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EASE OF EXCHANGE

WHILE DIGITISATION OF TRADE FINANCE OFFERS MANY BENEFITS, TAKE-UP HAS BEEN HINDERED BY THE NEED FOR ALL PARTIES IN A TRANSACTION TO 'BUY INTO' THE CONCEPT, EXPLAINS PAUL GOLDEN

Trade finance digitisation was never likely to be a 'big bang' phenomenon. This view was confirmed by a poll conducted at financial services forum Sibos late last year, where two-thirds of attendees suggested that it would be between four and 10 years before most trade was conducted digitally.

This modest rate of progress is considered unfortunate by observers such as Peter Wong, founding chairman of the International Association of CFOs and Corporate Treasurers China, and associate director of PwC corporate treasury consulting.

He believes that digital trade finance is a good option for treasurers looking to drive down the cost per unit of transacted revenue. "Increased transparency of receipt and payment flow information can result in improved cash forecasting, streamlined credit collection efforts and more efficient deployment of working capital," he says. "Digital trade finance can be an enabler for entry into e-commerce."

Yet, according to Rahul Magan, an India-based treasury manager for business process solutions company EXL, there are valid reasons why uptake has been slow. He says that digital trade finance is really only possible for organisations that already have a solid digital platform in place, as well as a legal entity set up in a major financial centre, such as Frankfurt, London, New York or Singapore, where currently the best banking infrastructure exists.

Magan also points out that trade finance digitisation is much more likely to happen when all three offices of a treasury function – the front office, the middle office and the back office – are on the cloud. In practice, however, it is rare for a corporate to have all three offices on the cloud. Finally, treasurers' risk management policies are often not up to date with current digital standards.

Digital trade finance

Digitisation allows corporates to achieve better control of their credit facilities, reduce fees and speed up the application process, enabling them to grow transaction volumes without the requirement for additional credit.

For export letters of credit, faster document preparation and reduction of errors allows exporters to offer better pricing. Buyers can also claim the goods earlier when the exporter sends the original paper documents directly to the issuing bank, while providing electronic copies to the domestic bank, explains Nick Pachnev, chief

technology officer of trade finance software company GlobalTrade Corporation.

Chris Bozek, global head of trade and supply chain products at Bank of America Merrill Lynch, refers to digitisation of trade documents as a means to an end. Depending on the client's objective, options include full end-to-end digital trade with multi-bank providers, or partial end-to-end digitisation within an existing platform, he explains.

"Companies that are best placed to benefit are those with large transaction volumes and generally higher-ticket transactions operating in a narrow industry vertical with a concentrated group of buyers/sellers and counterparty banks," says Bozek. "There has been relatively higher take-up in the commodities industry by both producers and trading companies, digitising both documentary and open account trading. Over time, other industries with similar characteristics will follow."

Henry Balani, head of innovation at payment services firm Accuity, concurs with this view. "We have noticed increasing usage among chemical manufacturers and mining companies, for example, where shipments tend to be in large quantities due to economies of scale," he says. "The commercial benefits can be significant once communication and document standards are agreed to."

Magan highlights speed as an important benefit of digital trade finance. "Today, the G7 currencies are getting extremely volatile and you can't keep your currency exposures open until the banks give the go-ahead," he says. "Paper-denominated trade finance sometimes takes weeks to get approval from banks. If you use digital trade finance, you could save millions and contribute to the profit and loss, provided you have the appropriate treasury infrastructure, a presence in certain specific markets, an updated corporate risk management policy and a skilled treasury team."

AUTOMATED TRADE FINANCE IN PRACTICE

In April, a bank payment obligation (BPO) transaction for an iron ore shipment from Australia to China was completed, involving food-processing company Cargill and mining company BHP Billiton as buyer and seller respectively, with ANZ bank as obligor bank and Westpac as recipient bank. The transaction was the first time that BPO had been coupled with an electronic bill of lading and commercial invoices through the essDOCS platform, an automated trade solutions provider.

By combining electronic bills of lading with the BPO transaction, original data and supporting documents can be submitted as trade data to be matched against the payment terms. Additionally, the release of original documents to the buyer upon data match can be automated.

Digital trade finance processes accelerate bank practices, for example, by bypassing the bank's front office to go directly to the back office for review and so forth, saving hours and possibly days in comparison to paper processes, says Ashley Skaanild, head of trade finance at essDOCS.

"It also enables banks to centralise their processes," Skaanild continues. "Discrepancy management is simplified and can be done instantly, electronically, while banks can start offering the electronic letter of credit again. There is real added value for an exporter that can receive payment days or even weeks earlier than in a paper scenario."

Digitisation allows corporates to achieve better control of their credit facilities, reduce fees and speed up the application process, enabling transaction volume growth

Banking on trade finance

While the benefits of digital trade finance are evident, it can be time-consuming to on-board all parties for each transaction. There are also implications for banks, which must ensure that the client remains fully protected with regard to information security, the transmission of accurate transaction data, the processing of data in a timely manner, and compliance with relevant laws and regulations.

According to Adrian Katz, CEO of accounts receivable securitisation provider Finacity, some banks are more proactive than others when it comes to meeting the challenge of trade finance digitisation. "For example, banks that have chosen to participate in SWIFT's Trade Services Utility and the ISO 20022 standards are stepping up. Sellers are also making huge strides by using standards such as the International Organization for Standardization (ISO), electronic data interchange and the Accredited Standards Committee X9 financial standards."

Meanwhile, electronic presentation will require new processes to be put in place around the technology, comments Ian Kerr, CEO of trade chain software provider Bolero International. These processes will need to be explicitly approved by all stakeholders within a bank – including legal, accounting, finance, treasury and compliance – to ensure that the process outputs feed into its internal reporting and operating structures.

What's next?

In addition to reducing documentation errors, digitisation increases the availability of financing liquidity, since funds can be disbursed quicker upon electronic presentation of the required documents, allowing for improvements in cash management.

But Balani notes that centralising the way in which trades are cleared could lead to further improvements. "While trade transactions are typically shorter in length (three months on average) compared with other financial transactions, there is an opportunity to improve the settlement times independent of the physical movement of goods. This increased liquidity and early receipt of funds by the seller is attractive to corporates."

It is unclear, however, how quickly any progress will unfold. Hari Janakiraman, head of global core trade products at ANZ bank, is frank about the challenges facing trade finance digitisation. He says: "Trade finance transactions involve multiple parties, such as shipping companies, chambers of commerce, insurers, customs authorities and inspection companies, all of whom must also move to electronic documentation and channels." So while this process has undoubtedly begun, it would appear that ubiquitous trade finance digitisation remains a work in progress.

Paul Golden is a freelance journalist who specialises in writing about finance