TRADE SERVICES IN THE BANK OF THE FUTURE

Parama Dharmawardene
Banking Consultant
Former Deputy General Manager, Sampath Bank

INTRODUCTION

The present government has adopted an export led growth strategy to develop the economy and make Sri Lanka a hub of the Indian Ocean region. The policies formulated as well as those being developed all have a strong focus on exports to grow the country's economy. The government claims that in order to service the huge debt burden especially the repayments due in 2018 and 2019 the country's only option is to grow the economy very quickly and in order to do is to grow the exports backed by foreign direct investments as well as local investments specially the SMEs. The government is aware of the need to have considerable imported inputs in order to process the export orders andistherefore is expected to grow the imports business as well. This appears to indicate a growth of business for banks in these two key areas, but the question is, whether in reality it will be so.

GOVERNMENT POLICY

The policies of the present government and the action plans being put in place by itis definitely aimed at growing exports in a very short period of time Even the Budget 2018 is expected to be export oriented having lots of incentives for exporters and investment in export business. Export growth is the government's strategy in the short=term, medium-term as well as the long-term. Increasing efficiency and streamlining processes with the use of technology are all included in the action plans.

Vision 2025

The government's economic vision is to make Sri Lanka a rich country by 2025. It hopes to do so by transforming Sri Lanka into the hub of the Indian Ocean, with a knowledge-based, highly competitive, social-market economy. It plans to create an environment where all citizens have the opportunity to achieve higher incomes and better standards of living. To achieve this it aims to create the conditions which will generate economic growth with equity. The structural transformation necessary to achieve this vision is currently underway. The 'Empowered Sri Lanka' document laid the foundation for this transformation by identifying the priorities of raising incomes, ensuring employment and housing for all, and improving the quality of life for all citizens. The government plans to position Sri Lanka as an export-oriented economic hub at the centre of the Indian Ocean. It recognises the fundamental reality that Sri Lanka has a domestic market of only 20 million consumers with a modest per capita income, and must rely on external demand for sustained, high, and long-term growth. The government hopes to strategically position Sri Lanka as the hub of the Indian Ocean, securing opportunities for local businesses in global production networks (GPNs). This outward-looking approach will increase the efficiency of the domestic economy, contributing to a better life for all Sri Lankans.

The government claims that the export performance has been weak. The strong anti-export bias in the economy is a result of often uncompetitive exchange rates alongside high effective protection rates. Sri Lanka's exports are still concentrated on a few, mainly low-technology products. The external sector has become heavily dependent on commercial borrowing, FDI inflows related to real estate development, and remittances from unskilled migration for foreign employment. Investment policies have failed to attract transformational, knowledge-based investments.

The Vision 2025 has identified shortcomings in investment facilitation and policy uncertainty are constraints to attracting investment. It plans to carry out the following towards achieving this objective: Move Sri Lanka into the top 70 countries on Ease of Doing Business global rankings from its current ranking of 110 through legislative and regulatory changes, clarify and reform investment incentive policies to improve investment policy predictability, encourage Public-Private Partnerships (PPPs), take steps to integrate SMEs into the formal sector

The Vision 2025 states that anti-export bias in Sri Lanka's trade policy has reduced the export share of GDP. Sri Lanka's share of global exports reduced from 0.09% in 2000 to 0.06% in 2016, while its exports as a share of GDP declined from 33.3% in 2000 to 12.7% in 2016. Export composition is stagnant and dependent on a few low complexity products. Export markets are undiversified with respect to markets and products. Para-tariffs have contributed to a highly complex, protectionist import regime, inhibiting Sri Lanka's entry into GPNs.

The government has formulated a new Trade Policy, along with an original National Export Strategy.It hopes to phase-out para-tariffs, develop a trade adjustment programme to mitigate any harmful effects on domestic firms and affected workers, take advantage of new and existing Free Trade Agreements (FTAs), enhance access to trade finance by strengthening the Sri Lanka Export Credit Insurance Corporation (SLECIC), with a window for export-import services, encourage diversification of exports into services, position Sri Lanka as a global logistics hub.

National Trade Policy

Ministry of Development Strategies and International Trade (MODSIT) stated that in recent years Sri Lankas openness to international trade and investment has declined sharply. The increased protectionism and inward orientation have slowed growth. Recognizing that no economy has grown sustainably in modern times without growing exports and opening to the world, the Government of Sri Lanka intends to adopt a national trade policy (NTP).

The policy is designed to stimulate growth and job creation by improving the ability of firms to export and to compete for the domestic markets. The centerpiece of the NTP is a more liberal, simple, transparent and predictable trade regime promoting trade led growth as envisioned in the Economic Statements of the government in 2015 and 2016. It aims to attract more export oriented foreign direct investment, to improve trade logistics, to make customs procedures more transparent and quicker, and to implement other measures to boost firms'ability to compete in global markets. The main measures envisaged under the NTP are to create; "competitiveness through domestic policy reforms, market access and trade facilitation, macro-economic balance, policy and institutional coherence and the adjustment of firms and people."

