A COVID SURVIVAL STRATEGY WITH SUPPLY CHAIN FINANCE

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From the desk of the CEO

A Lesson in Supply Chain Finance

"Never let a good crisis go to waste" (Winston Churchill) has much relevance today. Covid-19 has created a unique moment in the history of our planet. It has dealt as big a blow to the global economy as any war.

Crises are often regarded as catalysts for innovation. We are currently living through a time when the whole world has been forced to slow down. As we begin to see through the glass darkly the impact on trade and supply chains can be mitigated, even turned round, through technology playing an irresistible role in the definition of new trading patterns and practices, opening up a $20 billion opportunity in supply chain finance of which all trade banks want their rightful share. This paper analyses the perfect storm of Covid-19 and lists seven major areas of focus that show banks how to position themselves not only to survive but to obtain a competitive advantage in these challenging times.

Yours sincerely,
Manish Maakan, CEO, iGTB

Flexibility in Supply Chain Finance is vital and depends on fast onboarding and analytical insights.

This paper covers:

WHAT IS SUPPLY CHAIN FINANCE

Supply Chain Finance is a portfolio of risk mitigation and financing techniques designed to optimise the management of working capital in supply chain processes and transactions. Banks need to cope with numerous variations of these techniques in use today and no doubt more will evolve over time.

Each intervention in the financial supply chain is triggered by an event in the physical supply chain. In order to take advantage of the growing number of opportunities in the supply chain finance business, banks need to have full visibility into the underlying trade flows. iGTB Supply Chain Finance is the market leading solution designed to help banks grow revenue, reduce cost, reduce risk and improve operational efficiency in this increasingly competitive $20bn market.

Trade Ups and Downs

"Boom bust" 1. In the early 1950's world trade was worth $0.6 trillion. By 1970 it had grown to $3 trillion and by 2000, $6 trillion. In the years leading up to the financial crisis, an explosion of growth saw world trade exceed $16 trillion. There was much talk of the golden age of trade and numbers growing to $30 or even $40 trillion by 2020. Of course, the financial crisis put paid to all that and we saw a sharp downturn in the global economy which eventually forced trade to fall back to around $12.5 trillion in 2009.

Global trade boomed, then slowed, then rose again, and is now set for another dip

"Boom bust" 2. Since then some recovery came despite a few bumps in the road, until 2019 saw a great deal of instability, largely attributable to politically-motivated protectionism and the ongoing trade war between the US and China. CAGR fell from 6% to 2%. Now, in the wake of Covid-19 we are hearing forecasts from the World Trade Organisation and others that global trade could fall from anywhere between 13% in the most optimistic scenario to 32% in the most pessimistic scenario (see Figure 1). So the dip could be as much as 4 times greater than in 2009.

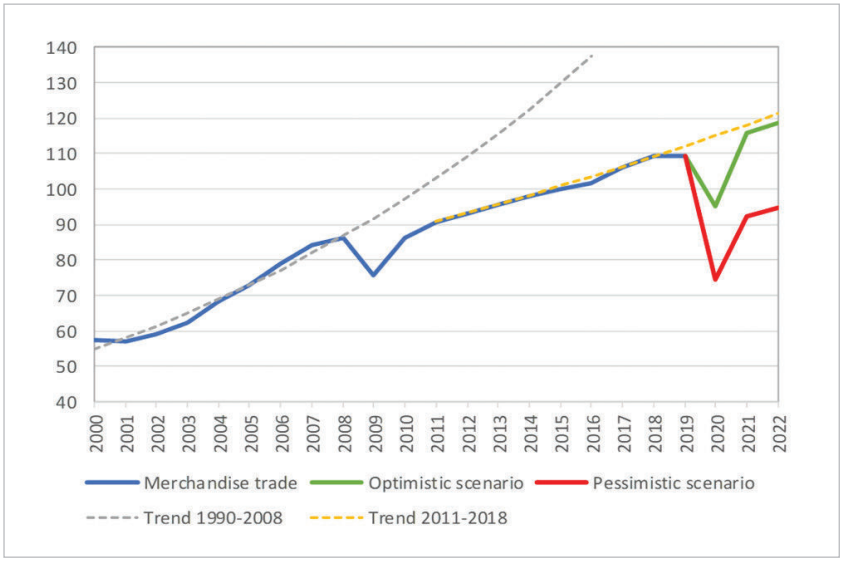

Figure: 1 Merchandise trade Optimistic & Pessimistic scenarios
Source: World Trade Organisation

Four Differences in the

Latest Boom-Bust

There are, however, four material differences between the current crisis and the last.

