Supporting Trade in a Time of Crisis

Global trade is having to adapt to unprecedented levels of disruption. Yet by combining elements – including digital – banks can play an important role in keeping business moving.

Treasury and Trade Solutions

Executive summary

- COVID-19 is having a profound impact on trade. Yet, operationally, trade has shown remarkable resilience.
- Logistical challenges have reinforced the value of standardised and digital trade platforms – positioning institutions that have invested in technology as industry leaders when it comes to facilitating efficient trade processes, as well as accelerating the longer-term journey from paper to digital.
- Digital platforms are helping to optimise supply chains by delivering consistent funding through electronic channels connected in a secured environment and linking trade distribution networks.
- Financial support extends beyond banks. It is through a combined approach – involving governments, central banks, development banks, corporate and investment banks, alternative lenders, ECAs and insurers – that businesses can most effectively be supported.
- The pandemic has demonstrated a new dimension in continuity thinking – that contingencies need to be truly global. Crises can engulf the world quickly, which means that speed and decisiveness are required.
- COVID-19 brings with it an increased risk of fraud, requiring heightened awareness and incremental checks – facilitated by the power of digital platforms.
- Sustainability must remain a key focus for trade, with the pandemic acting as an accelerator rather than brake.
- COVID-19 is fuelling a move away from global supply chains to more of a regional and domestic focus.

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The impact of the COVID-19 pandemic on trade has been profound. Disruption to both supply and demand dynamics and supply-chain logistics have resulted in the entire trade value chain coming under pressure. The World Trade Organisation estimates that global trade will decrease by between 13% and 32% overall in 2020[1] – a predicted decline potentially far greater than the 12.2% decrease in global trade recorded in 2009, at the height of the global financial crisis. According to Accenture, 75% of companies have experienced "negative or strongly negative impacts in their businesses"[2], with the knock-on impact on trade volumes likely to continue into 2021.

Operationally, however, trade flows have shown remarkable resilience. While there have been enormous volatility in demand, there has – equally – been continuity with respect to the operational flow of cross-border goods. One reason for this is that trade flows have benefitted from the decline in manual legacy and paper-based trade processes.

Certainly, and somewhat ironically, the timing of the pandemic – coming as it does after a period of innovation and growth in electronic trade processes – has been fortuitous. Once heralded as the "future of trade", the digital supply chain appears to have developed both the depth and breadth to have made a significant difference to the robustness of trade during this crisis. Banks that have invested heavily in trade technologies are now able to deliver digital trade finance solutions that enable their operations and documentary processing to continue remotely and their clients to initiate these transactions remotely, with little (or even no) disruption. Such banks can connect clients and counterparties digitally, enabling end-to-end transactions to be carried out seamlessly, with funds delivered electronically to buyers and suppliers across the globe.

There are three key components to the digital processes now benefitting crisis-hit supply chains.

First, the onboarding of counterparties onto the system, with effective and comprehensive due diligence taking place electronically, and with digital identities subsequently established for clients. This has eliminated the need to manually collect and submit documentation. The disruption has also resulted in new suppliers being sourced – for sometimes life-saving equipment – with due diligence having to follow behind. In these circumstances, having digital onboarding capabilities is paramount, and – from the perspective of Citi's customers – highly successful.

Second, bank-client connectivity. Digitalisation has allowed for far greater and more immediate connectivity, with banks connected digitally to client accounting platforms, either via APIs, host-to-host applications, web uploads, or platform-based functionality. Clients can provide requests for transactions or financing in real time and have them dealt with quickly and efficiently.

Third, with respect to digital payments and settlements. Having instant payments flowing globally as part of the trade settlement process, as well as part of an integrated supply chain finance solution through electronic trade platforms, has made an enormous difference to companies on both sides of a trade. This is especially true for sectors suffering short-term gaps in their supply chain or who need to provide funding to suppliers quickly by onboarding them electronically, or those suffering liquidity issues due to crisis-related volatilities in payment patterns. Sectors particularly at risk of a liquidity shortfall include energy, consumer, hardware and industrials, with 27%, 26%, 24% and 22% of firms in those sectors respectively at risk[3].

So no matter what the physical supply chain obstacles, the operational backbone underpinning trade has weathered the storm, highlighting the value of many banks' (including Citi's) investment in digital processes. Further proof, if needed, comes in the many enquiries we are receiving from companies that had previously resisted the move towards paperless trade. For trade to keep moving, they now realise digitalisation is key.

Financial backbone

Yet digital tools form only one part of the story. Finance is another element, with both corporates and their supportive financiers (perhaps local or specialist lenders) needing to also show balance sheet resilience during these difficult times. For instance, during this crisis some banks have experienced significant drawdowns of credit facilities, resulting in a liquidity crunch and balance sheet constraints that may impede their appetite for future funding.

