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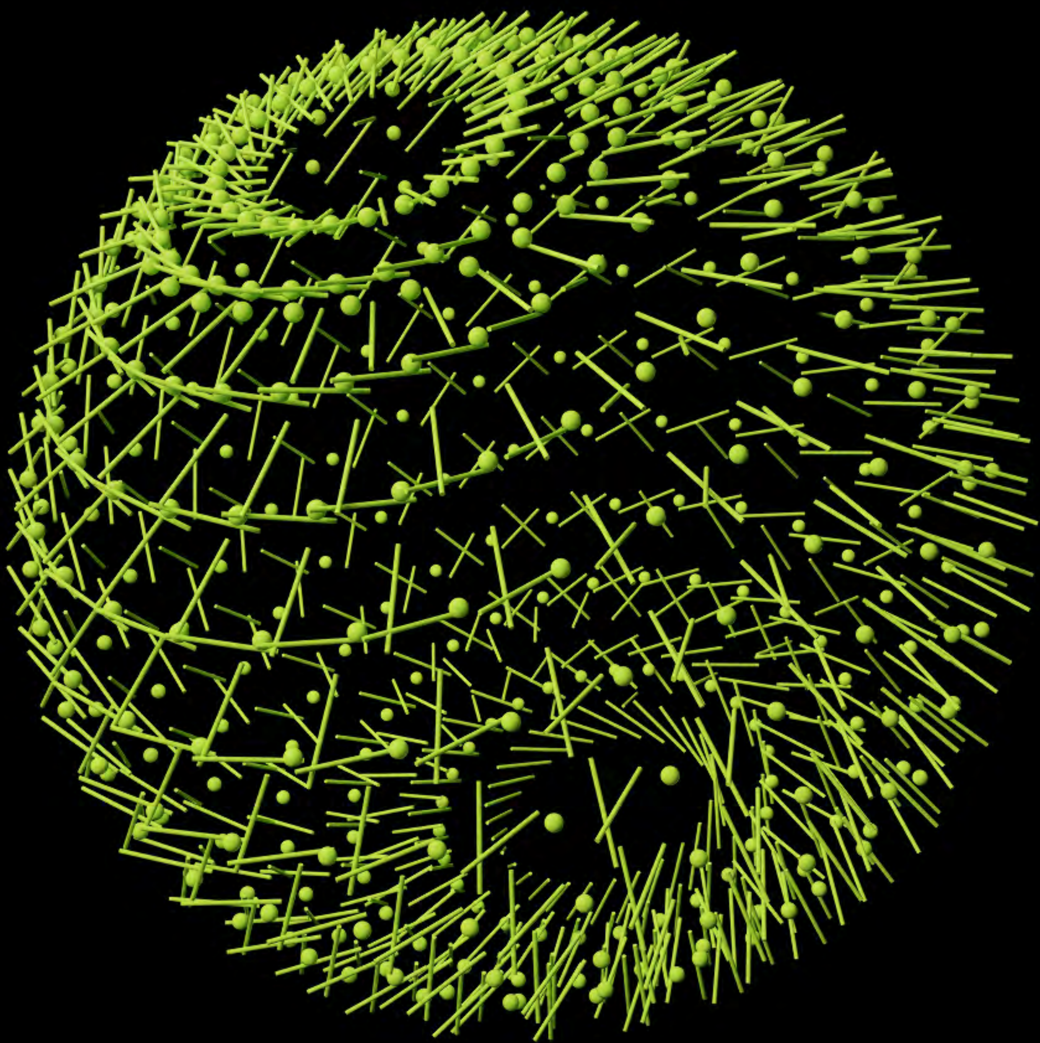

Trade finance ecosystem

The path to inclusive and sustainable growth

July 2022

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Foreword by ASSOCHAM

The trade finance market continues to respond to the ebbs and flows of global trade. After an overall dip during the pandemic, the market has recovered. However, it is expected to face continued headwinds on account of global trade dynamics. Trade finance instruments play a critical role in cross border and domestic trade facilitation in terms of mitigating counterparty risk and streamlining working capital requirements.

India has witnessed a steady growth in overall exports over the last few years especially since April 2021. The continuing pandemic as well as the war in Ukraine has led to a significant slowdown in the economy as well as increased the inflation rate. The impact of shifting supply chains and an increased likelihood of a global economic slowdown may weigh in on the global trade growth over next two years.

Government and regulators will continue to play an instrumental role by introducing new reforms and initiatives, policy changes and push for digitization to create an inclusive trade ecosystem. The expansion of existing platforms to further enable seamless exchange of information between the various participants in the ecosystem and increased digitization of documents across the value chain will enable the full potential of paperless trade. With the ongoing uncertainties, trade participants and finance providers will continue to look up to the government bodies to bolster the Indian economy.

Banks will need to continue to focus on digitalization, alternate credit models, partnerships with FinTech and API integrations to provide financial solutions to MSMEs, as banks will be the cog which will drive inclusive trade finance.

In this context, the ASSOCHAM is organizing the 3rd National Summit on trade finance for inclusive growth "Changing Dynamics Amid Geo-Political Issues" in the wake of many countries imposing trade sanctions amidst rising global tensions.

ASSOCHAM and Deloitte have come out with a Knowledge Report which tries to highlight the issues being faced by the industry and draft a roadmap for the coming times.

ASSOCHAM acknowledges the valuable contribution made by the Deloitte research team and their effort in preparing this in-depth ready reckoner.

We hope that this report will help regulators, market participants, government departments and other research scholars.

Deepak Sood
Secretary General, ASSOCHAM

Foreword by Deloitte

Countries across the globe are still trying to find their foothold after COVID-19, amidst continuing disruptions and uncertain geo-political situations. Although global trade has bounced back, it continues to face headwinds due to inflationary and recessionary pressures and protectionist and regionalist ideologies. Further, supply-chain rebalancing is likely to lower its growth momentum.

India, as an integral part of the global supply chain, has also been affected by these factors. However, several initiatives by the Government of India towards building trade ties, boosting manufacturing, creating an enabling infrastructure, digitalising the logistics value chain, etc., augurs well for India in these emerging trade dynamics.

Trade finance would continue to play a significant role in trade facilitation globally, though its underlying instruments and solutions will keep evolving based on the changes in the nature of risk associated with cross-border trade transactions. The financing gap of Micro, Small and Medium Enterprises (MSMEs) continues to be an unaddressed challenge globally with trade financing gap growing to US$1.7 trillion as of 2020.[1] The problem is equally pronounced in India with a large number of MSMEs at the centre of India's growth story. The trade financing ecosystem is envisaged to play critical role in bridging this gap. Participants in the ecosystem, including financing institutions, logistics solution providers, technology providers, along with government bodies, need to innovate and streamline the process to improve accessibility and reduce the transaction costs. Digitisation and collaboration will be key in driving this momentum.

While initiatives and innovation by individual participants would help put together the pieces of the puzzle, it is the collaborative and integrated approach across ecosystem that will unlock the true potential of innovation in trade finance market. Supply chain finance, distributed ledger technology, common standards and protocols, and movement towards sustainability have the potential to build an efficient and inclusive trade finance market. Supply Chain Finance (SCF), along with enabling platforms, such as Trade Receivables Discounting System (TreDs) in India, are envisaged to be a viable solution to ease the financial value chain linked to the supply chain, especially for MSMEs. SCF also has the potential to embed the sustainability quotient in buyer-supplier relationships for offering a differentiated proposition to suppliers that meet Environmental, Social and Governance (ESG) frameworks.

The creation of common standards and protocols around measurements and technology innovation to enable interoperability will be the key enablers in driving growth and efficiency. Technology has demonstrated the potential to make trade finance more efficient and inclusive; the onus is now on the participants in the ecosystem to innovate, collaborate, and build the consensus to drive outcomes.