Difference 1.

Following the global financial crisis, regulation has forced banks to strengthen capital and liquidity buffers, such that the global banking system is now in a much better condition to resist widespread market disruption.

Banks' balance sheets are stronger

Difference 2.

China's relationship with the rest of the world has changed. Over the past 20 years China has reduced its overall exposure to the rest of the world by some 25% whilst world exposure to China has trebled during the same period (see Figure 2).

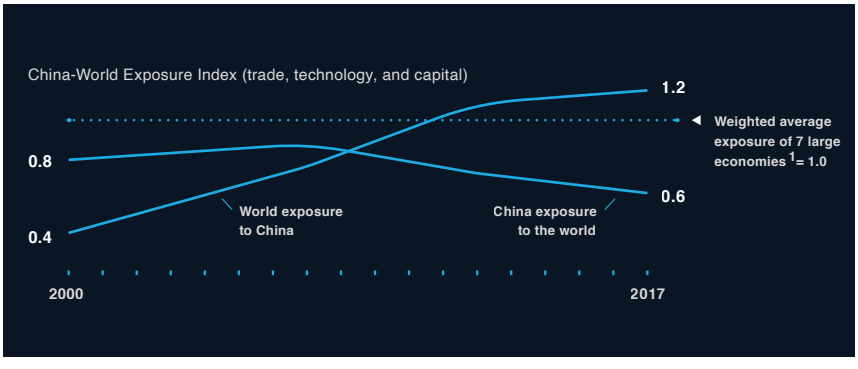

Figure 2: China has been reducing its exposure to the world while the world's exposure to China has risen.
Source: McKinsey Global Institute Analysis

China has become more entrenched in world supply chains whilst increasing its competitiveness by making significant investments in new technology

During this time China has made significant investments in technology, including artificial intelligence and robotics. This has not only made China outwardly more competitive in global markets but also inwardly more self-sufficient. Whilst the rest of the world is reflecting on how to reduce its overall dependency on China it is unlikely that this dependency can be eliminated in the foreseeable future. Another fundamental change is that China is no longer confined to building product. China has become a critical supplier of components and raw materials, thus leading to increased supply chain risk downstream.

Difference 3.

Volatility demands the ability to switch supply chains flexibly to avoid bullwhip amplification shocks

COVID-19 has provided us with an ample illustration of the fact that many companies are not fully aware of the vulnerability of their supply chains to the threat of global shocks. Rapid changes in well-established patterns of supply and demand can lead to a bullwhip effect in the supply chain whereby inventory demands may suddenly shift (see Figure 3). As one moves further along the supply chain towards the smaller and typically more highly leveraged suppliers upstream, so these changes become more and more acute.

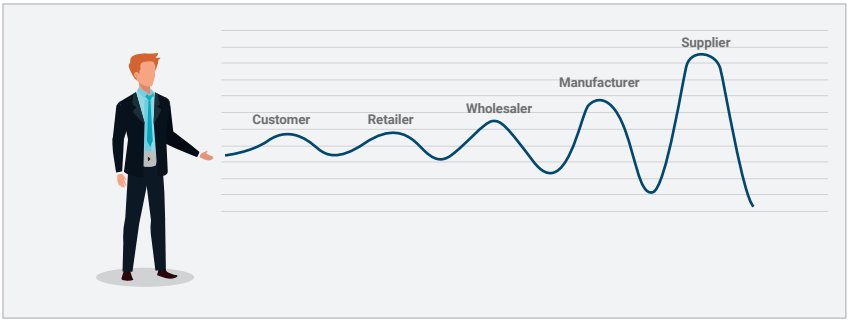

Figure 3: The bullwhip effect in supply chain

Difference 4.