The NTP also identified the major problems of the Sri Lankan trade regime to be the 'promotion of production for domestic market through a high and complex import tariff regime, lack of attention to trade facilitation, low level of regional connectivity and ineffective trade agreements and the lack of supply side capacity for exports.'

The new policy thus would seek to: 'Design and implement a comprehensive trade reform program with timing and sequencing to re-focus the current distorted and opaque trade regime by rationalizing tariffs, para-tariffs and NTBs, minimizing the use of specific tariffs and consolidating tariff lines into three bands; conduct a comprehensive review of trade and investment related legal and regulatory structures and undertake necessary reforms in the areas including immigration in parallel to the envisaged expansion of trade agreement to safeguard domestic services and industries and protect consumer interests, negotiate deep and comprehensive trade agreements with all major trading partners, beginning with India, China and Singapore; establish a more liberal regime of trade in services, aiming to attract FDIs; develop a national single window for facilitation of trade, implement the WTO Agreement on Trade Facilitation, widen and deepen the tax net to reduce the budget deficit and compensate for the loss of revenue from trade taxes and from that of tariff and para-tariff reductions, if any; allow the increase of the exchange rate flexibility to reduce bias against exports and will develop Trade-cost Adjustment programs to mitigate the adverse effects of trade liberalization on firms and people and to give time for adjustment.'

Sri Lanka's National Export Strategy (NES).

The Ministry of Development Strategies and International Trade and the Sri Lanka Export Development Board (EDB) is in the process of developing Sri Lanka's National Export Strategy (NES) to chart the next export growth cycle of the country. The development of this strategy is a central component of the "EU – Sri Lanka Trade-Related Assistance: Increasing SMEs' trade competitiveness in regional and EU markets" project, implemented by the International Trade Centre and funded by the European Union.

During the 1st NES consultation held in April 2017, a strategic vision for Sri Lanka's export growth 'Sri Lanka – An Export Hub driven by Innovation and Investment', was agreed upon. The achievement of this vision is supported by four key strategic objectives guiding the entire NES design process. To have a business-enabling, predictable and transparent policy and regulatory framework that supports exports. To drive export diversification through innovation and the strengthening of emerging export sectors. To strengthen Sri Lankan exporters' market-entry and compliance capacities. To become an efficient trade and logistics hub to facilitate exports.

The NES, with its 5-year strategy implementation period, lays emphasis on diversification of exports through strengthening of emerging sectors. Bearing in mind different growth trends, NES focus sectors are ICT, Wellness Tourism, Spice Concentrates, Boat Building, Processed Food and Beverages, and Electronic and Electrical Machinery. The focus sectors were identified based on quantitative and qualitative parameters derived from export potential assessments, conducted by the EDB and the BOI under the guidance of Harvard University, and further sector analysis by the Commonwealth Secretariat, McKinsey Co., the International Trade Centre and the World Bank.

In addition, the NES will ensure that all export sectors including the mature sectors will benefit from the strengthening of trade support functions. Through wide public-private consultations, the following trade support functions (TSF) were shortlisted to achieve the NES vision and strategic objectives; National quality infrastructure; Innovation and RandD, and Logistics. These trade support functions will aim at improving the overall competitiveness of Sri Lanka's export sector.

Free Trade Agreements

Sri Lanka is in the process of negotiating a number of Free Trade Agreements and the most critical are considered to be those with China, India, and Singapore. Many other countries in the region are also interested in having Free Trade Agreements with Sri Lanka and based on the principle that such agreements should favour the smaller or poorer country Sri Lankan negotiators should strive to get the maximum benefit for Sril Lanka's its exports. The CEPA and ECTA, the trade agreements with India ran into lots of criticism due to the ministry trying to sign an agreement much against the wishes of the Sri Lankan business community forcing the government to act with greater transparency and having to address many important issues not even thought of by them. The urgency displayed by the government without having the necessary safeguards has brought in skepticism among the business community with regard to all trade agreements. This has been sorted out to a great extent and there is more transparency and understanding among the parties concerned. These trade agreements are expected to be signed by 2018 and will provide enhanced opportunities for economic growth

Public Private Partnerships (PPP)

A public–private partnership (PPP) is a cooperative arrangement between two or more public and private sectors, typically of a long-term nature. Governments have used such a mix of public and private endeavors throughout history. However, the past few decades have seen a clear trend towards governments across the globe making greater use of various PPP arrangements. Although the government was focusing totally on Foreign Direct Investments the unsatisfactory progress has made it realize that private sector partnerships are a viable option to improve economic growth. Hence the government set up a PPP unit under the Ministry of Finance in order to explore the possibilities of attracting local investors.

