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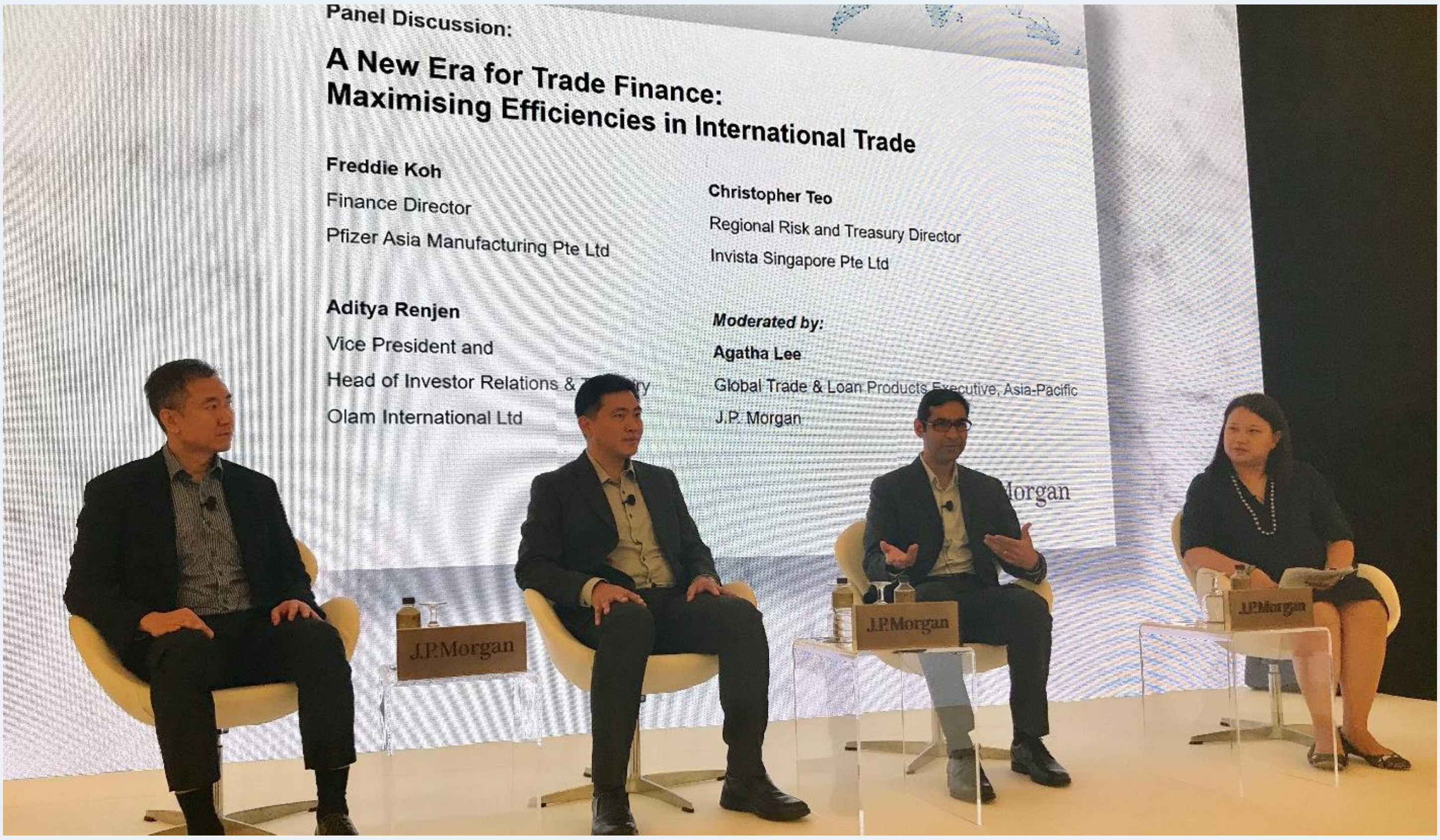
A New Era for Trade Finance: Technology, Innovation and the Drive for Efficiency

Speaking at a panel discussion hosted by J.P. Morgan in Singapore, finance and treasury directors of three major multinational firms discussed the impact that changing dynamics in international trade are having on their businesses amid globalization, protectionism and rapid advances in technology.