Digitalisation increases market resilience, enabling all those involved in global supply chains to obtain analytical insights and react quickly to changing circumstances

In these uncertain conditions it is imperative that companies are able to react in a more agile manner in order to anticipate the dynamic impact of disruption and get ahead of the bullwhip. Fortunately, new technologies including the Internet of Things, artificial intelligence and robotics can help to improve end-to-end visibility, breaking down silos and enabling stronger collaboration and optimisation.

Advanced contextual data analytics, making use of current as well as historical data, is an essential tool to be used in the detection of shifts in demand and the likely scenarios that may evolve, thus increasing overall resilience. At the same time, sophisticated tools can be used to adapt quickly by accelerating the secure and compliant onboarding of new counterparty relationships.

The Upshot is a

Shift in Global Supply Chains

The resilience of supply chains is being tested as never before all around the world. Even before Covid-19 struck, many were beginning to question the sustainability of an over-reliance on China and looking to diversify by seeking out alternative supply chains, often favouring so-called near-shoring arrangements with countries closer to home. The disruption to supply chains, business operations and financial markets brought about by Covid-19 has forced many companies to look again at the implementation of a "China Plus" strategy. That means having a contingency in place to work with one or more countries other than China, should the need arise. Just as China itself has been moving to reduce its dependency on other parts of the world, so the rest of the world will want to reduce its dependency on China.

Supply chain flexibility demands progressive rather than wholesale change, supported by adoption of digital technologies but also tempered by regulatory constraints

Governments are actively seeking to exercise more control over supply chains, especially for critical supplies such as medicines & equipment. The risk scenarios are not only related to the possibility of a second wave of the pandemic but also other factors that were already in play such as trade wars, acts of terrorism and regulatory reforms. Already we are seeing the emergence of alternative manufacturing hubs across Asia, including Indonesia, Malaysia and Vietnam, India is also well positioned to take advantage of diversification.

Of course it is never easy to relocate entire supply chains so transitions are likely to be more gradual than sudden with companies choosing to reduce their reliance on China rather than cancelling it out altogether. In the longer term, the economics of change may be influenced more by the introduction of automation. The use of e-signatures and acceptance of digital customs clearance will lead to greater efficiency, as will adoption of machine learning to forecast purchasing patterns.

The Crucial Need for Supply Chain Finance Now

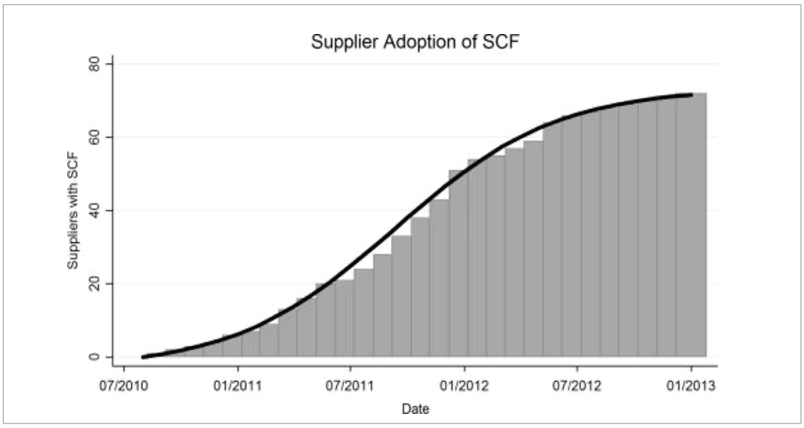

Figure 4: Supplier adoption of Supply Chain Finance post 2008
Source: Elsevier (International Journal of Production Economics)

In the wake of the financial crisis, supplier adoption of supply chain finance surged by over 70% in the space of 3 years...