Trade Facilitation Agreement (TFA)

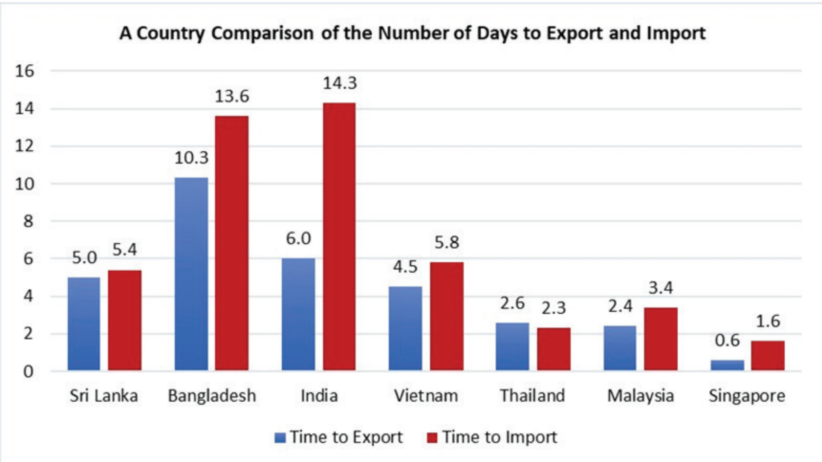
Sri Lanka submitted its instrument of ratification on 31 May 2016, becoming the 81st member of the WTO to ratify the agreement. Trade Facilitation indicators of the Organisation for Economic Co-operation and Development (OECD) show that Sri Lanka is on par with high-performing Southeast Asian economies like Thailand and Malaysia, in some areas, but lagging in other areas).

In governance and impartiality, fees and charges, and internal border agency co-operation, Sri Lanka is on par with Thailand and Malaysia. However, Sri Lanka registered low levels of external border agency co-operation, while falling significantly behind on advance rulings, appeal procedures, and the simplification of bureaucratic procedures with regard to documentation. Sri Lanka should gradually implement reforms to move towards the levels of trade facilitation in Malaysia, Thailand, and other emerging economies.

Improved trade facilitation will enable more seamless trade flows, and thereby catalyse export growth.WTO estimates suggest that Sri Lanka can expect trade cost reductions ranging from 13.9% to 15.8%, following full implementation of the TFA by a majority of member states.This could increase Sri Lanka's potential to link up with global value chains (GVCs), as streamlined import and export procedures will minimise global supply chain disruptions.The TFA can improve and streamline cross-border procedures, thereby reducing time and cost to export, which could allow for greater participation by small and medium-sized enterprises (SMEs) in trade. SMEs account for almost 52% of GDP but contribute marginally to Sri Lanka's trade. Onerous trade, Customs and border procedures which the TFA aims to shed are often cited by SMEs as "major obstacles to trade. By taking advantage of TFAF's soft infrastructure development programs, SMEs in Sri Lanka will be better equipped to locate potential export markets and connect to GVCs.

Sri Lanka established a National Trade Facilitation Committee (NTFC) in 2014, co-chaired by the Director General of Sri Lanka Customs and the Director General of the Department of Commerce.The NTFC's main task is to implement the TFA and other trade facilitation measures. For example, in January 2016, Sri Lanka launched the 'single window' system to streamline the export and import documents. This will link about thirty one government and other agencies to the Customs system in order to have all approvals at one point without the importers and exporters having to visit many institutions to obtain the various approvals. Although Sri Lanka has an operational NTFC, the World Customs Organization has highlighted challenges to Sri Lanka's NTFC, including varied levels of commitment of NTFC members, and gaps in the members' understanding of the TFA and of their role in the NTFC. Sri Lanka could look towards regional cooperation and international best practices to improve the effectiveness of its NTFC. Applicable best practices including developing a clear communication strategy in the NTFC's operational procedures; and developing a system of quantifiable measures to track Sri Lanka's progress in implementing the TFA, which in turn would highlight the effectiveness of the NTFC.

Many benefits will accrue from TFA. Its provisions on developing a single window and uniform documentation requirements, and streamlining border control procedures, will shorten Sri Lanka's average import and export times. According to World Bank 'Doing Business, Trading Across Borders' data, Sri Lanka currently takes almost five days to export, and almost five and a half days to import. While Sri Lanka fares better than emerging economies in South Asia like India and Bangladesh, it lags far behind Southeast Asian economies like Singapore, Thailand, and Malaysia, especially in terms of time taken to export (see Figure 1).An International Trade Centre report on non-tariff measures in Sri Lanka found that the Customs Department in Sri Lanka was a significant obstacle to trade, and accounts for 8% of procedural obstacles related to imports and 55.9% of those related to exports.The TFA can markedly increase Sri Lanka's potential in promoting export products, for example:TFA provisions on expediting clearance of perishable goods could enhance Sri Lanka's exports in the agro-food sector, which the government has singled out as a sub-sector with high export-earning potential; and Apparel exporters would also benefit from swifter clearance of goods and transit procedures, as many cater to 'fast-fashion' retailers that frequently change inventories.The WTO's 2015 World Trade Report observed a "positive and statistically significant" link between trade facilitation and FDI. Sri Lanka could therefore potentially improve its inflow of FDI by fully implementing the TFA.Reducing non-tariff trade costs related to trade procedures will enable Sri Lanka to better capitalise on its geographical location and efforts to improve maritime connectivity, especially given that, Sri Lanka is geographically positioned near high-volume trade routes in the Indian Ocean, with over 50% of global maritime oil trade passing through the Indian Ocean and Sri Lanka is improving the infrastructure of its ports in Colombo and Hambantota.