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[1] https://www.adb.org/sites/default/files/publication/739286/adb-brief-192-trade-finance-gaps-jobs-survey.pdf

Global trade has recovered from the pandemic downturn but continues to face headwinds

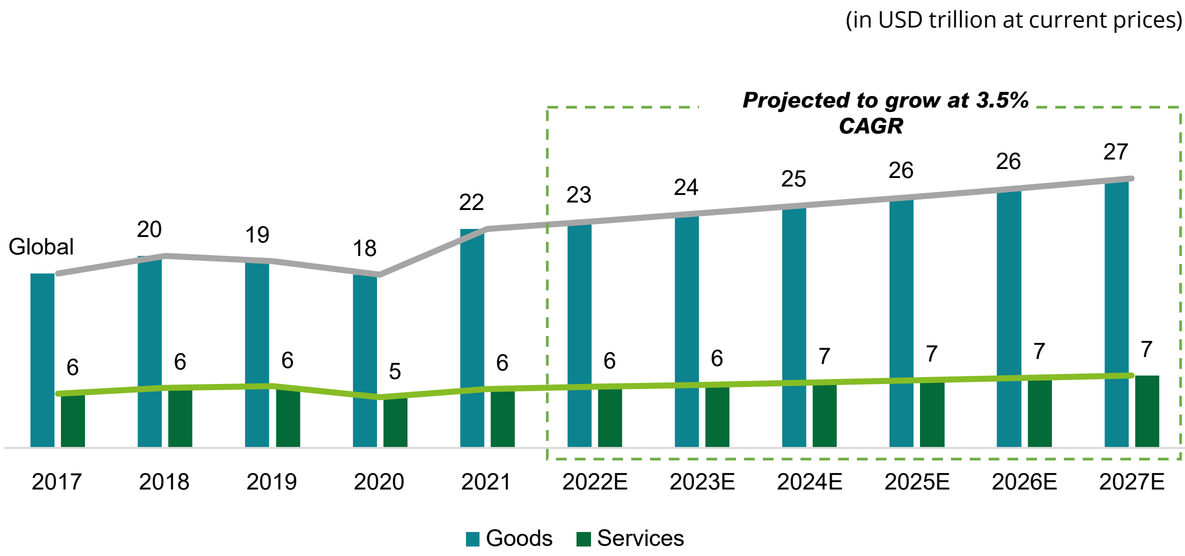
Continuing waves of the pandemic, along with the war in Ukraine, has led to significant economic impact, leading to a slowdown in the economy and inflation. Global growth, which indicated strong recovery at 6.1 percent in 2021, is expected to slow-down to 3.6 percent[2] in 2022 and 2023.

Global trade was the key driving factor behind the recovery in 2021. The global trade value grew to USD 28.5 trillion[3] in 2021, which was ~13 percent higher than the pre-pandemic levels in 2019. This growth can largely be attributed to increasing commodity prices, reducing mobility restrictions and increasing consumer demand, induced by the stimulus provided by several advanced economies.

However, global trade growth is expected to slowdown in 2022 and grow at 3.5 percent[4] CAGR to ~US$34 trillion over the next five years due to ongoing geo-political tensions, inflationary pressures, and continuing disruptions in supply chains.[5] The impact of shifting supply chains and an increased likelihood of a global economic slowdown may weigh in on the global trade growth over the next two years.

[2] https://www.imf.org/en/Publications/WEO/Issues/2022/04/19/world-economic-outlook-april-2022
[3] https://unctad.org/news/global-trade-hits-record-high-285-trillion-2021-likely-be-subdued-2022
[4] Expected trade growth for 2022-23 referenced from https://www.wto.org/english/news_e/pres22_e/pr902_e.pdf
[5] https://www.wto.org/english/news_e/news22_e/report_trdev_jul22_e.pdf

Figure 1: International trade flows, by value[6]



Source: UNCTAD, WTO and Deloitte Analysis

Key trends that will shape trade flows

Growing sovereign distress and sanctions

COVID-19-related logistics and supply-chain disruptions (due to lockdowns across nations) threw the global demand-supply equilibrium off balance. This added to financial and economic stress for several and especially emerging nations, pushing many into a debt crisis. Even though pandemic-related concerns seemed to wane by the end of 2021, geo-political crises thickened. Geo-political unrests, rising commodity prices, and increased financial sanctions on Russia have added to trade uncertainties, pushing several nations with weak economic fundamentals onto the brink of a collapse, with sovereign default in some cases, which will impact the trade policies pursued by nations.

Continuing supply-chain disruptions

The pandemic triggered a range of supply-chain disruptions including congested ports, shipping logjams, increased freight rates, and falling port productivity; however, these disruptions have prolonged with geo-political uncertainties, clouding the trade outlook. Primary factors contributing to the ongoing disruption include increasing energy costs, COVID-19 lockdowns in China, and a widening skill gap across the globe. Per the European Central Bank, it is estimated that world trade would have been ~2-3 percent[7] higher in the absence of these supply-chain shocks.

Regionalism and protectionism

Regionalisation of trade flows, through partnerships and trade agreements, has seen an increasing trend in 2021 and will continue to grow in 2022, such as the Regional Comprehensive Economic Partnership (RCEP) between east Asian and Pacific nations. This trend is leading to reverse globalisation and rising nationalism, beginning in the last decade, which is now transitioning to "friendly shoring" (to reduce supply-chain risks by limiting trade to a few trusted countries). On the other hand, major world economies have imposed policies, such as heavy-duty tariff, anti-dumping measures, preference of domestic goods, that have restricted trade free flow and exacerbated the on-going trade war.

Liquidity concerns

Central banks are tightening monetary policies and correcting their balance sheet in response to rising inflation. These have implications on currency valuations, capital flows, and borrowing rates. Consequently, competitiveness and the capacity to borrow gets affected, thereby impacting trade. For instance, higher borrowing costs can lead to expensive financing, adding to the financial

6 https://unctad.org/system/files/official-document/ditcinf2022d1_en.pdf
7 https://www.ecb.europa.eu/pub/economic-bulletin/focus/2022/html/ecb.ebbox202108_01~e8ceebe51f.en.html

constraints of all trade participants, especially MSMEs that typically remain underserved.

Climate change

Natural disasters in 2020 accounted for US$ 210 billion worth of economic losses[8]. It is estimated that a large natural disaster can erode ~2 percent of the country's services exports[9] and damage physical infrastructure, including port closures, restricting merchandise maritime shipping (which accounts for significant value of global trade). With the number of natural disasters having grown at 4.7 percent[10] CAGR in the last 5-6 years, trade flow is likely to be disrupted.

In addition to climate change disruptions, there is also a growing emphasis on green technology and sustainability, with the introduction of new regulations. This will change the trade pattern in favour of nations producing sustainable merchandise and services, and pressurise existing trade supply chains, further disrupting the trade flow.

Digitalisation

Industry 4.0 has become Trade 4.0[11] with the development of an integrated digitalised supply chain from the factory to the consumer, and active participation from the trade ecosystem stakeholders on digital platforms. This wave of digitalisation is expected to bring in efficiency in the overall trade processes. The confluence of new emerging technologies, such as blockchain, and previous technologies, such as IoT, abate any inefficiencies in the value chain.

[8] https://www.iii.org/fact-statistic/facts-statistics-global-catastrophes
[9] https://www.wto.org/english/tratop_e/devel_e/sympnaturaldisaster29112019_ankai_xu.pdf
[10] https://www.iii.org/fact-statistic/facts-statistics-global-catastrophes
[11] https://www2.deloitte.com/us/en/insights/industry/public-sector/trade-4-0-government-opportunity.html

The Indian economy is gearing up to well position itself in emerging trade dynamics

India has witnessed steady growth in exports over the last few years, albeit inconsistently; however, exports have performed well since April 2021. In FY22, India contributed to ~5 percent of global trade with US$756.7 billion imports and US$669.7 billion[12] exports. Exports have been considered to be an important pillar in India's ambitions of becoming a US$5 trillion economy by FY27 and exceed US$2 trillion by 2030[13]. In addition to exports, the government also aims to grow domestic trade by capitalising on its demand-driven economy.

