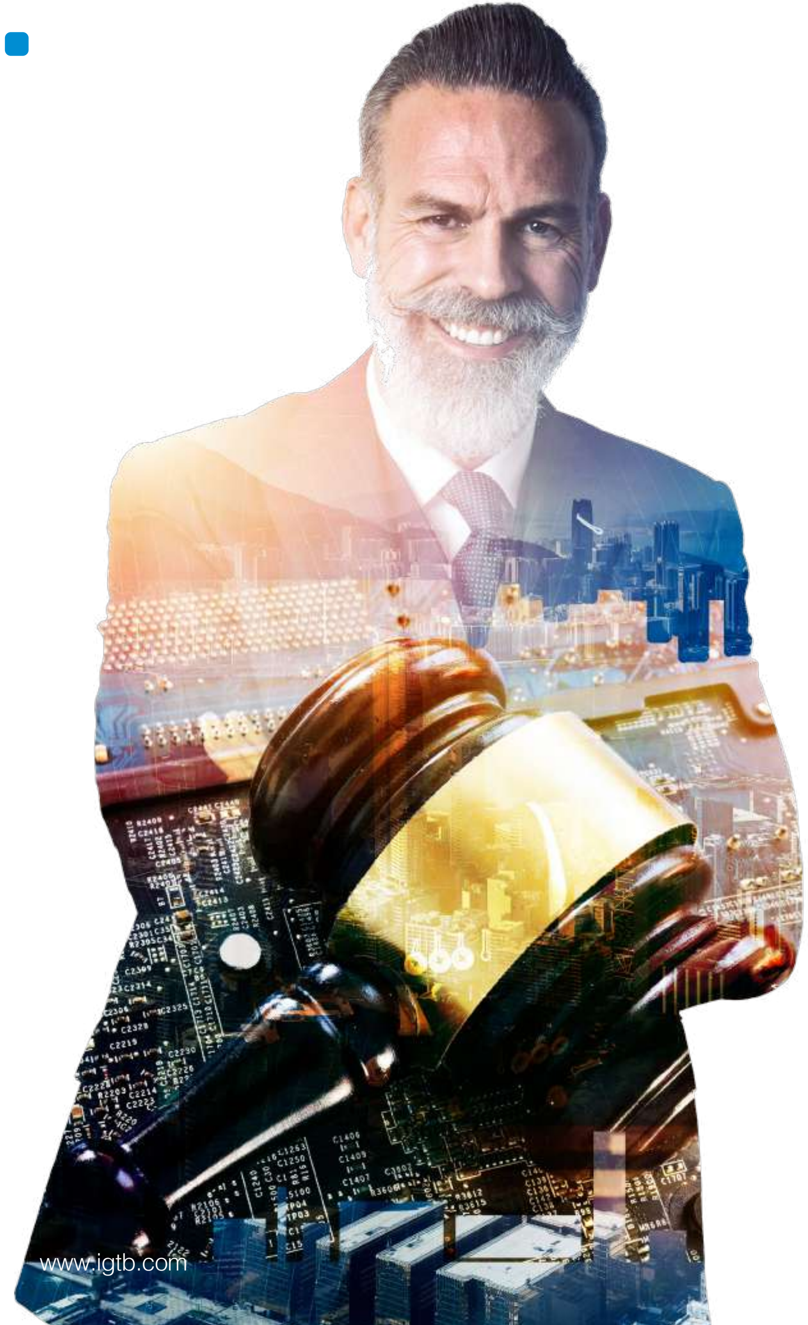
We are all aware of tourism, passenger transport, education, finance and logistic industries - but take a look at the relevance of major service sectors that Covid-19 has catapulted to the fore: technology, healthcare, telecommunications, media, design & marketing, research and development, environmental services – and yes, even construction. The last is increasingly using advanced technology in its operations such as drones for aerial surveillance of building projects, replacing land surveillance and construction through modular 3-D printing.

And so the examples by industry go on and on… And as each new industry sector finds its service pivot to exploit, so this nascent business activity disenfranchises traditional trade instruments from the growing future international trade wallet.

According to McKinsey*, over the last 10 years

"Trade in services …has outpaced growth in trade by more than 60 percent".