Source: World Bank, Doing Buiness, Trading Across Borders Data 2016

As a first step it is envisaged to set up a trade portal to facilitate trade by at least the middle of next year in order to enable importers and exporters to be aware off all regulatory requirements without being pushed from one institution to another to gather the required information. This is definitely a move in the right direction. NTFC is planning to streamline all processes and will without any doubt look at technology to automate processes in order to eliminate inefficiencies by making the process simple.

DIGITISATION OF TRADE

The global merchandise trade is approximately USD 15 to 16 trillion annually. While the estimated Trade Finance revenues for banks are around USD 23 billion. Trade Finance continues to be a highly paper intensive area of business in banking. It is estimated that in a single cross-border trade transaction around 30 to 35 original documents are required. The cost of handling LC transactions is high for banks due to manual document handling, checking and processing which in turn can lead to delays, occasional errors and inefficiency.

Digitisation of Trade and going paperless leads to faster digitization, smooth processing, saves costs, enhances risk management and better working capital management. The key solutions include Document Preparatory Services, Optical Character Recognition (OCR) and Intelligent Character Recognition (ICR) technologies, SWIFT MT798, Bank Payment Obligation, Electronic Bills of Lading, Blockchain (Still at early stage for Trade Finance)

Digitisation could transform trade finance.

The automation of key processes, such as the generation of purchase orders and invoices, document comparisons and sanction checks, improves working capital management and reduces operational costs. Not only does such automation enhance liquidity, but it also facilitates efforts to comply with regulatory and compliance requirements, by making processes overall more efficient and more reliable.

Digital contracts and documents streamline processes. The ability to access, review and approve original paperless electronic documents (e-Docs) separately from other parties allows for operational improvements at banks, ports and terminals. What's more, e-Docs enable individuals across the supply chain and across different countries to collaboratively draft documents; reducing errors, centralising processes, maintaining data integrity and accelerating the completion of agreements.

Of course, another noteworthy benefit of digitisation is the reduction in risk. The convergence of the physical, financial and document chains provides greater control and oversight over documents, centralises processes, enhances visibility and lessens the risk of fraud.

What's holding the industry back?

Despite the clear benefits of digitisation, uptake across the trade finance industry has been slow. The recently-published International Chamber of Commerce (ICC) Global Survey on Trade Finance revealed that just over 7% of respondents – primarily national, regional and global banks with trade finance functions, see digitisation as being widespread. Furthermore, one in five respondents reported that there is no evident digitisation at all, while two thirds saw very little evidence of the impact of technology.

Given the benefits, why is the trade finance industry acting so slowly? First, we must consider the considerable size of the task at hand. Digitising trade finance requires significant support and capacity in itself and involves participation from a number of parties. Many port authorities still require the original Bills of Lading (BL), and are often hesitant to digitise, for instance. In order for digitisation to be widespread across the industry the authorities must accept digital documents, and governments and regulators must create the infrastructure to support their use.

Furthermore, digitising trade is complex, requiring simultaneous changes over multiple industries. Even within a single organisation, changes to contracts and processes need to be made across departments; requiring corporates to consider their change management functions carefully and requiring banks to consider operational impacts and demands.

Another issue associated with digitisation is the potential increase in cybercrime activities. Some fear it could create the opportunity for new forms of fraud in the industry; particularly with regards to the potential for electronically forging or duplicating documents.

Finally, while digitisation must come from the banks, as the gatekeepers of trade finance, it is corporates that must demand it. So far, they seem reluctant to do so.

Readiness for Digitisation

The desire to move towards digitisation of trade definitely exists on both sides. Cash Management Solutions have seen much more success in digitisation. Quite a few business entities still prefers 'Traditional' way of extending their approvals and insists on signing documents rather than approving it online. Requirement of physical paper documents for areas such as Customs Clearance, level of investment needed and IT systems related security risks are some of the challenges in digitization of trade. Banks need to increase awareness amongst clients, especially amongst SMEs and small corporates and incentivize clients for using digital platform for trade transactions, wherever possible. Partnership between banks and FinTech Companies may open new avenues.

The industry goal of 'paperless trade' has met with limited success in part because efforts have been focused on digitising the financial supply chain while ignoring the physical supply chain. There is often confusion between the processes of converting paper documents into an image and passing it onto banks, and true digitalisation, which improves business processes through extraction and analysis of the underlying data.

While challenges remain, a significant amount of groundwork has already been laid to make digitalisation more achievable for the industry, particularly with regards to preparing legal standards, technical solutions and aspects of trade facilitation. For instance, the electronic Uniform Customs and Practice (eUCP), developed by International Chamber of Commerce (ICC), supplements the UCP (Uniform Customs and Practice for Documentary Credits) in order to accommodate presentation of electronic records alone or in combination with paper documents. This is crucial for harmonising the use of documentary credits worldwide. ICC also created the Uniform Rules for Bank Payment Obligations (URBPO), which govern BPO (business process outsourcing) transactions on a global scale. Meanwhile, SWIFT has developed the MT798, a new message type to be used to exchange data between SWIFT member banks and corporates.