With that vision, the government has undertaken multiple initiatives to foster both international and domestic trading activities by negotiating Foreign Trade Agreements (FTA) with multiple trading partners, promoting exports by reducing trade barriers through regulatory and tax reforms, and building manufacturing and logistical infrastructure.

[12] https://pib.gov.in/PressReleasePage.aspx?PRID=1816577
[13] https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1818447

Fostering integration through trade agreements

Between 2020 and 2022, India entered, or is in the process of entering into multiple trade agreements through mutual negotiations, including UAE, Australia, the UK, EU, Eurasian and African nations[14] , to diversify trade product exports, access to cheaper raw materials, intermediate goods, as well as capital goods, and attract foreign investment. From the existing trade agreements, India has witnessed ~21 percent growth[15] over the last five years in merchandise exports; for example, exports to ASEAN and SAFTA countries saw 25.3 percent and 18.7 percent growth, respectively, in the same period.

Reducing trade barriers and promoting exports

To promote exports and improve competitiveness, the government has initiated programmes to ease the setting up of businesses, incentivise manufacturing, and enhance logistical efficiency.

- The **Production Linked Incentive (PLI) scheme** was introduced to boost the country's manufacturing capabilities and exports. Under this scheme, manufacturing companies that foresee production of a minimum US$500 million within five years are provided incentives on their incremental sales. This scheme also focusses on attracting capital expenditure to 14 key sectors that currently constitute ~40 percent of the total imports[16], with a focus to reduce net imports over the next five years.
- The **National Single Window Clearance (NSWS)** is a one-stop platform, set up by the Department of Promotion of Industry and Internal Trade, to obtain approvals and clearances for start-ups, businesses, and Indian and foreign investors, to streamline the business registration and pre-operations processes. Currently, the platform supports approvals from 32 central departments and 17 states, easing the norms of doing business and promoting domestic trade.
- **The National Intellectual Property Rights (IPR) policy** aims to strengthen IP rights in compliance with the World Trade Organization (WTO) standards to foster market expansion and innovation in patent-sensitive industries. The government has introduced a 50 percent concession on Patent and Trademark fees for MSMEs, an 80 percent rebate on patent filling fees for start-ups, and a scheme to facilitate Startups Intellectual Property Protection (SIPP) under this policy. IPR licensing and usage fees can be a key area of export, which remains largely untapped. In 2020, only 0.6 percent of the total exports[17] was contributed by Intellectual Property licensing/ usage fees.
- Introduction of the **IndiaXports 2021 portal** aims to expand the knowledge and understanding of 0.1 million exporters[18] to equip them with information on 456 tariff lines, potential markets, export procedures, etc., to facilitate a better understanding of export procedures and associated costs.
- **The Pradhan Mantri Gati Shakti National Master Plan,** aims at modernising infrastructure and increasing logistical efficiency to provide multimodal access to diverse economic zones. This scheme intends to bring sixteen government ministries together to resolve the multi-modal and last-mile issues and reduce logistical cost overruns and inefficiencies.
- **Multi Modal Logistics Parks (MMLP)** are being built, under the Gati Shakti scheme, at strategic locations to enable seamless movement of goods and services and reduce logistical costs and overheads from the current 14-16 percent of the GDP to 7-8 percent[19].

[14] https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1781867
[15] https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1781867
[16] https://www.icra.in/Media/OpenMedia?Key=9698b7ef-0a8c-4720-8b48-79e947fbb05e#:~:text=It%20has%20the%20potential%20to,over%20the%20next%205%20years.
[17] https://www2.deloitte.com/in/en/pages/about-deloitte/articles/go-beyond-borders-to-grow-beyond-borders.html
[18] https://indbiz.gov.in/india-export-initiative-and-indiaxports-2021-portal-launched-by-minister-of-msme/
[19] https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1836626

Trade finance plays a key role in trade facilitation, while driving inclusive growth continues to be an area of focus

The trade finance market continues to respond to global demand dynamics originating from trade flows. After a dip in the overall market during the pandemic, it has recovered but is expected to face continued headwinds on account of global trade dynamics outlined in the earlier section. Trade finance instruments play a critical role in cross-border and domestic trade facilitation in mitigating counterparty risks and streamlining working capital requirements.

Typically, trade financial solutions can be categorised under three broad categories:

i. **Open account** include direct transactions between the buyer and seller, wherein the goods are delivered prior to the payment being made within a stipulated period. These are usually accounted for under cross-border payments for a country. While this is the most convenient solution, it also carries the highest risk for the seller, as there are no intermediary stakeholder guarantees being offered.

ii. **Documentary trade** includes letter of credits, bank guarantees, documentary collections, non-fund-based forms of financing. Under traditional trade finance, intermediary stakeholders assume risk in case of non-adherence to agreements between buyers and sellers. The exporter is paid by the importer upon the presentation of documents conforming to the agreed terms and conditions.

iii. Supply Chain Finance (SCF) a form of financing received mostly in relation with open account trade to help both buyers and sellers maximise their working capital by lowering the risk of disruption in the supply chain. SCF covers a range of working capital financing products including the following:

a. **Factoring:** Where a seller sells their account receivables at a discount to a third party against immediate payment
b. **Forfaiting:** Where the exporter relinquishes their right to receive payment from the importer on the agreed upon date, in exchange for an instant payment
c. **Reverse factoring:** Where suppliers with authorised invoices from buyers may receive third-party financing
d. **Dynamic discounting:** Where buyers pay the suppliers early to avail discounts on the invoice
e. **Pre-shipment financing:** Where financing is received against a purchase order or a proforma invoice

In 2020, open account was the most preferred trade financial solution, contributing to 43 percent revenue, followed by documentary trade (40 percent) and SCF (17 percent)[20] globally. The combined market of documentary trade and supply chain finance was estimated at ~US$6.9 trillion[21] in 2020 and is expected to witness slower growth on account of the global economic situation and shocks to the supply chain.

While documentary trade continues to provide a significant portion of overall trade finance, its share in global trade flows has been reducing over a period of time on account of multiple factors (enumerated below).

Factors impacting the decline in documentary trade

- **Rising demand for open account transactions:** It is expected that open account transactions will continue to grow at 3.2 percent CAGR, while documentary trade is expected to see a slower growth of only 1.8 percent CAGR.[22] The ability to streamline processes by reducing the stakeholders involved, higher efficiency with lower turnaround time, greater confidence in cross-border trade, long-standing buyer-supplier relationships with strong beliefs in timely payments, and the availability of better supply-chain management tools are driving open account demand growth.
- **Preference of supply chain financing:** Over the last few years, global supply chain financing volumes have grown substantially on the back of a confluence of variables, including greater emphasis on working capital, structural adjustments to SME financing, a deliberate shift towards digital adoption, transparency, and growing importance of sustainability in financing, coupled with a low default rate of 0.13 percent.[23]

India has been following a similar trajectory in the transition of respective market share of trade finance solutions. However, given SCF has picked up in India in recent times, traditional trade products currently have a higher share, compared with some global economies. SCF is now fast growing with participants actively working towards stitching end-to-end supply chain propositions and bringing in efficiency in processes and working capital cycles.

Even with the changing face of the trade finance market structure, driving inclusion continues to be a major challenge in this space. The global trade financing gap has increased from US$1.5 trillion in 2018 to US$1.7 trillion in 2020[24]. Globally, MSMEs are at the centre of this gap and account for 23 percent of the total trade finance demand, yet are responsible for 40 percent of the trade financing application rejections.[25]

Challenge of financing gap is equally pronounced in India with MSMEs at the centre of economic growth

India has 63+ million MSMEs contributing to about 6.1 percent of the country's manufacturing GDP, 24.6 percent of the GDP from the services sector, and ~40 percent of total India's exports[26], continue to remain underserved. In a study conducted by International Finance Corporation, a World Bank Group, it was noted that less than a fifth of the overall MSME segment has access to formal credit[27]. Hence, it has become imperative to understand the challenges that hinder MSME financing in India.