MODERATOR:

- **Agatha Lee**
  Head of Global Trade & Loan Products, Asia-Pacific, J.P. Morgan

PARTICIPANTS:

- **Freddie Koh**
  Finance Director, Pfizer Asia Manufacturing
- **Aditya Renjen**
  Vice President, Investor Relations & Treasury, Olam International
- **Christopher Teo**
  Regional Treasury Director, Invista Singapore

AGATHA (J.P. Morgan) How are globalization, protectionism and geopolitical risks impacting the way you do business?

CHRISTOPHER (Invista) One of Invista's biggest manufacturing plants is in China, so we are closely monitoring the regulatory and financial landscape and how that would impact the way we transact and do business in China.

In the longer term, the Belt and Road initiative will have a significant impact on trade. We see it as a trade enabler, especially for investors as China's middle and upper classes grow. Their consumption patterns would drive our business and help sustain and stabilize our firm's growth momentum.

ADITYA (Olam) The advantage of an agri-business like Olam is that food demand is less impacted by commodity and economic cycles. Countries that are dominant producers and exporters will remain so for the foreseeable future, while countries that are in deficit will have to import and consume. As long as trade is open, agri-businesses like ours will always have a role to play.

That said, markets with protectionist or nationalist agendas would impact trade. In countries that are most susceptible to this, we will look to participate in the domestic flows as a hedge.

■ **FREDDIE (Pfizer)** I don't think any company will be spared from geopolitical changes, especially protectionism. For pharmaceutical companies like Pfizer, protectionism makes it difficult to source and use quality ingredients from certain countries for particular markets. In such cases, patients will not be able to benefit from these competitively-priced, quality ingredients.

One of the desired outcomes of the recent U.S. tax reforms is to bring manufacturing bases and jobs back to the United States. While such developments could provide incentives for companies to consider shifting their manufacturing bases, the actual execution tends to be very complicated and expensive process that doesn't happen overnight. It will be a difficult operational decision for any company to make during the early stages of the tax changes.

In Asia, some countries are adopting market access restrictions. This means if you want to sell your products in their markets, you will need to be willing to work with the local suppliers and help them advance their manufacturing capabilities. These suppliers will need to incur capital spending and require working capital financing for their expansions. Hence, unless you have a robust supply chain with a good financing mechanism for your suppliers, it could prove to be a challenge to support their manufacturing ambitions.

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J.P. Morgan's view:

The Belt and Road initiative plan will see a projected $2.5 trillion increase in trade and billions of dollars poured into infrastructure and construction in the coming years. Once completed, it will represent the largest economic development project in history, covering a population of over four billion people and an economic output of $21 trillion.

On the broader trade picture, a political shift to protectionist and populist policies represents a threat to trade growth. The announcements of trade tariffs by the U.S. and retaliatory action by China have raised concerns of escalating trade tensions but our base case assumes a bumpy path of negotiation instead of a fully-fledged trade war.

For Asia Pacific, trade restrictions imposed on China could impact the region via the supply chain. From a macro perspective, Northern Asia's indirect exposure to China's exports is larger than ASEAN economies. From a market perspective, the information technology (IT) sectors in South Korea and Taiwan will likely be negatively impacted by the tariffs on China.

AGATHA (J.P. Morgan) How do new banking and fintech platforms and solutions impact supply chain financing?

■ **FREDDIE (Pfizer)** Supply chain financing (SCF) is relatively new in Asia when compared with the U.S. and Europe. Initially, I was skeptical about the benefits, but the reality is that you can leverage your credit standing to support your suppliers with lower financing costs to mutually benefit both parties. It largely focuses on balance sheet and working capital efficiencies and how you can stretch your money for other strategic purposes.

There are challenges, however, including the sensitivity around the amount of time it takes to record your invoices on your payables system. SCF only reduces financing costs if your internal processing time is efficient. Another concern is the ability to integrate your existing technology, including the Enterprise Resource Planning (ERP) software, with the bank's SCF platform. There may be challenges convincing suppliers to be comfortable with the platform, especially if you already have good infrastructure in place.