In the immediate aftermath of the financial crisis of 2008, demand for supply chain finance surged. Given the similarities in market conditions, there is every chance that the same pattern will emerge in the wake of Covid-19.

...and there are four reasons it will continue to grow now

Squeeze on liquidity. Post-2008 saw an immediate squeeze on liquidity that tended to hit SMEs hardest. This coincided not so much with the widely anticipated 'flight to safety' in the form of an increased uptake in letters of credit, but as a surge of demand for supply chain finance.

The need to support suppliers. Of the two main types of supply chain finance (supplier-led and buyer-led), post-2008 saw demand mostly for approved payables programmes, enabling big buyers to support their critical suppliers through the most difficult period of trading. These facilities were often combined with dynamic discounting arrangements to allow maximum flexibility in payment terms.

Faster onboarding. In the context of Covid-19, the financial stability of the supplier is even more likely to be negatively impacted than that of the buyer. The need for liquidity and risk mitigation is greater than ever before. It is more than likely we will again see a similar spike in demand for buyer-led payables finance. Given the simultaneous need to put alternative supply chain arrangements in place, many will also be looking to take advantage of the enhanced speed and efficiency now available in the supplier on-boarding process.

The time is now. Never has the resilience of the supply chain, from extraction to production to distribution to fulfilment to being paid – or managing what you pay – been more vital than now, as interconnected businesses seek to secure a bridge from pre-Covid through Covid-lockdown to post-Covid. The evolution of new technologies has created a fertile environment for innovation, meaning that supply chain finance is ready to come of age right now.

Seven Critical Areas of Focus to Win Market Share

…and get a sizeable slice of the $20bn pie. The promise of how to get that slice of pie comes from seven critical areas that have to be got right. Intellect believes they are all vital and should be accounted for in the adoption of any technology used for supply chain finance. And that's why we have built them into the iGTB solution set.

Focus 1

Approved Payables

In a buyer-led supply chain finance transaction, the buyer establishes a program with one or more of its relationship banks and invites its suppliers to join that program (see Figure 5). The supplier then has the opportunity to sell receivables payable by the buyer to the bank at a discount in order to obtain settlement before the due date. Unlike supplier-led transactions, the bank will typically not have any pre-existing relationship with the supplier. Hence, there is an intrinsic need for due diligence in the form of on-boarding. The arrangement is often advantageous to all parties since the credit risk is consistent with the credit rating of the (big) buyer.