[20] ICC Trade Register Report 2021: https://iccwbo.org/publication/icc-trade-register-report/
[21] ICC Trade Register Report 2021: https://iccwbo.org/publication/icc-trade-register-report/
[22] https://iccwbo.org/publication/icc-trade-register-report/
[23] Originally published as an ADB Blog :https://blogs.adb.org/blog/supply-chain-finance-no-danger-despite-recent-headlines
[24] https://www.adb.org/sites/default/files/publication/739286/adb-brief-192-trade-finance-gaps-jobs-survey.pdf
[25] https://www.adb.org/sites/default/files/publication/739286/adb-brief-192-trade-finance-gaps-jobs-survey.pdf"
[26] https://www.pib.gov.in/PressReleasePage.aspx?PRID=1759307#:~:text=With%20more%20than%2063%20million,the%20GDP%20from%20services%20sector.
[27] https://www.ifc.org/wps/wcm/connect/dcf9d09d-68ad-4e54-b9b7-614c143735fb/Financing+India%E2%80%99s+MSMEs+-+Estimation+of+Debt+Requirement+of+MSMEs+in+India.pdf?MOD=AJPERES&CVID=my3Cmzl

Figure 2: Distribution of MSME segment along with exposure and NPAs in FY21

	Distribution[28] ('000)	Credit exposure[29] (INR lakh crore)	NPA%[29]
Medium	34	6.88	16.8%
Small	314	7.15	10.4%
Micro	6,062	5.16	10.2%

Source: MSME, SIDBI and Deloitte Analysis

Most MSMEs have high financing requirements but little-to-no collateral and must rely on their current inventory, orderbook, and irregular cashflows for financing. This raises the overall cost of funds and documentation and complicates the loan application process, making it unaffordable for MSME to access financing.

Another factor contributing to this high cost of financing is the lack of financial literacy, leading to improper account keeping and little understanding of government schemes, limiting their ability to get better financing terms.

From a supply side, banks and NBFCs refrain from actively participating in financing this segment due to high default rates, which have further exacerbated owing to COVID-19 (Figure 2). To encourage the participation of financial institutions, the government has introduced multiple guarantee schemes to assist MSMEs in getting collateral-free loans, while the RBI has introduced Priority Sector Lending targets for the MSE segment. While MSME financing has exceeded pre-pandemic levels and guarantees worth ~INR 55,000 crore have been approved under CGTMSE in FY22, financing for Micro and Small Enterprises (MSE) remains to be a challenge with the lowest growth in the micro segment[30], impacting both domestic traders and exporters alike.

While innovation across different product portfolios of the financial ecosystem is required to address this gap, trade finance solutions including SCF will play a critical role in addressing this gap. However, to solve for this financing gap and drive financing inclusion, while minimising associated credit and operational risks, India will need to promote innovation and creativity across the trade financing ecosystem.

[28] https://msme.gov.in/sites/default/files/MSMEENGLISHANNUALREPORT2021-22.pdf
[29] MSME exposure based on Commercial loan ticket size from INR <10 lacs -50 crores with classification as mentioned in https://www.sidbi.in/files/article/articlefiles/MSME_Pulse_June-2021_final.pdf;
[30] https://www.crifhighmark.com/news-events/press-releases/2022/june-2022/crif-high-marks-msme-data-reveals-that-loans-totalling-3-729k-crore-were-sanctioned-in-fy22-up-182-from-fy20

Different participants in the ecosystem will have to play their part to create inclusive growth

Per a study conducted by UNESCAP in 2014, it was estimated that India can save ~700 million in costs, 19-20 percent in export time and gain 7 percent in overall exports[31] with the complete implementation of cross-border paperless trade. While there have been significant developments owing to digital infrastructure, product innovations, and evolving technologies, India is still far from paperless trade, even today. As discussed in the earlier section, a key beneficiary of the paperless trade will be the credit-starved MSMEs.

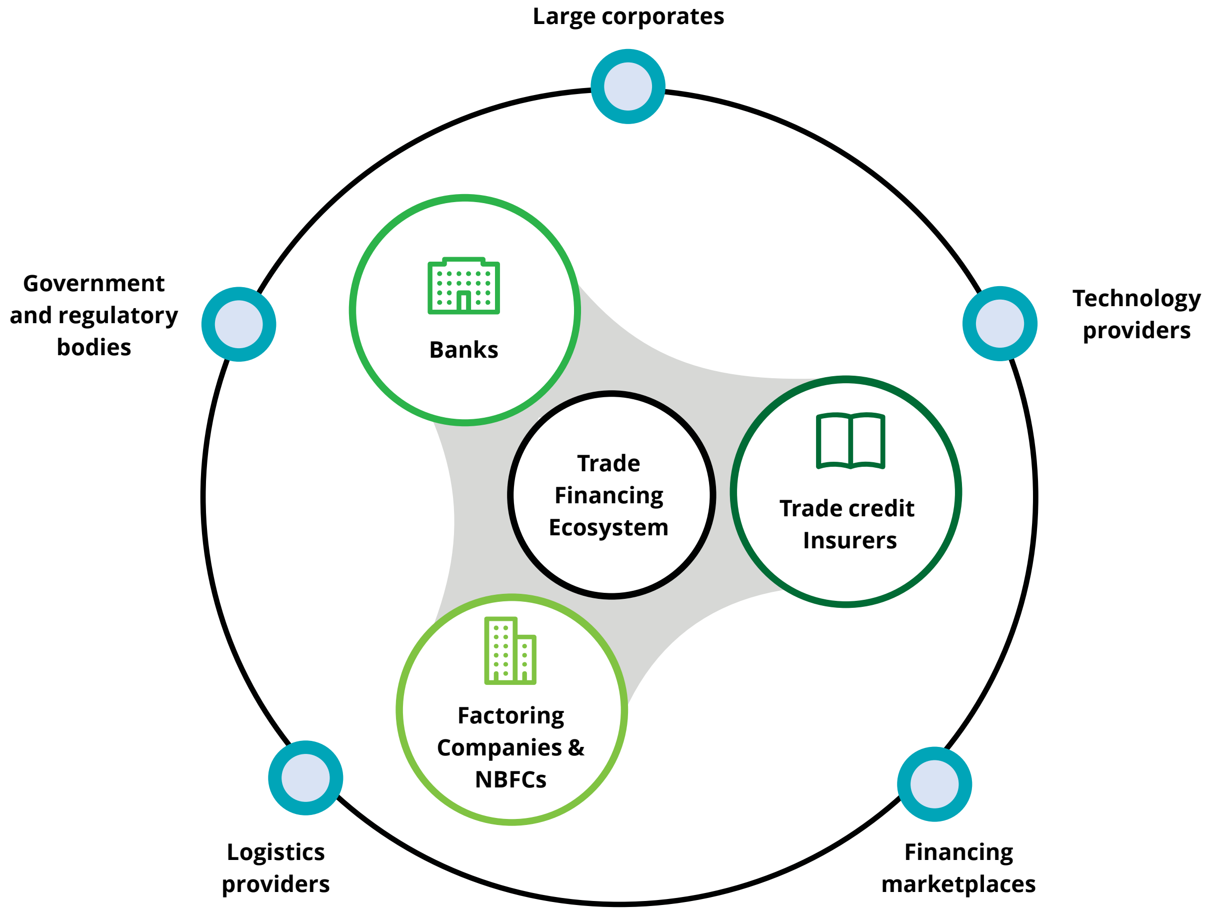
The trade ecosystem is complex and involves the participation of multiple players across the journey, especially cross-border trade. Currently, the trade finance ecosystem players in India can largely be divided into two categories, including:

- **Finance providers**, who actively participate in financing transactions and typically comprise of financial institutions, such as banks, NBFCs, factoring companies, and credit insurers.
- **Trade facilitators**, which include enabling parties who may not actively take part in the financial transaction, but assist in building an environment that expedites trade transactions, including financing leg. Players including the government, technology providers, marketplaces, regulatory authorities etc., fall under this category.