In this respect, "scale matters". Larger lenders like Citi have by-and-large been able to provide the required continuity of funding – sometimes helping bridge funding gaps due to supply chain constraints. And that can include requests for funding from smaller suppliers – some joining supply chains for the first time as part of a critical need. It is in such circumstances that the larger lenders can offer both the scale and speed needed to prevent disruption.

Again, at the other end of these transactions, digital platforms can play a role, in this case as an engine for the distribution of trade assets among investors. While major banks may sponsor the platforms, they can include a range of funders – including peer group banks, challenger banks, non-bank FIs and private investors. This works not only for the companies, but also for the major banks. Having access to digitalised investors with pre-agreed lines able to participate in trade financing allows for both scaling up, with respect to the size of facilities, and for the optimisation of assets, all while reducing the risk of funding disruption. For example, with some banks experiencing balance sheet stresses, credit limits may be triggered that would have previously resulted in a decline or even the pulling of facilities. Such platforms, meanwhile, allow alternative investors to be brought in to provide seamless liquidity to the supply chain.

Overcoming challenges

The business environment remains challenging. Consumption has decreased and investments put on hold. Meanwhile, inefficiencies in supply chains have resulted in price volatility for certain goods, or with goods sourced from unfamiliar sources.

This is affecting the cash flows and profitability of industries across multiple sectors which is triggering credit downgrades that are negatively affecting access to funding. Of course, some sectors are more impacted than others – with aviation, shipping, travel, hospitality, fashion and luxury goods particularly hard hit. For example, car registrations fell significantly in April, with France and Italy reporting decreases in sales of 88.8% and 97.5% respectively[4].

Any recovery will take time and will require government help. Certainly, governments and central banks have stepped in – most introducing helpful measures such as easing restrictions on commercial banks, cutting interest rates and increasing loans to states and businesses[5]. Monetary and fiscal levers that have been widely used include central bank liquidity support, central bank swap lines, the use of capital and liquidity buffers regarding financial policies for banks, and state loans or credit guarantees to improve access to capital. There are also schemes that allow banks to offer moratoriums on loan repayments.

Citi is playing its part: for instance, by signing an agreement to incorporate UK Export Finance (UKEF – the UK export credit agency) guarantees into the supply chain structure, thus incorporating export credit agency (ECA) support into the Supply Chain Finance Program.

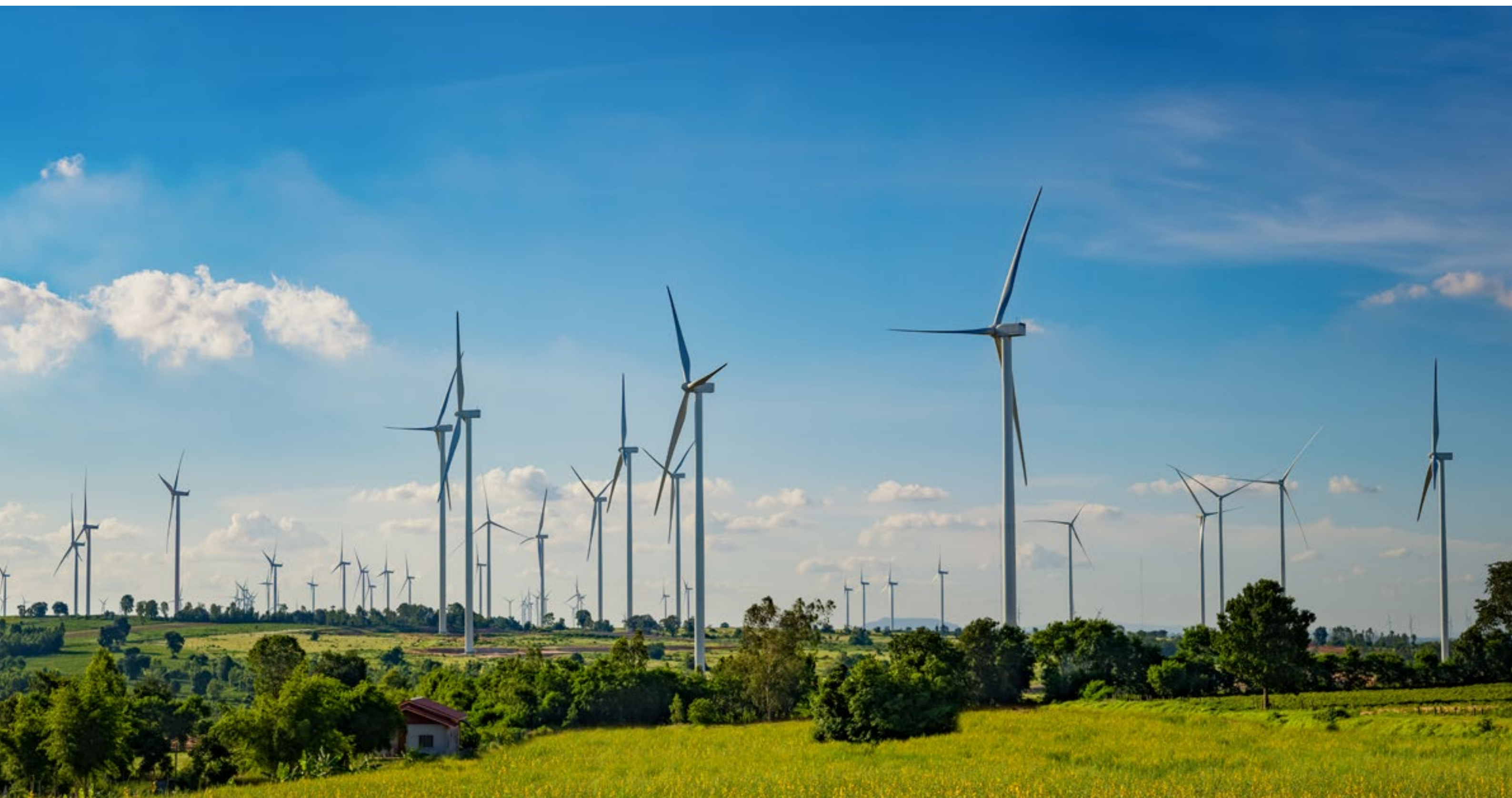
As with the global financial crisis of 2008, ECAs will need to become more active, expanding their facilities to include small- and medium-sized enterprises (SMEs). That said, pre-COVID structures aimed specifically at reinforcing supply chains should allow for expansion down the food chain (benefitting SMEs) rather than having to construct entirely new arrangements. Working capital ECA guarantees, for instance, have been launched by countries including Denmark, Sweden, France and the UK[6].

