The Evolution of Trade and Supply Chain Finance: Moving towards Digitization
供应链融资演变趋势

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Emerging Trends in Electronic Trade Finance

电子化贸易融资的新兴趋势
## Global Trade Trends

### 2016
- **Trade Growth in 2016: 1.7% (vs average 5% since 1990)**
  - 5th consecutive year growth in global trade < growth in global GDP growth
  - Developing markets: 42% merchandise trade
  - Intra-developing markets trade: Increase 41% → 52%
- **SWIFT Traffic fell for 5th year**
  - MT700 message volumes as low as 2009 levels
- **Markets reliant on primary commodities have headwinds**
  - Prices fell up to 50% in 2016 (priced in USD)
  - China – Africa trade corridor receded since 2014
- **Anti-financial regulatory compliance**
  - Trade finance gaps and strict compliance → SMEs were hit the hardest
  - Lack of compliance harmonization between jurisdictions viewed as impediment
- **Other Trends**
  - Trade finance gap being filled by multilateral development banks and Fintechs
  - Increasing trends observed in:-
    - claims under BGs and SBLCs
    - court injunctions from trade disputes
    - allegations of fraud

### 2017
- **Trade Growth in 2017: 3.6%**
  - Still lower than the average 5% since 1990
  - Risks remain from slowing emerging economies and financial volatility
- **Rise of the Fintechs**
  - SMEs flight to alternative financing still at early stages
  - Companies unfamiliar with digital financing (Peer to Peer lending, Debt-based securities and Crowd funding)
- **Embrace disruption**
  - Banks are exploring ways to work with Fintechs to reach those least linked with traditional trade financing
  - Digitization in banks can promote transparency, efficiency and equality
- **Asia remains primary market for trade finance**
  - Despite challenges, trade continues to be an important factor for GDP growth
- **A New Hope**
  - WTO’s Trade Facilitation Agreement (TFA) was ratified by 2/3 acceptance on Feb 22, 2017. Reduce red tape at borders, add $1tn global trade flows & create 20MM jobs
  - Consider a new e-commerce agreement under WTO

Sources: ICC – Rethinking Trade & Finance 2016

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Client Drivers for Trade Digitization and Standardization

贸易融资数字化和标准化的客户因素

- More efficiency in conducting their business model
- E-invoicing & doc fulfillment platforms that connect all parties including buyer & suppliers
- Advanced bank agnostic trade software solutions
- Digitize & automate their processes
- Consolidated MIS across banks
- Reduced Receivables to Cash Cycle (DSO)
- Solutions have customizable workflows & based on industry standards messaging
- Mitigate risks inclusive of credit, fraud and physical document loss
- Accelerate trade processing to be more competitive
- Reduce cost through standardizing interfaces with their banks
- Increase efficiency through improved internal workflow & control
Banking Industry’s Response
银行业采取的应对措施

SWIFT for Corporates
BPO & e-B/L
E-SCF and Document Presentment
3rd Party Doc Prep Providers
Blockchain
Cybersecurity

Partnering with Doc Prep Providers
- J.P. Morgan partners with third party document preparation provider to provide doc prep services to our clients on a referral basis. (Trade Technology Inc.)
- J.P. Morgan will be able to log into the doc prep provider website and print the documents prepared by the service provider

E-SCF and Document Presentment
- SCF program leveraging e-platform to help buyers to extend payment terms while allowing suppliers to discount their receivable
- Client presents documents directly to Issuing Bank or Remitting Bank while electronic images of the document set is sent to J.P. Morgan
- J.P. Morgan will check documents, handle incoming payment and discounting the export bills if required

Standardization through Multi-Banking (MT798)
Question #1
问题 #1

1. Companies in which of the following industries are not eligible for Supply Chain Finance program:

A. Manufacturing
B. Pharmaceutical
C. Retail
D. Logistics
E. All above apply

1. 以下哪些行业的公司不符合供应链融资计划:

A. 制造业
B. 制药
C. 零售
D. 物流
E. 以上均符合
Question #2
问题 #2

2. Based on your experience, which of the organizations listed below offers a more competitive Supply Chain Finance solution?

A. Banks
B. Fintechs
C. Finance company of the client group
D. Each of the above has its own advantages
Recent Development in Supply Chain Finance

供应链融资近期动态
Supply Chain Finance: Market Updates
供应链融资：市场最新动态

What has changed....