*Source: McKinsey 2020 Global Payments report



Key Factor #2

Standards

The growth in open-account payments business is being dynamically changed through global regulatory initiatives like Open Banking and the adoption of ISO 20022.

The former is stimulating the shift to real-time business, the spectacular seeding of market place developments and, importantly, is driving crossover innovations between banking and fin-tech industries, such as the explosion of embedded finance in commercial activity. This was, of course, the key historical driver that led transaction bankers to get excited about the significance of having supply chain finance as a product line – the need to become relevant in their clients' trading activity and to navigate the trade flow points to open up lending opportunities.

More recently, the Open Banking initiative has seen an evolutionary shift, where banks, and their clients, have latched on to real-time transaction models and value-added solutions, creating an opportunity in the corporate arena. In part this has propelled more immediate provisioning of working capital solutions as new data inputs permit more instant validation around a client's business, supporting lending fulfilment immediacy.

The effective use of new technologies is driving the velocity of money exchange and growth in underlying payments volumes in both domestic and international markets.

A Sibos poll run on LinkedIn in 2020 also revealed that 48% of respondents saw new value-added services as the true benefit of Open Banking, with 29% choosing open banking compliance, 19% fin-tech collaboration and 5%, client connectivity.

So we can expect further value-added use cases driving payments growth.

But if the consequences of Open Banking are becoming more pervasive in further promoting the relevance of payments in an international context, the impact of ISO 20022 in erasing the hard coded vertical lines of the trade and payments businesses is attracting less attention.

The ISO standard is seen as a necessary payment innovation supporting fresh payment rail initiatives – currently being established across a number of countries. But we need to remind ourselves that ISO 20022 was always conceived by SWIFT as the de-facto industry 'gold' message standard covering the full remit of its businesses – Payments, Trade, Securities and Treasury.

In fact it is hard not to conceive how the new standard won't be quickly and fully embraced by 'trade' specialists. Given the extended information that the message structure allows, it temptingly offers a tremendous upside to take away friction points around reconciliation and dispute management. Companies will be able to provide details of bills of lading, application of credit notes, deduction details as well as data supporting origin-of-goods compliance checking. In short – a pathway for more automation, reduced processing time and a clear transport mechanism for remittance data to support reconciliation.

The roll out of ISO 20022 will drive a more uniform way for banks to review how they want to bring the intersection of 'trade' and 'payments' together.

Key Factor #3

Innovation

As targets for disruption, Trade and Payments have attracted major investor interest and eye-watering funding levels. Transparency and immediacy have driven the success of industry initiatives such as SWIFT's gpi service and the roll-out of domestic instant payment schemes across the globe. We have witnessed a true explosion of payments growth, as the velocity of activity and the ease of initiation and tracking is truly mobilized. Increased transparency and payment development have looked to strengthen security and inherently build trust and business adoption. SWIFT payment volumes registered double-digit Fin message growth in 2020, even in compromised times.

So innovation has been a driver of usage. No surprises there.

But business model evolution, with the growth of B2B marketplaces, has been another major phenomenon in stifling the use of traditional trade instruments in favour of domestic and cross-border payment products.

These marketplaces bring together, in one place, all of the participants and associated services for international trade: suppliers, buyers, shippers, logistics, finance, inspection services, marketing news and software applications that facilitate digital catalogue production, purchasing and sales.

And if we ever needed a reminder on the importance of this new market place dynamic, especially during this pandemic period, take a look at some key data points:

1. The size of the business-to-business e-commerce market is estimated to reach USD 20.9 trillion by 2027, expanding at a CAGR OF 17.5% until then (Research And Markets).

2. B2B online marketplaces will account for approximately 30% of all worldwide online B2B sales by 2024 (Digital Commerce 360).

3.According to Forrester, US business–to–business e-commerce transactions are expected to reach USD 1.8 trillion by 2023 representing 17% of all B2B sales in the country.

4. B2B business values are some 6 times larger than the more familiar B2C market demand (Statista).

Of equal relevance is the payment optionality normally offered to business customers transacting on these market places:

i. Payment on delivery

ii. Term payments

iii. Cards

iv. Cheques

v. Mobile Wallets

the first two categories being the largest volume contributors.