There are also clear signs that momentum and interest are growing at the industry level. Last year, commodity traders Cargill and Wells Fargo collaborated on the first electronic export letter of credit along the US-to-Taiwan shipping route, using the essDOCS digital platform. This reduced the process from more than ten days to five days or less. More recently, Traydstream (a trade-finance fintech firm) partnered with PFU (a subsidiary of Fujitsu) and Lloyd's List Intelligence (a global maritime intelligence service) to expand its new trade-digitalisation and compliance-screening solution.

Overall, emerging markets have been the fastest adopters of digital practices, demonstrating both regional sophistication and a willingness to experiment and try new technologies, clearly important in boosting progress and encouraging wider uptake.

There are several steps that industry players themselves can take to support the digitalisation process. First and foremost, different players must link up and communicate. Progress depends on industry consensus, as ultimately no company can digitalise trade by itself. In the early stages of digitalisation, companies and banks should focus on trades for which others are already in the process of applying new technology, in order to gain and share experiences.

In addition, it is recommendedto digitalise in stages in order to guarantee success and ensure that the benefits are realised throughout the industry. Companies could first digitise their documents through an online DocPrep solution, then digitise trade finance via online applications, and finally proceed to end-to-end paperless trade.

Given that digitalisation is a large and complex project, which will certainly take some time, it is also important to set realistic timeframes. Corporates and banks should set annual targets for incorporating new technology, and then work towards those goals. Aligning aims with those of other organisations and counterparties will also help achieve industry-wide success in digitalising trade.

of the trade-finance industry is still in its early stages, but greater uptake will lead to innovation and a plethora of benefits. With greater collaboration and the development of standards, industry leaders can encourage much-needed progress.

Everyday life has been transformed by digitalisation, and most industries are similarly being overhauled by technological developments. In an era of slow growth, and at a time where the trade finance gap is at its largest and most crippling, Trade Finance must now accelerate its own digitisation journey. Automation, efficiency and risk reduction, the benefits are very clear

Next steps for digitisation

A crucial step towards bringing digitisation to the trade finance industry is harmonisation. Trade often relies on a dense network of counterparties, banks and logistics companies. For the benefits to be felt all parties must be prepared and equipped to deal with digitisation. In line with this, communicating plans both internally and at an industry level will ensure that others learn from work and can collaborate towards digitisation.

In addition, the global survey discusses how slowing down and automating processes step by step can actually accelerate progress. For instance, companies can start by digitising the creation of documents through an online 'DocPrep' solution, and then digitise trade finance via online applications, and finally move to end-to-end paperless trade. Taking the process steadily rather than rushing to overhaul all systems is a more likely route to success.

It is important to remember that digitisation is a large-scale project, and cannot happen overnight. Realistic timelines are therefore important when setting goals and annual targets. Such goals can also be aligned with counterparties and even industry competitors, in order to achieve widespread success.

While still a work in progress, the increased uptake of digitisation will certainly streamline trade finance. The slow uptake to date is concerning, but there are ample opportunities and benefits looking forwards. More should be done to help accelerate this development and ensure that the uptake of digitisation is widespread. If corporates demand digitisation, banks will respond.

Blockchain technology for digitization.

Looking towards the future for International Trade Finance digitalization the Distributed Ledger technology has a potential role in digitizing trade finance. Today, buzzwords such as 'blockchain' and 'Uberisation' are commonplace in the shared economy. While the idea of applying blockchain technology to international trade and commerce is not new, the pace of innovation in this area has recently increased. Blockchain, the technology behind decentralized cryptocurrencies like Bitcoin, is being used to simplify trade practices and solve the real world challenges presented by the current manual and paper-intensive processes being used. Blockchain has the potential to revolutionize the international trade finance industry by serving as a trustworthy intermediary. Blockchain uses a public ledger to track transactions and would reduce transaction costs by eliminating the need of an intermediary. Previously, the use of a trusted third party was the only means for mediating disputes, and preventing fraud. A study, cited by CNBC, found that during the first half of 2016, venture capital firms have invested $290 million in Blockchain technology.

Convincing all of the parties involved in international trade finance to digitalize their processes will take time and large investments. Digital is not new. However, the pace of investment and efforts aimed at digitalizing trade finance provides a powerful opportunity for innovation in this area.

What is Blockchain Technology?

The blockchain is an incorruptible digital ledger of economic transactions that can be programmed to record not just financial transactions but virtually everything of value. Picture a spreadsheet that is duplicated thousands of times across a network of computers. Then imagine that this network is designed to regularly update this spreadsheet and you have a basic understanding of the blockchain.

Information held on a blockchain exists as a shared and continually reconciled database. This is a way of using the network that has obvious benefits. The blockchain database isn't stored in any single location, meaning the records it keeps are truly public and easily verifiable. No centralized version of this information exists for a hacker to corrupt. Hosted by millions of computers simultaneously, its data is accessible to anyone on the internet.