- Rising of Fintechs and other SCF players in the market
  - Increasing Fintechs, Finance corps, Factoring corps, logistics corps and etc. flood into SCF market
  - Collaboration between different type of SCF providers are becoming more common
- Structural elements of SCF
  - Adoption of electronic SCF solutions is growing
  - Increasing club deal/ syndicated structures at the outset with multiple funders lined up to provide capacity
  - Market pricing continues to become more competitive – potentially unsustainable in Basel III environment
- In China, SCF has increased its strategic importance and visibility as a core working capital solution especially for companies with a global presence.
  - Local RMB sourcing followed by import sourcing
  - Chinese offshore subsidiaries are looking at SCF for their local & import spend

Buyer and Supplier Behaviors

- Broader industry takeup: starting to see a snowball effect in many segments
  - Consumer, retail, diversified industrials – deep historical usage
  - Pharmaceuticals – aggressive takeup in last 3-4 years has created significant penetration
  - Oil & gas/ metals & mining – underpenetrated but current WC needs mean this is likely the next sector to “pop”
- Longer payment terms are adopted across the globe
  - China is at the forefront with terms moving beyond 100-120 days in many cases
- Client adoption continues across multiple axis
  - Deeper – new supplier segments not previously addressed (logistics, transportation, advertising/ media)
  - Wider – new divisions, new regions/ countries (local spend & import spend)
- Fewer and more selected suppliers to streamline the supply chain, strengthen supplier relationships and negotiate better price and terms
- Acceleration in Investment Grade companies joining programs as suppliers and also adoption by new spend segments
- Intermediate Suppliers Adopting SCF as both Seller and Buyer
## Comparison Between Different SCF Providers

<table>
<thead>
<tr>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Competitive funding cost to be provided for SCF</td>
<td>• Limited capabilities to support distributor end</td>
</tr>
<tr>
<td>• High degree of security for all parties due to regulatory requirements</td>
<td>• Less flexibilities due to regulatory controls, such as supporting docs and etc.</td>
</tr>
<tr>
<td>• In-depth knowledge in various industries and advisory services will be provided to clients.</td>
<td></td>
</tr>
<tr>
<td>• Strong on-ground implementation capability to ensure the success of the program.</td>
<td>• Lack of on-ground implementation resources</td>
</tr>
<tr>
<td>• Integrated SCF solutions (incl. various banking products) to support global flows</td>
<td>• Higher financing cost due to lack of competitive funding sources</td>
</tr>
<tr>
<td>• Highly digitalized with less manual paperwork or legal agreements.</td>
<td>• Lack of on-ground implementation resources</td>
</tr>
<tr>
<td>• Flexible arrangement in terms of supplier onboarding, financing tenor and etc.</td>
<td>• Higher financing cost due to lack of competitive funding sources</td>
</tr>
<tr>
<td>• Specialized in certain industries, such as retail and etc.</td>
<td>• Negative impact to accounting treatment</td>
</tr>
<tr>
<td>• Multi-funding channel allowing corporate to provide self-funded SCF solutions</td>
<td></td>
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**Bank is the key SCF player with supplement of Fintechs and other financing providers**

### Physical Supply Chain

- **Supplier**
- **Manufacturer**
- **Whole Seller**
- **Retailer**
- **End User**

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**J.P. Morgan**
How J.P. Morgan Delivers a Different SCF Experience?

摩根大通如何提供与众不同的供应链融资体验

Advisory on Payment Term

- An analysis has been done on the Days of Sales Outstanding (DSO) of all China suppliers under J.P. Morgan’s existing SCF programs.
- Among those segments, suppliers accepted the term extension from 45 to 75 days, 60 days to 120 days etc.

<table>
<thead>
<tr>
<th>Segment</th>
<th>DSO (Days)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Printing/ Packaging</td>
<td>110.2</td>
</tr>
<tr>
<td>Commercial/ Marketing</td>
<td>79.5</td>
</tr>
<tr>
<td>Diversified Industrial</td>
<td>207.5</td>
</tr>
<tr>
<td>Capex</td>
<td>116.7</td>
</tr>
<tr>
<td>Chemical Ingredient</td>
<td>111.8</td>
</tr>
<tr>
<td>Electronics</td>
<td>215.0</td>
</tr>
<tr>
<td>Distribution/ Logistics</td>
<td>89.6</td>
</tr>
</tbody>
</table>

Success Factors of SCF Program

- Client sponsorship attributes are highly correlated with success with a Coefficient of Correlation of 0.86 (where 1.0 indicates perfect correlation). Higher sponsorship scores “pull” other attributes towards overall success while lower sponsorship scores skew results towards less success.
  1. Senior management engagement in project and program governance
  2. Quality of Client Project Leads and Team – Capacity, capability and influence
  3. Well-defined project governance structure, clearly articulated roles and responsibilities, training and education of project team members, results tracking
- Other client characteristics are less positively correlated with success with a Coefficient of Correlation of 0.28

