Global Trade – Reflections on the Past Three Decades
Thirty years ago, trade was a much less complicated business than it is today but it was also more opaque.

It is hard to imagine now, but there was no internet and no global credit reports to enable buyers and sellers to familiarize themselves with each other. As a result, it was difficult for companies to know who they were doing business with. The role of banks was to remove the mystique between buyers and sellers: they were a crucial link between trade parties and the main conduit that facilitated trade.
The banks that performed that role were largely a different group than the market leaders today. More than 100 other banks that offered trade services 30 years ago have either gone out of business or been consolidated into ever larger banking groups. Famous names in trade finance such as Manufacturers Hanover (now part of JP Morgan) and Irving Trust (now part of Bank of New York) have long gone.

Trade finance was simple in 1983 for two main reasons. Firstly, in instrument terms, most trade was facilitated by letters of credit (LCs) and documentary collections; supply chain finance and balance sheet heavy structures were many years away from being created.

Secondly, compared to 2013, global trade was tiny in scale. What were then described as global corporations in 1983 were far from global: Japanese companies trading around the world did not think of themselves as a single entity and issued LCs with different subsidiaries. Moreover, the idea of a global supply chain did not exist: every component in a Japanese VCR imported into the US was manufactured in Japan (unlike most products today, which contain components and processes that take place in multiple countries before final assembly).

The use of technology in trade finance 30 years ago was limited: everything was paper-based. When I started at JP Morgan in 1982 each unit had two typists who typed manifolds, which were carbon copies that would be split up and sent to different parts of the bank for posting of exposure or bank liability, for example. At that time, every bank in New York operated an LC shop in the city, checking documents. Telex, a simple way of sending text messages, dominated communications, and courier services such as FedEx and DHL were only just becoming popular.

While computer technology was beginning to make inroads into cash management in the early 1980s, with basic systems being deployed and communications taking place via dial-up modems, trade was some way behind (as it remains today). Change was coming – my first project at JP Morgan was to deploy SWIFT – but it would take years to impact most clients. The limited use of computers (the PC had just been invented) meant that concepts such as straight-through processing (STP) - later to become a mainstream corporate goal – were impossible to imagine in the 1980s. From a banking perspective, the absence of PCs and the internet meant that there were no client-facing products.

Globalization and technology change everything

Much of the phenomenal growth in trade that has occurred in the past 30 years can be attributed to globalization. Globalization has many parents, including liberalization of regulations and political change (in 1983 the Iron Curtain was firmly in place and China was four years into its experiment in capitalism that would transform the global economy).

However, ultimately it is the ambition of corporates that has made globalization a reality. Coca-Cola is now available in every country in the world bar two (Cuba and North Korea), while General Motor’s most profitable market is now China (a vehicle market that did not exist in 1983). Global corporates and global supply chains have become ever more important in trade. Similarly, human arbitrage – such as offshore production and low cost sourcing – has taken hold as a business strategy. Many of these developments have become possible because of increasingly sophisticated and cheap technology.

Bank’s capabilities to serve these increasingly global clients accelerated dramatically from the late 1980s onward. The advent of SWIFT allowed electronic communication between banks and moved banks away from a paper-based low-volume model. Desktop computer systems and the internet eventually culminated in the creation of electronic banking systems such as CitiDirect, which enabled STP in cash management.

However, despite some advances, trade has been a laggard in the adoption of technology. In cash management, many corporates achieve STP rates of 90%. Moreover, it is possible to send a $100 million wire transfer through SWIFT and have a perfectly clean transaction that requires no human interference. In contrast, a $5,000 LC – regardless of whether it is presented electronically or on paper – still has to be checked manually. Even if that process...
could be made electronic, many processes in trade – such as invoicing or bills of lading – must be seen by human eyes.

One potential way to overcome these challenges is Optical Character Recognition (OCR), which Citi is currently developing and hopes to bring to market in the near future. The use of imaging of documents has become increasingly prevalent in recent years: images are scanned and then sent to low-cost processing centers. While the process remains manual it is not paper-based. The use of OCR would be an evolution in this model. Scanned text would be readable by machine. The huge (and cheap) processing power now available would strip data from images and then check it. Only details which did not match expectations would then need further examination.

OCR would help to overcome one of the greatest challenges for banks: that trade finance is not scalable in its current form. While cash management is now almost entirely machine-driven and is therefore scalable, every new trade client requires a bank to take on more manpower. Citi currently has 1,000 document checkers in its trade business: a 50% increase in their productivity as a result of the introduction of OCR would deliver huge benefits.

**Collaboration and competition**

The idea of collaboration between banks in trade finance emerged relatively recently. Before 2008, most corporates sought to centralize their trade and cash services with one bank in order to improve pricing and reduce complexity (for example, in the number of interfaces used). That strategy blew up in 2008 when the financial crisis threatened the viability of some banks.

In response, companies realized that they no longer wanted to be dependent on one bank and began to select multiple providers to ensure they had a back-up plan. This strategy presents difficulties, however. While structures such as SWIFT Member Administered Closed User Groups have emerged to deal with the challenges of multi-banking in cash, no such automated infrastructure exists for trade. Moreover, while ERP vendors such as SAP have integrated cash management capabilities into their offerings, similar developments have not occurred for trade (partly due to complexity and partly because many companies only have limited trade volumes).

There have been attempts to make trade multi-banking easier, such as Bolero. However, the slow growth of Bolero highlights the challenges of imposing standardization on trade. There are too many parties involved in the trade business – including many countries’ customs posts that still require paper-based filing of import documents – to make everything electronic. Rather than such an ambitious goal, it makes sense to retain paper where necessary but digitize it where possible. The growing use of SWIFT MT798 messages to standardize trade communications between banks shows one achievable way in which digitization is possible.

**The future of trade**

Globalization is certain to continue with a wider range of companies, including smaller and medium-sized firms, becoming integrated into global supply chains. Meanwhile, trade flows are likely to become more volatile. This is vividly displayed in the case of Brazil: six years ago around 90% of its cross-border trade was with the US. Just a couple of years later, about 90% was with China, as it sought commodities to support its industrial growth. Now, with growth in China slowing, Brazil’s export balance is roughly 60% to China and 40% to the US.

What is important to remember is that trade flows are not country-driven but company-driven (as the continued growth of trade despite the failure of World Trade Organization’s Doha round of trade talks demonstrates). If China does not want Brazil’s commodities, then Brazilian companies will find new export markets. Similarly, if China is successful in shifting its economies to services and consumption, manufacturing companies – and trade flows – will move to new centers such as Bangladesh and/or Vietnam.

To remain up-to-date with fast-moving developments in trade finance, it is essential that companies work with a bank that both understands their needs and objectives and is hard-wired into global trade. Trade is changing rapidly and for clients to fulfil their goals, their bank has to be at the heart of developments such as supply chain finance and the growth of export agency finance.

Clients also need to make sure that their bank consistently invests in trade and the technology needed to improve efficiency. As a global institution with an on-the-ground presence worldwide, we’re supported by international trade flows. And we support the companies that drive global trade: all of the 40 companies that represent 80%-90% of Brazil trade are Citi clients, for example. Whatever the next 30 years of trade finance looks like, we are well-positioned to support it.