SETTLING THE OPEN QUESTION: BANKS CHAMPION COLLABORATIVE INNOVATION AS CORPORATES SHIFT TO OPEN ACCOUNT

The continuing move toward open account trade and away from traditional trade finance techniques offers corporates new levels of speed and flexibility, but it also exposes them to higher risks. According to Adeline de Metz and Raphael Barisaac, global co-heads of trade finance at UniCredit, however, a number of bank-led collaborative initiatives are addressing the problem, highlighting the ascendancy of industry-wide cooperation as a means of meeting the growing needs of corporate clients

The steady shift from traditional documentary trade to open account transactions in recent years is not breaking news. Yet the consequences – both for corporates, who must contend with liquidity and risk issues, and for banks, who must cater to their growing needs – are still being processed.

Banks have the added challenge of bringing new solutions to the market against a backdrop of shrinking margins and growing compliance requirements. Yet the quantity and quality of initiatives and innovations continue on an upward trend. For instance, we are now seeing supply chain finance solutions developed through bank-fintech collaboration, while a consortium of banks is creating a blockchain-based trade finance platform for European small and medium-sized enterprises (SMEs). These not only help solve complex and longstanding challenges for clients of all sizes, but also embody the collaborative spirit that is becoming the blueprint for success in an age of trade finance evolution.

Adeline de Metz, global co-head of trade finance at UniCredit

THE OPEN ACCOUNT TRADE-OFF

While traditional instruments such as letters of credit or performance guarantees are still preferred when corporates trade in particularly high-risk markets, open account trading continues to rise in popularity in cross-border trade. Despite the benefits of open account transactions in terms of simplicity and cost, however, the trade-off is an increase in risks and a decrease in the availability of credit. Multinational corporations (MNCs) and SMEs typically face different challenges in this respect – MNCs typically look to mitigate risk and optimise their balance sheets, while SMEs often run into problems with liquidity – yet the solutions and the need for credit are similar for both.

The difficulty is that when transactions take banks outside their usual geographies to higher-risk markets, having the necessary credit appetite to fully cater to their corporate clients can be problematic. One solution for banks is to partner with local banks in these regions who have stronger appetites for this kind of debt. Alternatively, risk coverage tools provided by third parties such as private insurance companies can be used to create more structured transactions that alleviate risks. There is, however, another avenue that banks and corporates can explore to bolster the security of open account trade – supply chain finance.

THE SUPPLY CHAIN SOLUTION

Indeed, supply chain finance is a

fast growing market. Typically, the driver of supply chain finance programmes is the larger MNC buyer that wants to optimise its working capital while shoring up the strength of its supply chain. Yet today we are seeing more and more demand from SME suppliers in remote geographies that want to leverage their buyers' strong credit ratings to access finance. Either way, banks are major players which are actively supporting the majority of supply chain finance transactions in the market.

What's more, the field is ripe for innovation. Until recently, supply chain finance programmes supported mainly the largest suppliers, in limited numbers, because factors such as insufficient automation hindered supplier on-boarding. Now there are solutions on the market addressing many more suppliers, serving more geographies. UniCredit has co-operated with several fintechs to offer such innovative solutions, ranging from supply chain finance portals that auction approved supplier receivables, to those that are able to rapidly on-board thousands of suppliers from anywhere across the world.

HELPING EUROPEAN SMES FLOURISH THROUGH BLOCKCHAIN

When we shift the focus from higher-risk overseas trade to domestic trade and transactions in familiar developed markets, open account is particularly dominant – comprising 80% of all cross-border European transactions, for instance.

Raphael Barisaac, global co-head of trade finance at UniCredit

For European SMEs, who conduct the vast majority of these trades, accessing credit is a common pain point. Indeed, according to the World Bank, 50% of SMEs do not have access to formal credit.

This new culture of collaboration – bringing together banks, fintechs and regulators to work on common objectives – may hold the key to developing a new generation of trade finance innovations in the future.

Yet steps are being taken to address this. Digital Trade Chain (DTC), for instance, is a blockchain-based trade finance platform developed by a consortium of seven European banks – including UniCredit – which is designed to provide financing support for SMEs trading open account.

Providing SMEs with a consolidated view of trade transactions on a highly scalable platform, DTC promises a raft of benefits. It will allow European SMEs to initiate trades with new partners both domestically and in other European markets while optimising administrative tasks by digitising the entire trade process from order to settlement. It is also configured to enable trading partners to track and trace transactions as they are processed, as well as acquire immediate information on counterparties. Ultimately, the speed, cost and transparency of transactions will see dramatic improvements.

Nevertheless, developing and implementing this technology on the required scale hinges on a consortium that spans the European market – the collaborative aspect is pivotal to DTC's success. Each bank brings unique added value through its own knowledge, experience, capacity, and client base – and we expect consortium membership to grow to include additional banks, as well as trading partners such as shippers, freight forwarders and credit agencies in the near future. With a pilot expected before the end of this year, we hope DTC can pioneer a unique, commercialised blockchain

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solution that has widespread impact – all enabled through close industry collaboration.

AN INDUSTRY IN HARMONY

What's more, this growing atmosphere of collaboration is not limited to inter-bank initiatives. Increasingly, we are seeing fintechs being brought into the field as banks seek to use all resources at their disposal. Indeed, despite early murmurs of competition between banks and fintechs, they have emerged as natural bedfellows. While fintechs are agile and can leverage advanced IT proficiency, banks bring client coverage, credit appetite, funding capability, and a deeper knowledge of buyer-supplier relationships to the table.

Yet the nature of collaboration between fintechs and banks can vary. Many corporates approach fintechs with a view to using platforms where banks simply act as funders. Yet this can pose problems. For example, corporates may not be fully comfortable about a fintech's ability to secure the necessary bank funding to make their programme sustainable, while they also face the challenge of combining and reconciling the different approaches and cultures of their partners.

Far better for all involved is for banks and fintechs to pre-emptively establish an intimate understanding of one another's offerings, as part of a collaborative 'ecosystem' in which both sides are open and inquisitive about their capabilities, and are able to co-operate from an operational standpoint. Working in tandem and drawing on previous experiences, banks and fintechs can then anticipate client needs and proactively approach them with ideas, or involve clients in the development of combined solutions from the earliest possible stage so that these are more likely to appeal to their specific needs.

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UniCredit particularly favours this latter approach, which resonates with our desire to elevate the requirements of the client above other concerns. Implementing each solution on a case-by-case basis, we have a comprehensive portfolio of solutions – including our own digital supply chain finance platform – that caters to all types of transactions, and all types of clients.

This new culture of collaboration – bringing together banks, fintechs and regulators to work on common objectives – may hold the key to developing a new generation of trade finance innovations in the future. Pooling resources, complementary areas of expertise, and drawing on a multitude of different outlooks enables digital innovation that satisfies client needs, at the required scale, like never seen before.

A word of warning, however: with a number of valuable new tools such as the Bank Payment Obligation already available, banks and corporates alike must be wary of allowing long-term visions to obstruct immediate solutions that can offer benefits in the present. While there is no shortage of innovation in the market, the sheer size and complexity of the global trade ecosystem – involving so many different parties – is affecting adoption rates and slow meaningful change.

The onus is therefore on banks and other industry players to focus on the challenges of today and ensure the best solutions gain traction, rather than singularly looking to develop the 'next big thing'. Through close collaboration, however – along with careful investment, and, above all, a tight focus on client needs – the trade finance industry can continue to evolve and find new ways of facilitating corporate growth. ■

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