As revolutionary as it sounds, Blockchain truly is a mechanism to bring everyone to the highest degree of accountability. No more missed transactions, human or machine errors, or even an exchange that was not done with the consent of the parties involved. Above anything else, the most critical area where Blockchain helps is to guarantee the validity of a transaction by recording it not only on a main register but a connected distributed system of registers, all of which are connected through a secure validation mechanism.

The blockchain network lives in a state of consensus, one that automatically checks in with itself every ten minutes. A kind of self-auditing ecosystem of a digital value, the network reconciles every transaction that happens in ten-minute intervals. Each group of these transactions is referred to as a 'block'. Two important properties result from this, firstly, transparency; data is embedded within the network as a whole, by definition it is public and secondly, it cannot be corrupted altering any unit of information on the blockchain would mean using a huge amount of computing power to override the entire network. In theory, this could be possible. In practice, it's unlikely to happen. Taking control of the system to capture Bitcoins, for instance, would also have the effect of destroying their value.

SWIFT TRADE SERVICES UTILITY (TSU)

The TSU is a centralized matching and workflow engine. It provides the timely and accurate comparison of data taken from underlying corporate purchase agreements and related documents, such as commercial invoices, transport and insurance. Unfortunately no Sri Lankan bank or other organization has not shown much interest in making use of this facility.

Although traditional trade instruments represent a falling percentage of global trade, the value of such instruments is continuing to grow. Meanwhile, corporate demand remains strong for trade services such as document comparison, discrepancy management and foreign exchange hedging.

Such services often require an exchange of data between the buyer's bank and the seller's bank. The TSU meets this need by comparing structured data from the two primary banks and advising them of inconsistent data. Further banks can also be included into the TSU workflow.

From a corporate point of view, the TSU can lead to faster access to funds, as well as better prices and/or higher credit limits. Other features include; providing timely and accurate comparison of data from underlying corporate purchase agreements and related documents, supporting messages including purchase order, invoice, transport, insurance and certificate data and handling data, rather than electronic versions of paper documents.

The TSU complements the delivery of new supply chain finance solutions. The Bank Payment Obligation is an irrevocable obligation from one bank to pay another bank. The Notice of Intent to Pay message indicates one corporate's intent to pay another corporate. Together, these solutions provide a strong backbone for pre-shipment and post-shipment financing.

Corporations are moving from traditional trade instruments to open account-based trading. They require solutions that help them improve their inventory control, reduce working capital requirements, and manage their payables and receivables in an efficient way. Discrepancies in documents need to be detected instantaneously to avoid delays and additional costs in the trade process. Banks are well placed to provide risk mitigation services if they have sufficient visibility on the transactional events from Purchase Order to Payment and parties involved. TSU aims to provide that visibility.

TSU creates visibility, allows matching and pre-matching of the trade details, and keeps track of outstanding at Goods Line item level, a previously labour intensive and costly activity. Data reliability adds value to all the parties involved, and creates opportunities for banks to provide finance services at the different trigger points such as Purchase Order Issuance/ Acceptance and Shipment and Invoice Acceptance. Using the TSU data banks can also offer document preparation and reconciliation services on account payables and receivables, since they already handle the payments traffic.

DIGITISATION IN SRI LANKA

Buyers and sellers are interested in having more efficient and less costly solutions and the use of technology in handling international trade business is a logical move. Internet banking helped to increase efficiency and reduce to a certain extent costs to both to banks as well as the importers. Sri Lanka Customs upgraded the Asycuda software system they are using in order to allow importers to file their Customs Entries electronically and make the payments using the payment gateways of the commercial banks.

While Sri Lanka's automation efforts were moving at a slow pace there were many software solutions in the global environment. SWIFT came up with the Trade Service Utility (TSU) which is available globally and can be used at any time. However so far no bank in Sri Lanka has not shown much interest in using this facility.

The legislative enactments required for performing electronic transaction are already in place and the government is ever willing to pass any amendments required to the existing laws in order to support such transactions. Digital Signatures are no more a legal bar. However, although Information Communication Technology Agency of Sri Lanka (ICTA) is certified to issue electronic signatures locally they have still not obtained certification for international operations which they must attend to without any further delay.

The major shipping companies have the facility to use Electronic Bills of Lading. However, since the infrastructure is not available to perform transactions electronically, they are compelled to print the Bills of Lading and use the paper documents for clearance purposes.

The government is paying lots of attention to SMEs to boost export growth. They will need a simple and easy technology for their trade transactions as the paper based system is very inefficient, labour intensive and costly. They will, therefore need a technology which is simple, efficient and less costly.

BLOCKCHAIN: IS THIS THE FUTURE FOR TRADE FINANCE INNOVATION?

Banks have successfully tested blockchain for trade finance agreements. But can they realise the full potential of distributed ledger technology in this space?

Blockchain holds considerable promise, but all too often it fails to find sustainable use cases. Trade finance is one significant exception. This traditional revenue source for banks is ready for disruption. A whole new approach, informed by blockchain logic, could bring the very transformation an established yet restricted business is crying out for.