[31] https://www.unescap.org/sites/default/d8files/knowledge-products/Benefits%20of%20Cross-Border%20Paperless%20Trade_Apr2019.pdf

Both, the finance providers as well as the trade facilitators, need to work cohesively to bridge the existing gap in financing and create an environment that will enable seamless trade transactions and bring India to the forefront of the global trade landscape.

Figure 3: Players in the trade finance ecosystem



Source: Deloitte Analysis

Role of finance providers

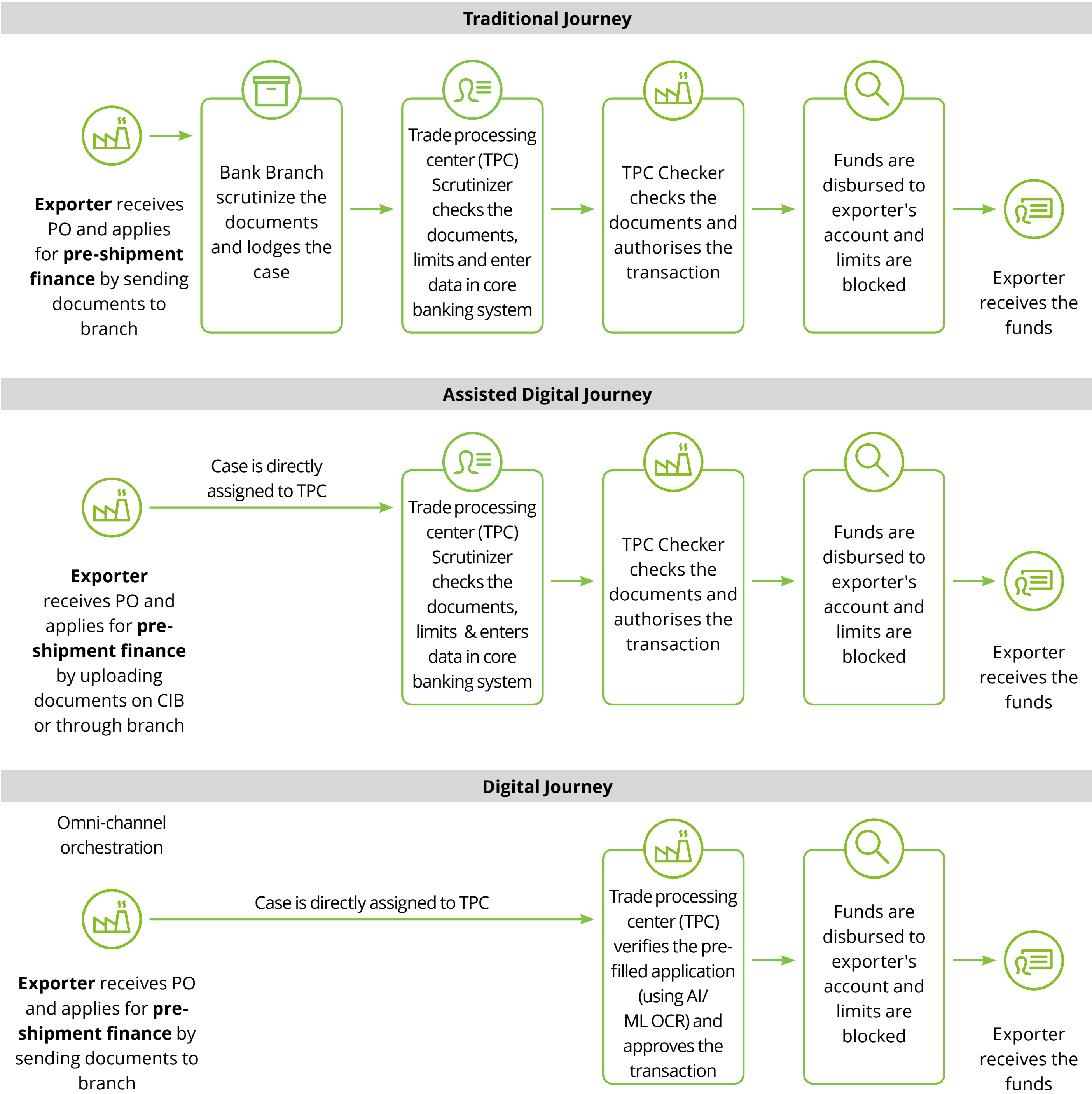
Banks

Trade finance has historically been an inherently paper-heavy process with ~400 billion[32] documents currently in circulation for documentary trade, leading to higher operating costs and cumbersome processing. With the focus on digitalisation, banks have already identified the need to modernise their operating processes to improve customer experience and bring down operating costs, while facilitating secure global trade practices. This gains more relevance when providing financing to small and medium players who have limited documentation, lack of historical records, and a general perception of being risky. Banks are moving towards using alternative data sources such as Goods and Service Tax (GST) returns, past payment records, business model evaluations using Artificial Intelligence/Machine Learning (AI/ML), advanced analytics, and Application Programming Interface (API) integrations with third parties to bridge these gaps.

Banks will need to continue to focus on digitalisation, alternate credit models, partnerships with FinTech and API integrations to provide financial solutions to MSMEs, as banks will be the cogs that drive inclusive trade finance.

[32] https://iccwbo.org/media-wall/news-speeches/new-icc-survey-shows-pace-trade-finance-digitalisation/

Figure 4: Bank facilitating an end-to-end digital pre-shipment journey



Source: Deloitte Analysis

Factoring companies and NBFCs

Factoring is an important trade financing method as it provides immediate liquidity to the MSME and eliminates the risk of delayed payments. India's factoring landscape is governed by the Factoring Act, which also enables NBFCs that meet specific conditions to register as a Factor with RBI.

While the Factoring Act improved the situation of MSME credit to a certain extent, it did not meet with great success. According to the twenty-fourth report of Standing Committee on Finance presented in the Lok Sabha, Factoring credit contributes only ~2.6 percent of the overall formal MSME credit in India as opposed to 11.2 percent in China.

Given the focus of the government to empower MSMEs, the Factoring Act was amended in 2020 and in 2022 to allow banks and NBFCs to provide Factoring services as well. With the latest 2022 amendment, the eligible count of NBFCs, has significantly gone up from the previous seven. With more NBFCs being able to participate in Factoring, capital access to micro and small enterprises, will also increase. NBFCs also need to create innovative solutions customised to smaller organisations, create alternative data models to assess financial health of the organisation, and utilise technology to create integrated platforms, speeding up documentation, credit decisioning, and transaction processing.

While the actual impact of this amendment and growth in the contribution of Factoring in the overall MSME credit is yet to be seen, it is evident from the recent amendments that Factoring will play an important role in bridging the trade financing gap and give a strong foundation to MSMEs to grow their trade transactions.

Trade credit insurers

Credit insurance typically covers overall trade transaction by providing protection to the seller against buyers who may default on their agreement/ declare bankruptcy. Until recently, the regulation did not allow the benefits of trade credit insurance to be passed on to banks or factors and was limited to transactions when sellers did not intend to assign trade receivables. This led to hesitation in banks/ factors to provide financial solutions, even more so to MSMEs, whose risk profile is higher.

However, the revised guidelines issued by Insurance Regulatory and Development Authority (IRDA) in 2021 have brought in a much-awaited relief by including the banks, factoring companies, and other financial institutions under this cover. This is a welcome change as it will provide insurance protection to financial institutions against credit risks, defaults, and geopolitical risks, thereby instilling confidence to provide financial solutions for trade transactions and bridging the current gap. The new guidelines have also broadened the scope of insurance offerings which will enable general insurance companies to create customised insurance solutions for financial institutions.