A win-win-win on approved payables

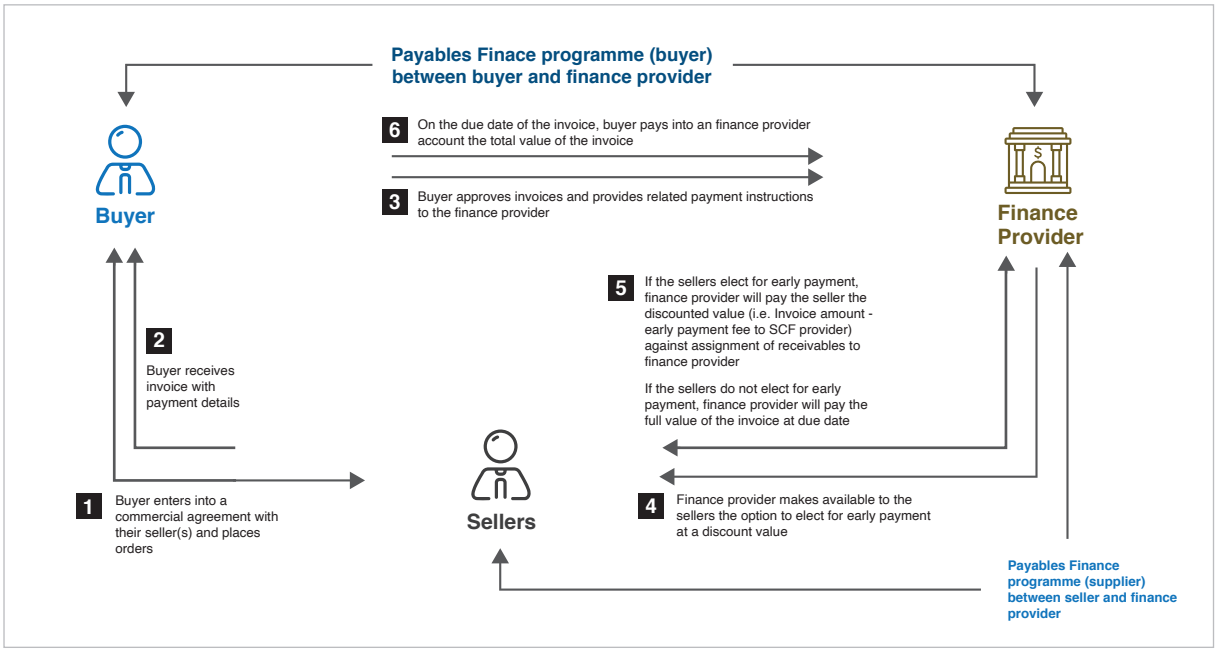

Figure 5: Approved Payables

Focus 2

Dynamic Discounting

Approved Payables programs often include a dynamic discounting option. Under dynamic discounting a supplier can obtain an early payment directly from the buyer (see Figure 6). The value of the discount is variable according to the point in time in the transaction lifecycle that the discount is applied. This kind of arrangement may not only provide buyers who are in a relatively strong cash position with an attractive option to pay early but it may also make the difference between a supplier staying in business or not.

Dynamic discounting offers increased flexibility on when and how to pay, thus enabling optimum management of liquidity

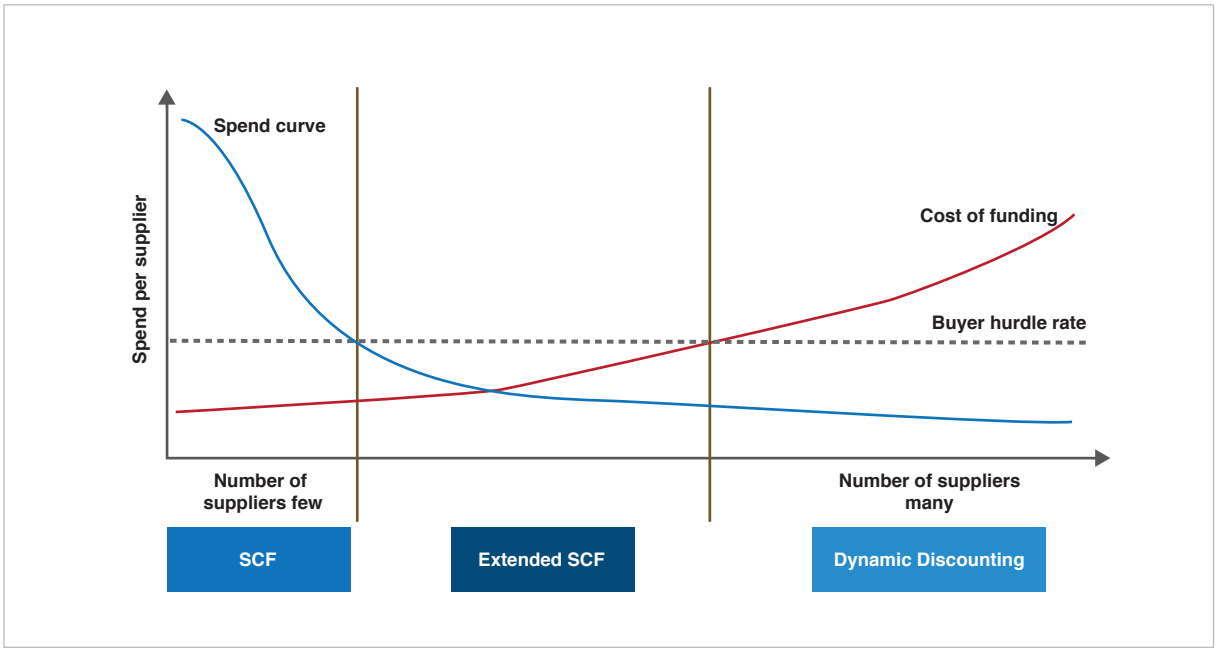

Figure 6: Dynamic Discounting

Focus 3

Supplier Onboarding

One of the biggest challenges of setting up new supplier relationships is the onboarding process, often calling for the gathering of data from multiple sources and multiple sequential approvals, Automated, data driven processing will optimise collaboration and transparency and will ultimately reduce the risk and the red tape (see Figure 7).