An actual automobile plant would plan a move to a whole new production platform, one that would simplify process, adopt new workflows and manufacturing techniques, and handle much higher volumes of output. Yes, the margins on each new unit would be lower and the production costs would be lower too. And the sales volumes accessed in new markets would be orders of magnitude higher. In the end, offering a product much better suited to the realities of the modern market would make more money.

Can the same logic and practices be carried over to the Trade Finance market? Yes they can. But only if and when three pre-conditions are met: Banks are prepared to contemplate reductions in current trade finance margins, in pursuit of substantial growth in new markets. They are prepared to radically overhaul their current Trade Finance operational practices. They are prepared to apply the workflow logic and discipline that a blockchain informed approach brings.

How can they meet these pre-conditions and start to reap the rewards of trade finance transformation? The commercial decision around margins will be for each institution to assess. But no bank can afford to dismiss "democratisation" of their service out of hand, if they are serious about breaking out of the current limitations. The second two points are more practical.

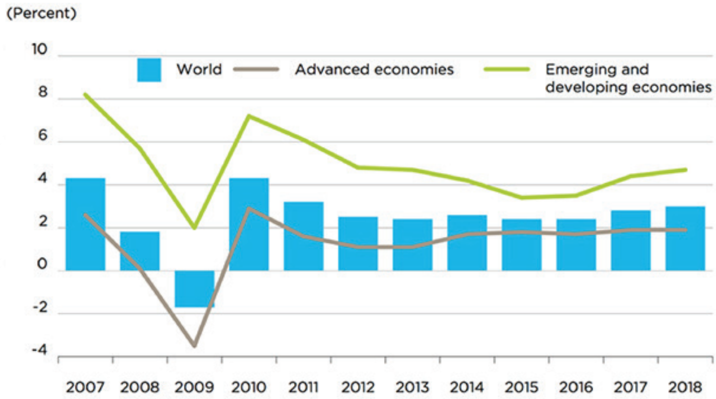
Placing the end-to-end Trade Finance process on a new platform would have a very clear objective: to offer all exporters and importers fast and easy access to credit issuance and advisory services. This is a radical shift but it is within reach. An open, automated and transparent trade finance platform, that replaces cumbersome trust mechanisms with automatic checks and assurances, is a technical possibility right now.

Today, 'classical'Trade Finance relies on a whole series of complex and disparate checks to ensure trustworthiness. Even with these in place, fraud is still a real possibility. And banks can be exposed to substantial risk. Blockchain is a perfect candidate approach for assuring a business critical sequence of events that minimise risk. For example, a network of multiple nodes, respecting pre-determined business logic, while eliminating any scope for tampering. This, surely, is an accurate top line description of the Trade Finance environment and a blockchain underwritten 'shared truth" environment is a technical possibility today.

Transformation won't arrive overnight. But the blockchain technology that enables it, cannot be overlooked. Banks themselves are currently best placed to lead their own transformation, from the front. But if they don't engage, there's little doubt that innovators and disruptors from "outside" will intervene. Many established banks are already assessing the potential of blockchain, but they need to move fast. Unless they seize the nettle, they risk being badly stung.

The Future of Trade Finance

The global shortage of available trade financing poses a huge risk to economic development and international trade; however, new technologies are disrupting old-school trade financing processes, offering better transparency and real-time monitoring throughout global supply chains.



Sixty-one percent of banks have identified a shortfall in the provision of trade finance, up from 53 percent last year. Yet in an era of intense change to the commercial lending landscape, it is important to investigate the improving reputation and trust of new alternative finance providers, and the real blockchain-backed trades shaking up traditional letters of credit.

World trade growth has slowed down over the past five years and banks have reduced their lending portfolio as a result of Basel III regulations, which basically mean that lent capital is characterized in a more stringent way and banks cannot leverage to pre-2008 levels (figure2). As a result, some 58 percent of all declined trade finance applications to banks originated from small- and medium-sized enterprises (SMEs), up from 53 percent in 2014.

Source: Global Growth, Historic and Future Projected Growth, World Bank Group, 2016

Meanwhile, technology has started to disrupt the trade finance space, with the internet of things (IoT), no longer just a buzzword, being used and implemented in the trade finance domain. IoT hasn't just stirred interest in the consumer space (think Amazon's Alexa controlling your fridge), but also innovations around supply chain finance, where buyers, sellers, storage containers and warehouses can begin to talk to each other, providing real-time 'big picture' status updates.

Many finance processes are going paperless, but what exactly does this mean for trade finance? Paper heavy processes such as Bills of Lading and Letters of Credit are becoming a thing of the past, as digital equivalents take over. Companies such as essDOCS and Bolero have paved the way for e-bills of lading and e-docs, which has led to efficiencies, faster processes and automation. As alluded to earlier, combining the electronic documentation with tools such as know your customer (KYC), anti-money laundering (AML) and compliance is a lot easier when documentation is transferred quickly, has an audit trail and can be electronically tracked.