For all the three finance providers, the key focus will be on digital transformation to create end-to-end integrated processes leading to cost optimisation, operational efficiency, and a superior customer experience. The three key pillars that enable digitisation include the following:

i. **Automation** – Trade financing processes have multiple built-in checks and approvals that increase the turnaround time, owing to manual workflows and processes. To increase efficiency, banks' trade finance processes need to be streamlined using technologies such as rule-based workflow engines, Optical Character Recognition (OCR), Robotic Process Automation (RPA), and analytics. This will not only increase efficiency but also reduce operational costs and accuracy of the processes.

Figure 5: Key innovations used in trade finance digitisation

OCR and RPA

Digitisation of documents to convert uploaded documents into digital data sources and auto-populate application forms

AI/ML & natural language process

Conduct scrutiny checks (documentary & compliance related) through AI/ML and NLP based rule engines

Internet of Things (IoT)

Ensure real-time information pertaining to documents as well as goods with the help of sensors and other devices

Advanced analytics

Enhance decision making during:

- Pre-transaction scrutiny (KYC checks)
- Transaction processing (predictive analytics to detect patterns)

Source: Deloitte Analysis

ii. **Collaboration** – While automation will help streamline a financial institution's internal processes, it is imperative for financial institutions to collaborate with players in the ecosystem to create a digital experience for customers. Financiers are already moving in this direction by partnering with FinTechs specialising in trade technologies across the lifecycle, from KYC, onboarding, utilising alternate data sources during credit processing, creating analytical models for identifying early warning signals, and propensity to default. For instance, some leading Indian banks have partnered with FinTechs to offer customised solutions for MSMEs to ease access to financing. In summary, the theme for inclusive trade finance will be "collaborate rather than compete".

iii. **Omni-channel experience** – While financial institutions focus on digitalising the backend processes and collaborate with multiple players to increase efficiency and reduce costs, it is extremely important to provide a unified experience to customers. Financial institutions are moving towards creating singular platform with offerings that serve as a one-stop solution for MSME customers. These platforms provide an integrated experience across channels. For instance, customers can start the onboarding journey from a mobile app and continue it seamlessly through internet banking, from the point where they left off. Customers can access integrated dashboards across products at a single place. This will serve as a win-win situation for both, the financiers and MSMEs.

To enable digitalisation across the above three levers, banks need to up their game by revamping their IT architecture and move towards nimbler, microservices-led architecture from the legacy point solutions. The technology landscape of the banks needs to be scalable, agile, and robust at the same time. Banks will have to evaluate build vs. buy decisions for implementing these platforms which will be based on bank's vision and strategy.

Role of trade facilitators

While core finance providers are responsible for access to trade finance, trade facilitators play an important role in bringing together the entire trade finance ecosystem. With the impending themes of digitalisation, alternative supply chains, uncertainties in the geo-political environment, they will continue to play a pivotal role in enabling an "inclusive trade finance ecosystem".

Cross-border trade transactions are usually of two types, export and import transactions. The role of facilitators' also changes with the type of transaction. The illustration below highlights the flow of goods, documents, and information across the export transaction, starting from the exporter receiving the purchase order to customs clearing the goods and completing the shipment. However, a few activities in the transaction continue to be manual and need digitalisation and automation to make the ecosystem more efficient.

Figure 6: Role of "trade facilitators" (export transaction)

Source: Deloitte Analysis

Government and regulatory bodies
The government is a key player in facilitating trade and financing. The government has been working towards empowering MSMEs by facilitating financing and driving inclusion. Multiple measures during COVID-19 were adopted to provide liquidity to MSMEs by making funds readily available from financial institutions. Additionally, to foster digitised credit facilities, the Indian government introduced the "Digital India" campaign and has been working towards building a digital infrastructure for the comprehensive interoperability within the trade ecosystem.

Another notable initiative has been the launch of e-invoicing where business invoices are authenticated electronically, returns are auto populated, and information is automatically transferred to GST and E-way portals. E-Invoicing has been to help enterprises and banks meet tax compliance and reduce invoice fraud in the ecosystem, due to the integration of e-way bill. This will also enable the ease of financing for MSMEs with financial institutions gaining access to invoicing data by integrating with GST Suvidha Providers (GSPs).

Along with the government, regulatory authorities such as the Reserve Bank of India (RBI), Insurance Regulatory and Development Authority of India (IRDAI), Central Board of Excise and Customs (CBEC), are a part of India's trade financing umbrella. They play a key role in fostering inclusion amongst stakeholders while optimally assessing and mitigating risks. They have been instrumental in introducing multiple initiatives, including the following:

- Given the success of Export Data Processing and Monitoring System (EDPMS) and Import Data Processing and Monitoring System (IDPMS) platforms, which were introduced by RBI to eliminate the manual processing of shipping bills and bills of entries, it is imperative to extend its services. RBI is currently assessing the integration of Courier Bill of Entry (CSE) and Courier Shipping Bills (CSB) onto the platforms, allowing financial institutions to easily access CSB/CBE data.
- IRDAI's latest guidelines on passing on the benefit of trade insurance to financial institutions is a key step, which will increase the willingness to offer financial solutions for trade transactions.

The government and regulatory bodies will continue to play an instrumental role by introducing new reforms and initiatives, policy changes, and push for digitalisation to create an inclusive trade ecosystem. The expansion of the existing platform to further enable the seamless exchange of information between various participants in the ecosystem and drive digitalisation of underlying documents across the value chain will unlock the full potential of paperless trade. With the ongoing uncertainties, trade participants and finance providers will continue to look up to the government bodies to bolster the Indian trade economy.

Logistics providers
The logistics providers form the backbone of the entire trade ecosystem by ensuring the movement of goods to their destinations safely and efficiently. Besides this, they are also in charge of facilitating a regular flow of information, including the completion of financing documents and providing real-time updates about deliveries. However, the logistics industry in India is highly disintegrated and fragmented with the market largely owned by unorganised players.

With multiple challenges faced by the logistics players, such as rising fuel prices, inefficient transit systems, middlemen, infrastructure issues, it is the need of the hour to create an efficient system built towards streamlining the sector. National Logistics Policy (NLP) has been designed with the intent to address these problems by bringing in standardisation, formalisation, and digitalization in the sector. It also aims to create a multi-modal system by integrating different transport modes.

Digital transformation across the sector is another focus area. Players need to provide an end-to-end lean and digital logistics solution by utilising Internet of Things (IoT), automation, analytics, and Artificial Intelligence (AI). The sector is witnessing multiple partnerships between FinTechs, logistics providers, and financial institutions to provide an end-to-end journey for customers, focussed on transparency, seamless information exchange, and efficiency throughout the value chain. With each player focussing on its core competency, these platforms aim to provide an integrated journey from document digitalisation, customised financial solutions, visibility of goods in transit, delivery, acceptance, and payments.

Technology providers

With the focus on digital transformation and the creation of integrated platforms, technology providers will play a pivotal role in bringing together the entire trade ecosystem. There are multiple opportunities to strengthen the entire trade financing value chain through a robust technology architecture, which will enable digital, efficient, and automated processes. These trade technology companies provide solutions that can digitise KYC, on-boarding, documentation, credit appraisals, along with other processes. Financial institutions can reduce their time to market significantly and reap benefits by partnering with technology providers.

Another emerging theme is the standardisation of trade APIs, making it easier for companies to integrate with multiple financial organisations. Currently, banks create their proprietary API catalogues and companies need to integrate separately with each bank. With a common set of API standards, this will become an easy and cost-effective exercise. Many technology firms are also providing blockchain solutions to increase security, transparency, traceability, and real-time transaction tracking by storing them on a distributed ledger.

While the technology advancements will continue at a rapid pace, it is imperative for financial institutions to collaborate with technology providers and implement agile and scalable solutions aimed at reducing the financing gap.