Onboarding new supplier relationships can be extremely stressful, costly and time-consuming. Streamlining it lowers risk, improves efficiency and builds stronger relationships and so greater competitiveness

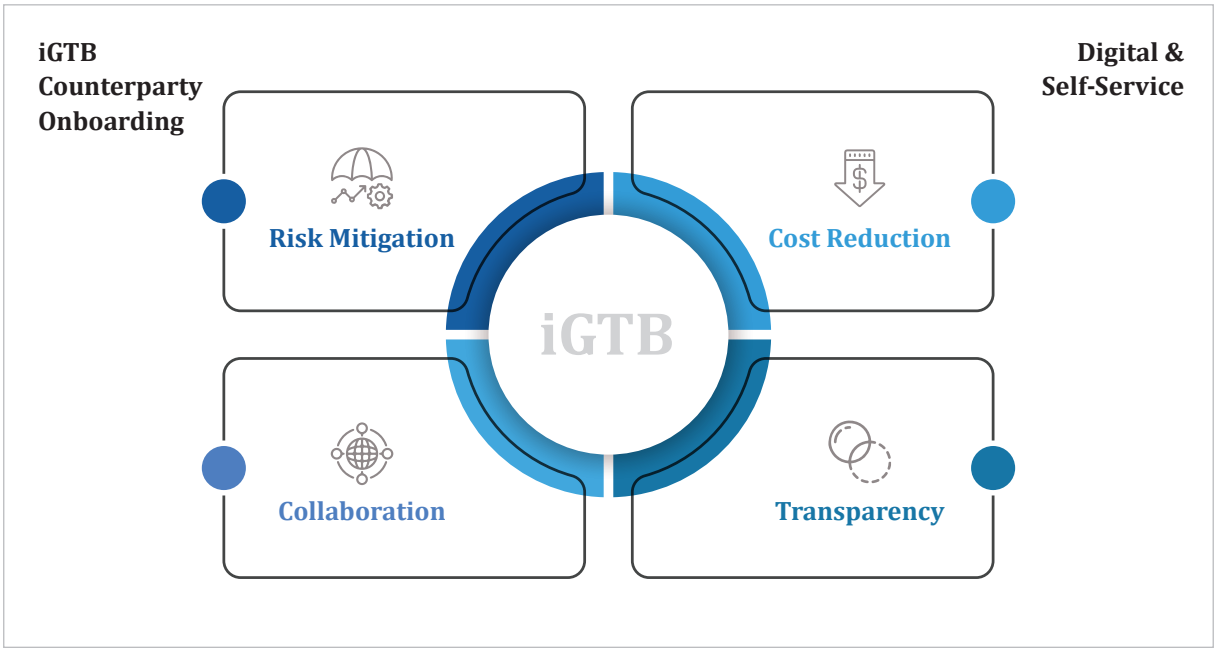

Figure 7: Supplier Onboarding

Focus 4

Digitalisation

For generations, the business of trade and trade finance has been notoriously reliant on labour-intensive paper-based processing, from bills of lading to warehouse warrants, from bills of exchange to promissory notes. In many jurisdictions it is mandated by law that documents such as bills of lading must be physically presented in paper form and requiring wet signatures. Covid-19 has not only created a disruption to the physical movement of goods but also a disruption to the physical movement of the paper documents that are required to support transportation and transfer of ownership. Even when documents are being delivered they often end up in the wrong place at the wrong time given that operations personnel are no longer routinely arriving at their normal place of work but more likely working from home. The enforced lockdown of the global economy has led to unprecedented bottlenecks. It is now increasingly clear that data needs to be made available by digital means.