Big data will also lead the future of trade finance. Companies that are able to map out, visualize and overlay data from numerous sources will be able to take a new approach to assessing risk and credit, integrate areas of the supply chain and innovate in the trade finance sector. Flexport is an example of an innovator disrupting the freight forwarding industry.Flexport is challenging the status quo by applying a modern software layer as part of our freight-forwarding service, enabling their team to be efficient and allowing importers to have full visibility and control into their shipments every step of the way.

Global trade is one of the biggest and oldest industries in the world that still operates like it is 1970. The final trend that we see in the Trade Finance space is the future securitization of commercial lending products to make them investable. The road to this has started asinvoice finance, traditionally a paper-based bank product that allowed companies to factor their receivables (such as invoices), has now been turned into an asset class by fin-tech giants such as MarketInvoice, and more recently, Satago.

Allowing a peer-to-peer-like model gives sophisticated investors (in some arenas) the chance to not only help pool their capital into funding the SMEs of the future, but has also created an asset class that is less risky than lending to individual companies. The UK government has also taken a pro-investing-in-SMEs approach through the introduction of innovative finance ISAs and Seed Enterprise Investment Schemes. We will see Letters of Credit and Bank Guarantees following suit, allowing the much-needed financial support to grow trade finance internationally. The next step will be creating more accessible investment products surrounding these trade types.

It must be noted that, despite all of the innovation and potential new face of Trade Finance, these things take time. The integration of blockchain into aspects of trade finance took several years and is far from mainstream, despite huge advances from major high street banks implementing blockchain-based trade finance solutions (e.g.Barclays). In addition, fraud and security remain vulnerable to attack, particularly in international trade finance.

We remain cautiously optimistic for the future of trade finance; new technologies provide compliant, safe and secure means to finance businesses that trade globally.

Conclusion

The open economic policies of the government in 1977 was a bonanza for banks as it was compulsory that all imports under the ‘Special Import Licence (SIL)’ scheme to be under letters of credit.. However, the continuous liberalization has resulted in banks losing out on some lucrative business which they enjoyed over the years. The continuous liberalization resulted in a decline of the Documentary Credit business and thereafter the Documentary Collection business as well in favour Open Account as the preferred method of payment resulting in a substantial loss of commission income for banks. The fast growing E-commere business is an example of banks losing out on trade business which they have been enjoying earlier.

For decades banks in Sri Lanka have always looked to have a monopoly in international trade finance business as it is the most important segment to generate profits. The focus of foreign banks operating in Sri Lanka on this area of banking is ample evidence to this effect.

Therefore stiff competition is seen among banks in trying to grab as well as retain the more profitable customers in this segment.

Another development is the wholesale suppliers of funds lending direct to corporates resulting in banks losing out on deposits as well as advances. With Foreign Direct Investments there is also the danger that banks of foreign investors overseas providing off-shore facilities to their clients depriving the Sri Lankan banks of their business.

Blockchain technology is bound to distrupt the trade finance business of banks in a very significant manner. Today we can see that technology is evolving at a very rapid pace and it is not uncommon to find that users leapfrog several solutions to embrace solutions based on the lastest technology available, in order to be ahead of the competition. Blockchain has created lots of excitement in the technology industry due to the tremendous advantages it offers to the users. The distributed ledger system ensures a high level of security making it almost impossible for hackers to break in. The efficiency, reduced costs and the ability to go beyond just financial services into other areas as well makes it possible to easily access the global value chain. It will be only a matter of time before Corporates and even SMEs look to move out of the inefficient, high cost, labour intensive, high risk paper-based systems into a digital system witch will spell danger to the banks which have been enjoying this profitable business for several decades.

Fintech providers have been aggressive in looking at new business opportunities and unless the banks make their move fast they are bound to cash in on this to provide solutions to customers and compete with banks. It is very likely that banks will partner Fintec companies to provide solutions to their customers and avoid the loss of this attractive business segment.

The disruption caused by technology as well as competition from both local and overseas banks as well as non-banking institutions all trying to finance the global value chain will bring in a host of new challenges to banks. The staff will have to acquire a completely new set of skills to perform in the new environment and the skill gaps will have to be addressed very quickly and the banks will have to be transformed with innovative new business models to remain competitive. Therefore Trade Services in the bank of the future may be a totally new, small and efficient operations.

References

- How digital trade finance is making it easier to exchange – Paul Golden – The Treasurer
- Digitalisation and Trade Finance: What's Next? - International Banker
- Harnessing the Power of Digital for International Trade Finance - Gianvito Grieco
- The trouble with trade finance digitisation - Standard Chartered, Home › Insights
- Digitization of Trade Finance - Global Trade Review
- Digitisation: gaining momentum in trade finance » GTNews.com
- Blockchain: Is this the future for trade finance innovation? - Capco
- What is the Future of Trade Finance? – Brink – The Edge of Risk
- Implications of the WTO Trade Facilitation Agreement for Sri Lanka – Lakshman Kadirgamar Institute of International Relations and Strategic Studies
- Vision 2025