So again, if the payments industry is being propelled by the tsunami of business marketplace development, traditional trade instruments are notable for their exclusion, left out in the cold - irrelevant in the new commercial engagement model described above.

Key Factor #4

Customer Periscope

As Harvard Business Review predicted last October, "When the Covid-19 pandemic subsides, the world is going to look markedly different. The supply shock that started in China in February and the demand shock that followed as the global economy shut down exposed vulnerabilities in the production strategies and supply chains of firms just about everywhere as a consequence of all this, manufacturers worldwide are going to be under greater political and competitive pressures to increase their domestic production, grow employment in their home countries, reduce or even eliminate their dependence on sources that are perceived as risky, and rethink their use of lean manufacturing strategies that involve minimizing the amount of inventory held in their global supply chains."

The shift in reconstructing new and stronger supply chains will not be achieved overnight, but the clamour for change will happen and will also dovetail nicely with country policy and broader democratic requirements to support green trade and review corporate responsibility credentials of new trading counterparts.

What we can pretty safely predict is that Corporate Banking KPIs will be turned on their head as leaders question business ethics, relevance of each banking institution in rebuilding the fabric of the economy, as well as supporting innovative and growth sectors, with a maniacal eye on incubating the SME sector.

In short, Transaction Banking professionals will need to drill down deeper and understand their complete customer flow dynamics, the underlying changing business relationships and the new trading corridors that clients and prospects are looking to develop. The client relationship function will continue to be the prevailing dialogue conductor within the Corporate and Institutional Banking division but working very closely with chameleon-like partners that straddle both legacy Trade and Payments & Cash Management product lines.

The future ‘product’ mission will need to gravitate towards more key existential themes, namely to:

i) drive penetration of a clients’ total sales volume,

ii) build the share of cost of goods purchased and processed through the bank’s channels,

iii) be the working capital engine to support customer business expansion, as well as

iv) become the risk mitigation agent in ensuring healthy client business development.

So for those banking institutions that have still to get to the Transaction Banking 2.0 organisation where today they tie their allegiance to a singular Trade function - with no real Cash Management and Payments business – their days are likely to be numbered already.

For the rest of the Transaction Banking community, a clearer articulation and alignment of structures and competency to be relevant in the Transaction Banking 3.0 world, against the seismic shift in traditional trade towards open account business, is needed. And the clock is ticking…

Who knows we might even get back to the simple reiteration of base banking reference categories such as International Commerce specialists and Working Capital advisors. Perhaps, Supply Chain Finance will finally becoming a key sub-category as complexity reduction in trading is achieved through less fragmentation of delivery and underlying assets and as geopolitical tensions ease and normalise?

What a world to look forward to!

I'll certainly cash in on this trade vision.

ANDREW ENGLAND

Director & Head of Strategy, iGTB

Andrew England is a member of the main Board of the Intellect Group and Director of Strategy for Intellect Global Transaction Banking, iGTB. He has over 30 years of banking experience having spent his entire career in this domain. Andrew brings with him his invaluable experience in managing transaction banking for leading banks across the globe and runs the iGTB Oxford School of Transaction Banking curriculum.

The journey began with Lloyds Bank as an International trainee working in a number of roles across Spain, Portugal and France, where he spent almost ten years before joining Citibank in 1990. During his career at Citibank, Andrew held various portfolios, with a particular focus on cash and trade product management.
He went on to join Deutsche Bank in 1998 as Head of Product Management Cash Management adding Global Trade Product responsibility later on. In his last role there he became one of five Global Transaction Banking Executive Members running the Transaction Bank, responsible for Global Cash & Trade Products with a team of 200 + FTE.

In 2008 Andrew joined as Head of CEE Global Transaction Banking, at Unicredit Group, based in Vienna. In this role he was responsible for establishing a transaction bank across 19 countries in the region and building its market share and revenue in Corporate and FI products. In early 2012 Andrew was back at Lloyds Bank, this time as Head of Transaction Banking, covering Cash Management, Trade & Supply Chain services, Balance Sheet management and Cards Acquiring, reporting to the Director of Corporate and Commercial Banking.
He was also the Senior Advisor Transaction Banking for McKinsey Group.

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