Of course, the barriers that have so far restricted the widespread adoption of paperless trade have had more to do with trade policy and regulation than technology. During these extraordinary times, governments and authorities have been forced to adopt emergency measures, allowing the electronic presentation of documents in place of wet ink originals. Cargo companies are issuing more and more electronic bills of lading. More than 60 chambers of commerce have adopted electronic certificates of origin.

The evidence to date suggests that the switch to digital has been a success to the point where we may reasonably anticipate a rapid shift in cultural behaviours and a much wider tolerance towards the adoption of new digital trade technologies. Artificial intelligence, natural language processing, machine learning, distributed ledgers, smart contracts, track and trace and the Internet of Things will all have a role to play in the drive towards digital.

The drive towards digital is now irresistible. This will bring business benefit and enhanced operational efficiency not only to the world of traditional trade but also to the supply chain in general

Smart contracts contain pre-written logic that can be used to reduce operational risk by the automation of workflow. They can be used to help, for example, with the automatic uploading of purchase orders for financing and the translation of data for document preparation or paperless trade. They can also potentially be extended into artificial intelligence.

The evolution of track and trace devices also enables us to monitor the location and condition of smart objects in transit, hence reducing the operational risks commonly associated with the transportation of goods. The ability to extend this technology back into the supply chain also enables us eventually to guarantee the provenance of goods in support of sustainable trade.

It is estimated that global trade banks, could save in excess of US$2.5 billion and increase their revenues by approximately 10%, by adopting an integrated digital solution that incorporates these future technology solutions through intelligent automation and collaborative digitalisation.

Focus 5

Artificial Intelligence, Machine Learning & Natural Language Processing

The use of standard optical character recognition (OCR) to read text from trade documents has become commonplace. The adoption of next generation technologies such as artificial intelligence and cognitive computing will enhance both the efficiency and productivity of performing operationally intensive tasks, such as document processing and compliance checks (see Figure 8).

Where documents still exist in paper form, an AI system such as iGTB's IDX can be used to interpret unstructured data – even if never seen before – and work out what it means.