Frequency Distribution

- Characteristics Mean= 5.9
  - Median=6.7 / Mode=5.7
  - Min= 3.3 / Max=9.3
  - Standard Deviation = 1.4
- Sponsorship Mean= 6.6
  - Median=6.6 / Mode=8.4
  - Min=1 / Max=9.4
  - Standard Deviation = 1.9
What’s Next?
贸易融资的未来？

Where is Asia heading with Trade

- Despite political uncertainty, economic headwinds and rising Fintechs, banks in Asia need to embrace disruption and trade is still source of growth
- Completely paperless transaction processing – broader adoption of Electronic Bill of Lading through platforms such as Bolero / essDOCs (eliminate the risk of lost or fraudulent documents and reduced sales cycles)
- Continual need for alternative option for risk mitigation and financing - BPO? What else?
- Drive for multi-banking standardization continues - SWIFT for corporates?
- Broader and more sophisticated mobile / tablet based solutions using Apps (improved transparency and MIS)
- Blockchain Trade Finance – J.P. Morgan and handful of banks already developing trial projects (need to resolve critical tech challenges such as scalability, privacy, latency & ecosystem development)
- Banks and regulators need to work together to tackle trade based money laundering
- Trade fraud in the digital space becoming increasingly more complex (J.P. Morgan spends > 20% of tech budget on security & controls, 7% on cyber capabilities)

“How long before Trade to become mostly Digital?”

- 1-2 years 8%
- Never 5%
- Others 20%
- 4-10 yrs 67%

Only 8% can see Trade going completely digital in the next 1-2 years

Source: SWIFT Annual SIBOS Conference 2014
Appendix
附录

To Reach 50 Million Users, It Took:

75 Years for the Telephone

And 3 ½ years for Facebook

4 years for the Internet

38 years for Radio

13 years for TV
Appendix - Disruptive Digitization has shaped the evolution of the Trade landscape

附录- 在贸易融资格局演变历程中，颠覆性数字化技术起到了重要作用

Even though the adoption of e-channel is increasing, Asia continues to lag European and US markets in terms of trade business managed electronically

Source: Greenwich Associates – Large Corporate Trade Finance study 2014
Based on 400 respondents for Asia (excluding Indonesia), 297 for Europe and 168 for the United States
Appendix - Blockchain and Trade Finance

附录 - 区块链和贸易融资

### What is Blockchain – A Recap

- Is an immutable & consistent transaction protocol and data store shared by all nodes of a distributed network
- Provides the ability to record and transfer ownership of digital assets, such that all nodes automatically agree on ownership rights at any given time

### Industry

- **Why are Banks so interested in Blockchain for Trade**
  - Under Basel III, regulatory conditions aim to:
    1. Mitigate banks using short-term assets to fund long-term liabilities (One-Year Minimum Maturity Provision)
    2. Ensure sufficient cash & liquid assets to meet all their short-term obligations (LCR)
      - increased cost to trade finance
    - Risk of disintermediated by NBFI – not subject to same tight regulatory rules
  - **Reduce costs by removing all inefficiencies & waste**
    - invest in technology
    75% of European treasurers are focusing on investing in trade finance technology
  - **Avoid Past Mistakes (Bank-to-Corporate Model)**
    - To adopt Blockchain in supply chain / trade finance, need to move beyond Bank-to-Bank Model
    - In order for Blockchain to work, there needs to be an industry-wide effort towards implementation
  - **Banks need to:**
    - Create awareness among corporate clients around blockchain features and technology enhancements
    - Map bank-to-corporate blockchain applications with real-case trade finance business processes
  - **Corporates need to:**
    - Provide use cases to test the assumptions and establish true potential of blockchain in trade (address requirements & concerns)

Sources: Study of European treasurers (C2FO – 2017)
Appendix - Trade Finance on Blockchain – Case Study
附录-基于区块链技术的贸易融资 – 案例研究

**Digital Trade Chain (DTC)**

- 7 European Banks
- Logistic Companies
- SME clients of 7 Banks
- Track & trace
- Mobile access

**Texan Cotton Trade**

- US Cotton Merchant
- Chinese Importer
- Banks

- First global trade transaction between 2 unrelated banks
- Uses blockchain technology with 2 other emerging technologies (i.e. smart contracts and internet of things)
- Involved international physical shipment
- Open account trade using physical supply chain trigger & digitized bill of lading (Oct 2016)

**J.P. Morgan Global Trade’s Response**

- Review projects in the market - No clear transformative efforts yet
- Proof of Concept
  1. Documentary Trade – working with bank partner on LC flow
  2. Supply Chain – leading initiative around asset distribution on open account side

Jan 2017: 7 European-bank consortium deliver trade finance on blockchain through DTC platform
Quicken / streamline order-to-payment process
Aim to bring more business opportunities to banks
- lending money, selling guarantees, managing cash & handling payments

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Q&A