Financing marketplace

The government has launched multiple financial marketplaces to provide easy access to funding for organisations, especially MSMEs; however, the objectives of these platforms have not been fully realised. There is a need to identify initiatives to increase their participation on the platforms, and make it easier for organisations to avail financial solutions.

Trade Receivables Discounting System (TReDs) platform licenses launched by RBI aimed to act as a catalyst for bridging the financing needs of MSMEs by auctioning the invoices through the platform and play a significant role in addressing the financing gap. Three TReDS platforms that have been licensed by RBI till date, have collectively processed 26.64 lakhs invoices worth Rs 56,694 crore since their inception in 2017 till Q3FY22[33]. With recent amendments to the Factoring Act and enablement of TReDs platforms to file Assignment of Receivables on behalf of financial institutions, the platforms are expected to see a further increase in overall transaction volumes.

In line with the TReDS initiative to promote inland trade financing, the government recently introduced International Trade Finance Services (ITFS) platform to boost international trade financing. The platform intends to enable Indian traders access financing products through financiers across the world via factoring, forfaiting, and other trade financing services. While the platform is still in the process of being set up, there are a few foreseeable challenges, including the willingness to on-board by both exporters and importers and active use of the platform to extend credit. However, if implemented successfully, it will lead to easy access to finance for organisations at a competitive cost, in their preferred currency, and at the lowest possible rates through transparent, online auctioning.

Large corporates

Over the past few years, large corporates have taken on the onus of not only digitising their supply chain but also investing in their technology platforms to provide easy financing to their suppliers in the value chain. This helps build mutual trust and respect between the corporate and their supplier and allows the supplier access working capital with no barriers. For example, one of India's largest automobile manufacturers has partnered with a nationalised bank to provide inventory financing to their dealer partners to provide enhanced digital lending services. It is important to note that for companies that are tying up with financial institutions to provide financing options to suppliers, the intention is not to convert it into business, but instead support stakeholders in the value chain.

[33] https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1783945

Integrated and standards-based approach is way to build sustainable innovation in trade finance market

While initiatives and innovation by individual participants would help fit the parts of the puzzle, it is the collaborative and integrated approach across the ecosystem, which will unlock the true potential of innovation in the trade finance market. We believe four focus areas will drive an integrated approach and enable long-term effectiveness in driving innovation in trade finance:

1. Growth in SCF
2. Scaling of Distributed Ledger technology-based solutions
3. Common understanding and adoption of standards and protocols
4. Need for sustainable trade financing

For India to drive a sustainable trade finance growth over the next five years and propel exports to its set vision, it will need to focus on supply-chain products for inclusion, well-defined protocols for innovation in Trade 4.0, and regulations on sustainability for future growth.

Growth in SCF

Supply chain financing (SCF) helps both suppliers and buyers optimise their working capital. Due to the high-visibility and transparency of flow of goods amongst the supply chain players, SCF has become a more reliable form of trade financing, further fuelled by the availability of digital solutions in this space.

Because of these factors, reduced lending cost and highly increased confidence amongst lenders, SCF is a key solution in financing MSMEs in the supply chain ecosystem and in driving inclusion.

Despite the potential for SCF in India being high, its market remains untapped with slow penetration due to a lack of financial literacy, dependency on offline cash-based transactions and paper invoices, lack of documentation standardisation to prove past trade relationships, lower technological intervention, non-scalable financing processes at financial institutions, and a "dealer-based financing" mindset[34] where financing is typically facilitated by the corporates to their immediate MSME suppliers.

Individually, banks and other financial institutions are capitalising on opportunities to partner with FinTechs that specialise in digital SCF solutions, enhance process automation and efficiency, and employ alternative credit risk assessment methodologies, such as AI-based financing models that can offer greater insights into the supplier's creditworthiness and repayment potential. However, these solutions only solve some operational aspects challenging SCF growth in India.

To foster innovation and promote SCF at a large scale, there is a need to:

- Enable innovation in technology to solve for inefficiencies in SCF and building integrated solutions
- Create framework to reduce the compliance burden and standardise the documentation requirements to reduce the time for due diligence conducted by banks and other financial institutions
- Promote the use of new technologies, such as blockchain and AI to bring in more transparency in the ecosystem
- Develop programmes that focus on educating MSMEs and corporates on the advantages of building SCF ecosystems
- Introduce and promote ecosystem-wide platforms to support solutions for all

Sustainable supply chain growth will be critical to drive efficiencies in the trade ecosystem in India and towards financial inclusion.

Defining the framework for common standards and protocols to support innovation, scalability, and collaboration

The trade value chain has witnessed rapid innovation and adoption of new technology with the digitalisation of public infrastructure by the Government of India and evolution of emerging technologies, such as Internet of Things (IoT) and AI/ML. While these disruptions have been disjointed, they are not governed by any policy or framework, leading to unrestricted experimentation and innovation.

However, in view of the global trade value chain disruptions, the World Trade Organization (WTO) recognises the long-term implications of unbridled innovation, and has provided directional inputs and considerations for governments to assist them in drafting these regulations and policy changes:

- Building digital infrastructure and data connectivity, in line with global standards and cyber-security principles
- Creating a data model framework to allow interoperability between multiple digital platforms for seamless exchange of cross-border data and documents, while preserving the data identity and privacy
- Drafting legal frameworks to provide global recognition to electronic documentations, such as e-signatures and transactions, in collaboration with a regulatory framework recognising digital tokens and smart contracts in global trades
- Introducing the liability framework to establish end-point traceability and accountability in the tangled ecosystem of multiple players, digital platforms, and government authorities
- Enabling the legal framework to establish authenticity and recognition of digital identity for both legal and natural individuals, and physical and digital objects created by IoT devices in trade transactions.

Likewise, the International Chamber of Commerce (ICC) has launched the Digital Standards Initiative (DSI) to digitise trade processes and enhance interoperability, particularly by developing open trade and technology standards. This body has also introduced a standard toolkit to guide every trade participant on the adoption of existing standards, as

[34] https://www.niti.gov.in/writereaddata/files/Connected-Commerce-Full-Report.pdf

well as on interoperable digitalisation frameworks to handle interoperability bottlenecks between blockchain and existing non-blockchain systems.

Considering these initiatives, India will have to define a framework to utilise global standards and mechanisms for adopting them in the context of local needs and the environment. This would need wider consultation across different participants and industry bodies, leading to the creation of a roadmap and a plan of execution and monitoring.