Development banks, meanwhile, need to rekindle their trade finance and shared-risk facilities (A-B loans) and increase their guarantees. Hopefully, such a multi-pronged approach will allow for a temporary fix until the recovery can take hold, although longer-term support may ultimately be needed.

Increased checks to mitigate fraud

Another issue to emerge as a result of the pandemic has been the increase in fraud, driven by the unfamiliar environment and supply chain volatility. While previous crises have also produced similar spikes in incidents related to bank and loan fraud, money laundering and corruption, we are, again, lucky to have such advanced digitalisation as a defence.

Nonetheless, increased awareness and the undertaking of incremental checks – including the cross verification of data points – is a must. An example of this is the way in which banks are implementing specific processes to assess new suppliers of medical equipment to determine if they are genuine transactions. Digital firewalls are the answer, with password-protected, digital identities established. Furthermore, through deep, digital know-your-client (KYC) checks, banks can establish the genuineness of new client counterparties. This can include using AI learning tools that access trade registers, recognise the legal entity of the company and identify their track record. Citi continues to invest in technologies that use AI to detect and help prevent such frauds.



The wider picture

Finally, while the pandemic is creating a new environment for trade, the sector must not lose sight of its recently-acquired supply chain sustainability goals.

Citi continues to be a major advocate of sustainability within supply chains – with all counterparties required to meet environmental, social or governance (ESG) standards. Between 2014 and 2019, the bank financed and facilitated US$164 billion in environmental finance activity, exceeding our US$100 billion goal four years ahead of schedule[7]. A host of corporates, including Maersk, Nestle and BP are transforming their operations, committing to have net zero emissions by 2050.

Benefits for strong, ESG-driven companies include top-line growth (fuelled by consumer preferences) and reduced production costs (through efficiencies in energy and raw material consumption). Analysis by Citi shows that corporates with a high ESG rating outperform their contemporaries by 7% on a shareholder return basis[8]. And in 2019 Fitch announced that 22% of its corporate credit ratings were being influenced by ESG factors[9].

Certainly, sustainability has become a significant factor in trade – and will remain so, with the disruption likely to accelerate rather than delay that trajectory. Indeed, the pandemic is reaffirming its importance, not least in raising questions regarding how to optimise supply chains. For instance, COVID-19 has re-exposed the heavy reliance upon China's manufacturing sector in global supply chains[10]. That said, some diversification away from China was already underway in many countries. A survey undertaken by McKinsey Global Institute in December 2019 reported that 70% of companies expected to change their globalisation and sourcing strategy, with 32% looking to move operations closer to end consumers[11] – a trend the pandemic is accelerating.

While the industry comes together to find ways to support global trade during the pandemic and in its immediate aftermath, it is clear that once we emerge from all this the world of trade is likely to look very different. Not only will we see a re-evaluation of supply chains, the industry has been awakened to the true value of digitalisation. That long-promised move away from paper-based trade is now surely upon us. Yet future progress will be inspired by our actions today, which must be laser focused on the long-term despite the immediate needs of the crisis.

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