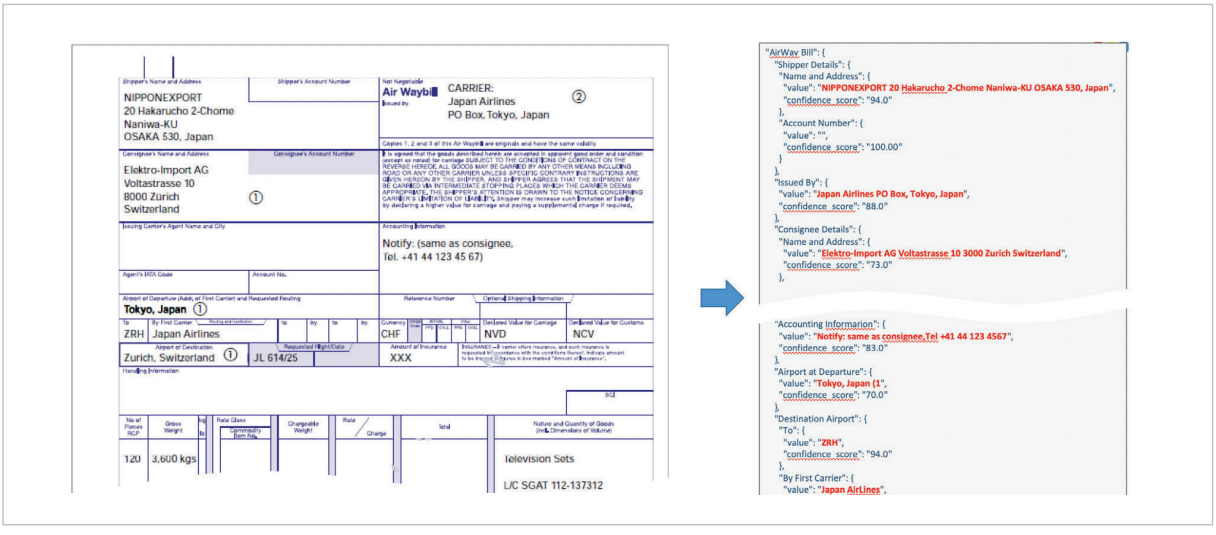

Figure 8: Data Extraction using AI and OCR

The adoption of machine learning and natural language processing techniques will enable the automation of a complex web of cognitive processes associated with due diligence. Its application will eventually benefit multiple aspects of international trade, including the more efficient management of supply chains, contracts and regulatory compliance, ultimately opening up new opportunities for easier access to finance.

Focus 6

Data Analytics

In the wake of supply chain disruptions due to Covid-19, many observers have reiterated the need for participants in the chain to obtain greater visibility in order to optimise supply chain efficiency. Visibility creates the opportunity for others in the ecosystem to plan and take action, such as engaging with alternative suppliers. During lockdown, some suppliers have been forced at least temporarily to cease production. Some third party logistics providers are unable to transport goods across borders. Supply chain lenders also need to better understand the information flows in supply chains, not just the financial health of one participant. They require visibility into the supply chain and real-time monitoring of physical transactions.

Data is of little or no use without insights that come from predictive analytics.

Information is vital to any business activity. These days we are often swamped by too much information. We need analytical tools to help us make sense of the data and make informed decisions based on business intelligence.

In the digital world, data is the new collateral. The evolving art of predictive analytics enables banks to better manage their relationships, revenues and risks (see Figure 9).

Figure 9: Advanced Analytics

Focus 7

Industry Rules & Standards

It is true that as an industry we still lack a degree of certainty around rules and standards. The absence of clear definitions remains a barrier to interoperability. There are, however, a number of industry initiatives currently in play that will eventually enable us to overcome the obstacles. These include the International Chamber of Commerce (ICC) Banking Commission's work on the development of a new set of Uniform Rules for Digital Trade Transactions (URDTT) as well as the Digital Trade Standards Initiative (DSI). The ICC is also encouraging lawmakers and governments to adopt the UNCITRAL Model Law on Electronic Transferable Records to support the verification of electronic signatures and address other security related concerns.

Other industry initiatives of note include the ITFA Digital Negotiable Instruments (DNI), the Electronic Payment Undertaking (e-PU) and BAFT's Digital Ledger Payment Commitment (DLPC).

The adoption of new technology will be supported and enhanced by an evolution in industry rules and standards.

Conclusion

The Covid-19 pandemic has gifted us a rare opportunity to reset and re-shape the world we live in.

What may previously have been regarded as a dream – paperless trade – is now a reality.

What may previously have been regarded as difficult – supplier onboarding – is now made easy.

What may previously have been regarded as impossible – interpreting vast amounts of unstructured data – is now child's play.

What may previously have been regarded as low margin – supply chain finance – is now a $20 billion revenue opportunity.

Let's not allow this crisis to go to waste.

About the author

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David Hennah leads the trade and supply chain finance business at iGTB, having previously held a similar position at Finastra (formerly Misys).

David has previously worked for Barclays, ICL/Fujitsu Services and SWIFT and has more than 40 years of experience in senior leadership roles across banking, software and consultancy.

Outside the UK, David has lived and worked in France, Belgium and Germany and once worked literally overseas, managing the Barclays branch operation on board RMS QE2. David has become well-known in recent years for his leading role in bringing the ICC Bank Payment Obligation (BPO) to market.

He is the author of the ICC Guide to the Uniform Rules for BPO. More recently, he has assumed a variety of industry roles, including serving as co-chair of the World Trade Board (of which he remains a member), chairmanship of the ICC working group that is currently drafting a new set of rules for digital trade and acting as an expert advisor to both the ICC Academy and the London Institute of Banking & Finance (LIBF).

David is married with four daughters. He enjoys walking and running, having once walked 1000 miles from John o Groats to Lands End and completed three London Marathons.

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