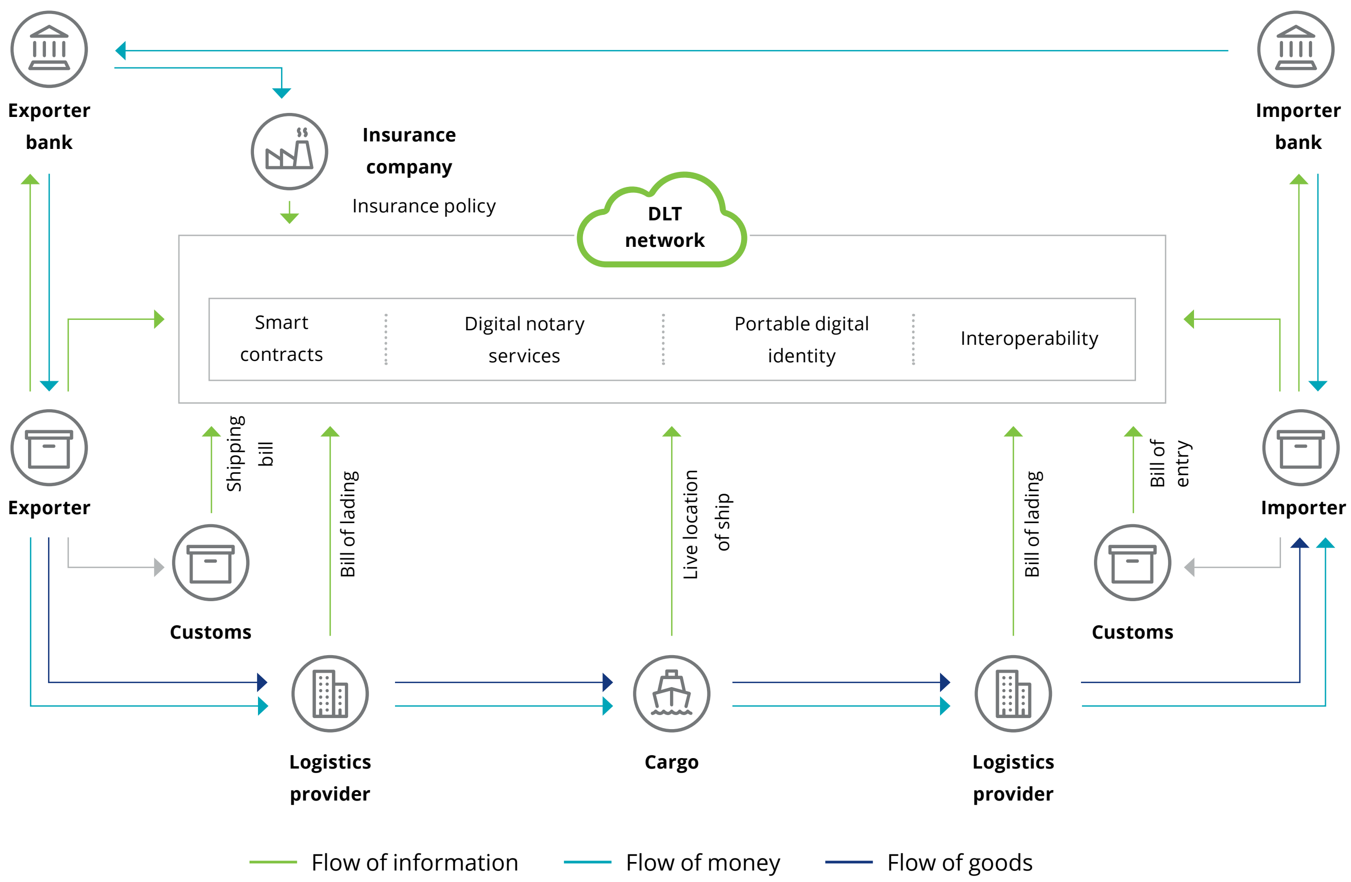
Distributed Ledger Technology-based trade ecosystem

Distributed Ledger Technology (DLT) has the potential to solve most inefficiencies in the trade and trade finance ecosystem. The shared, immutable ledger accessible by the ecosystem seems to be a credible technology, which can solve the current problems faced in international trade, including interoperability, post-financing real-time transfer of title of receivables, and frauds.

While there is a wide recognition of benefits that DLT can bring in creating an efficient trade finance value chain, the adoption and scale of DLT-based solutions are still limited. There is a significant uptake in experimentation in this area over the last few years, which has led to an understanding around its use cases and their potential benefits. However, large-scale adoptions are still low due to issues such as standardisation, governance, and privacy. Building common standards and protocol, as discussed in the section above, will further aide in building interoperable solutions in this space, which can augment the pace of innovation and adoption.

Experimentation around Central Bank Digital Currencies (CBDCs) globally is another area that has the potential to enhance the capabilities of these platforms. However, their usage needs to be evaluated in light of various design options being considered for roll out of digital currencies across the globe.

Figure 7: Distributed Ledger Technology (DLT)-powered trade ecosystem



Source: Deloitte Analysis

Defining policies and frameworks on sustainability to remain ahead of the curve

Sustainability is the capability to cause little or no damage to the existing environment, including its physical, economic, and social dimensions. Apprehensions stemming around sustainability affect all facets of global trade, i.e., from procuring raw materials, processing work-in progress products, to the final product, as well as customers and suppliers across the value chain.

As of today, India is one of the top three greenhouse emitters with a 60 percent higher carbon footprint vis-à-vis the global average. However, with increasing momentum towards sustainability and the introduction of regulations and frameworks by advanced nations, India risks losing its competitiveness in exports as India's strategic trade partners will move to import sustainable merchandise and services in the long run. One such initiative is Export Finance for Future (E3F), a coalition of six EU nations and the UK, which chalks out principles to incentivise the trading of ecological goods, and review and penalise carbon-intensive projects, especially those that use fossil fuels. These coalition countries accounted for 11 percent of the India's exports in FY22.[35]

One way to tackle apprehensions and achieve sustainable development is by using trade finance as a tool to drive changes. Sustainable SCF can be used as a medium to drive sustainability by offering better contractual terms during supply chain financing if players can achieve certain environment-related goals. Globally, a lot of experimentation is underway to drive sustainability through supply chain financing, leading to enhanced monitoring and transparency across the supply chain. The potential of DLT solutions to support transparency in the entire supply chain is also being evaluated. The confluence of DLT solutions along with financing structures and other critical variables could lead to solutions for a sustainable future.

Given that globally, several countries are ready to participate in sustainable supply chain finance, there is a need for a mechanism to measure sustainability. The existing factors and mechanisms for measuring Environmental, Social and Governance (ESG) compliance are not in consonance for measuring sustainable supply chain finance. There is a need to redefine standards and create a framework for automated and consistent measurement of sustainability. In light of the growing awareness on climate change and demand for sustainability, global organisations, such as ICC and ADB, are also actively working towards drafting global standards and frameworks to define sustainability. The assessment of sustainability will be adjudged against three dimensions: **Economic, human/social** and **environmental.**[36]

Though the drive towards global sustainability standards may not be uniform for each nation due to varying socio-economic conditions, it will lay the ground for innovative solutions to produce and finance sustainable goods and services. Hence, as the first step, it has become imperative for India to act in defining sustainability standards that progressively match global expectations and keep up the momentum in export growth.

[35] https://tradestat.commerce.gov.in/eidb/ecntq.asp

[36] https://iccwbo.org/publication/icc-standards-for-sustainable-trade-and-sustainable-trade-finance/

About ASSOCHAM

The Associated Chambers of Commerce & Industry of India (ASSOCHAM) is the country's oldest apex chamber. It brings in actionable insights to strengthen the Indian ecosystem, leveraging its network of more than 4,50,000 members, of which MSMEs represent a large segment. With a strong presence in states, and key cities globally, ASSOCHAM also has more than 400 associations, federations, and regional chambers in its fold.

Aligned with the vision of creating a New India, ASSOCHAM works as a conduit between the industry and the Government. The Chamber is an agile and forward-looking institution, leading various initiatives to enhance the global competitiveness of the Indian industry, while strengthening the domestic ecosystem.

With more than 100 national and regional sector councils, ASSOCHAM is an impactful representative of the Indian industry. These Councils are led by well-known industry leaders, academicians, economists and independent professionals. The Chamber focuses on aligning critical needs and interests of the industry with the growth aspirations of the nation.

ASSOCHAM is driving four strategic priorities - Sustainability, Empowerment, Entrepreneurship and Digitisation. The Chamber believes that affirmative action in these areas would help drive an inclusive and sustainable socio-economic growth for the country.

ASSOCHAM is working hand in hand with the government, regulators, and national and international think tanks to contribute to the policy making process and share vital feedback on implementation of decisions of far-reaching consequences. In line with its focus on being future-ready, the Chamber is building a strong network of knowledge architects. Thus, ASSOCHAM is all set to redefine the dynamics of growth and development in the technology-driven 'Knowledge-Based Economy. The Chamber aims to empower stakeholders in the Indian economy by inculcating knowledge that will be the catalyst of growth in the dynamic global environment.

The Chamber also supports civil society through citizenship programmes, to drive inclusive development. ASSOCHAM's member network leads initiatives in various segments such as empowerment, healthcare, education and skilling, hygiene, affirmative action, road safety, livelihood, life skills, sustainability, to name a few.

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