■ **ADITYA (Olam)** In the food supply chain, new fintech offerings definitely have a role to play. They can enhance traceability, reduce costs and also provide non-traditional sources of funding to those who haven't or can't be served by mainstream banks.

■ **CHRISTOPHER (Invista)** A large part of our sales invoicing to customers is on letters of credit or trade terms. This involves heavy documentation, which has become a challenge. Often, our shipments would have arrived at the port and we're just waiting for documentation. This has led us to pursue a digital solution for letters of credit and documents against payment. We recently ran a pilot on documents against payments, completing a transaction – that usually takes five to six days – in just six hours.

It's important to keep in mind that the digitalization of trade is a journey. Blockchain won't happen overnight. It will probably take ten years, but we want to start the journey today. We want to understand the requirements for electronic documents, which countries are still using paper documentation and which are more advanced. Through this process we'll learn more about trade and begin to challenge our current processes to drive greater efficiencies on our paper flow because we realize through the electronic process that certain steps can be eliminated.

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J.P. Morgan's view:

As working capital management becomes a greater priority for corporates, the SCF proposition will continue to gain traction in new industrial segments, particularly oil and gas and the metals and mining sectors.

Industries beyond the traditional SCF-heavy sectors, such as consumer and retail, are increasingly utilizing SCF to manage their working capital. The SCF proposition can enhance working capital while improving vendor relations.

The advent of blockchain, which combines peer-to-peer networking, smart contracts and cryptography to create a decentralized ledger of transactions and other information, also opens up exciting possibilities for streamlining supply chain processes. Early adopters will pave the way for further innovation in trade digitalization, eventually leading to increased adoption among competitors and suppliers.

AGATHA (J.P. Morgan) Ten years down the road, where will we be in terms of trade digitalization?

■ **CHRISTOPHER (Invista)** I'm a firm believer that blockchain technology will be the future solution for trade and cash management. It might come earlier because the technology space is moving quickly and government initiatives are coming together to support this.

Also, we'll probably see the widespread use of robotics. If you call the bank to check on your account today, you are already talking to a chat bot. Corporates are starting to adopt this for basic queries and questions. Many companies have already automated the manufacturing process. Overall, we will see more robotics and automation going forward.

■ **FREDDIE (Pfizer)** Trade digitalization is all about trust - whether or not to trust new systems or new ways of doing things. One key factor underlying that decision is your experience with the technology.

We are probably still a while away before we can be totally paperless because some people are still accustomed to paper documents. But as more leading corporates accept electronic documents and beyond the inflection point, I would expect the majority to follow, facilitating the adoption of the new technology.

■ **ADITYA (Olam)** It's not about changes in the future because today's technology already has the potential to transform the way that trade and supply chains work. The problem is the incentive structure. It's already working today in consumer banking, which is why you see so much innovation there. Take e-wallets or digital banking for example; they work between the bank and the customer under one regulatory framework. Customers don't have to walk into banks anymore.

In contrast, it's much more difficult for trading companies because there are so many parties involved – banks, ports, shippers, customers and more. When it all comes together, it will be perfect; but between now and then, we will need a lot of bilateral agreements and someone to coordinate them.

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— **Freddie Koh,** Finance Director, Pfizer Asia Manufacturing

J.P. Morgan's view:

As trade becomes increasingly digitalized, it opens the door to new players and could render traditional trade finance providers obsolete. Banks must adapt to this new environment to remain competitive.

Companies must do the same. Many have already modernized their approach to customers, products, services and operating models through online and digital technology, where purchase orders, product specifications and design images are sent electronically from supplier to purchaser, while invoices and packing lists are exchanged efficiently over email. Digitizing trade finance is the next logical step.

Corporates want to manage their trade activities with ease and sophistication. It's a natural outgrowth of the global supply chains that have evolved over the last 10 to 15 years. They need visibility, control and flexibility in an order placement and fulfillment environment; this is where digitization provides a solution.

For more information, please contact your J.P. Morgan representative.