What does the US-China trade war mean for Asia-Pacific, and for clients?

Vishal Kapoor (VK): It’s important to see the trade war in a historical context. Over the past 15 years trade between Asia and the US (and also Europe) has moved from a commodity-based trading model, where Asia was simply the source of raw materials or basic products, to a more strategic model, where US and European companies have effectively moved their supply chains to China. A new change is now underway with companies choosing to diversify their sourcing outside China in order to mitigate the impact of increased tariffs imposed over the past year. There is not a wholesale shift of production away from China, which would be extremely difficult given the scale of operations in the country. Instead, new facilities – when they are required – are overwhelmingly being located outside China. There is a realization among many corporates that they have been over-concentrated in China.

Where are companies choosing to locate new production facilities?

VK: To a large extent it depends on individual companies’ business models, but it is also a reflection of costs and in some cases customer demand. Countries that offer compelling strategic opportunities include Vietnam, India and Mexico. Aside from Chile, Mexico has free trade deals with more countries than any other state, according to The Economist. One common theme is that corporates often choose a market where they already have a presence or from where they can reach into a larger market because it is much easier to use existing infrastructure rather than establish a business in a completely new location or a greenfield site.
What other developments are occurring in trade in Asia?

VK: The media and other commentators are focused overwhelmingly on the US-China trade war, which is understandable given that these are the world’s two largest trading countries. However, arguably over the longer term the increase in intra-Asian trade could be a more significant development. According to the Asian Development Bank (ADB), Asia’s intra-regional trade share—measured by value—rose to 57.8% in 2017 from 57.2% in 2016—above the 55.9% average during 2010-2015.

The pace of growth of intra-regional trade is likely to have accelerated further in the past year due to the US-China trade war. The imposition of tariffs on Chinese imports by the US has prompted many (in order to retain contracts) to shift production, often to neighboring countries such as Vietnam, from which finished goods are now exported. At the same time, many companies had already begun to move part of their value chain out of China as costs were increasing. One well-known multinational electronics contract manufacturing company which previously assembled its products in China now has an assembly line in India, while continuing to source components from across Asia.

The 18 new free trade agreements signed in Asia-Pacific since 2017, including the Comprehensive and Progressive Trans-Pacific Partnership, and the prospective Regional Comprehensive Economic Partnership,1 should further bolster Asia-to-Asia trade. As the ADB notes, by strengthening the intra-regional share of trade, Asia can build a buffer against the fallout from increasingly inward-looking policies worldwide.

How can banks support clients in this changing environment?

VK: In the past, banks have mainly supported clients through the provision of finance to facilitate their imports and exports—it was a straightforward business. That is no longer the case and clients’ needs are changing dramatically.

There are three principal ways in which banks currently support their clients—and their client’s supply chains.

Firstly, many companies in the supply chain find it difficult to find attractively priced, consistently available funding: banks must support them in this. Secondly, many clients find it challenging to capture capacity with their preferred suppliers given the highly competitive nature of many sectors and the limited supply base. In such circumstances, supporting suppliers with attractively priced finance can be a valuable way to gain an edge on competitors and secure access to supplies. Thirdly, as the nature of business changes due to digital disruption and an increasingly 24/7 business culture, clients need to manage their payables, receivables and working capital cycle more effectively. If a bank can find a way to support a client’s suppliers, then that client can extend their payables and enhance their working capital. More generally, trade finance is evolving to focus not just on serving the needs of clients but on adding value to the entire supply chain. To do that, banks need to understand the flows of their clients’ entire ecosystem so that they are able to offer end-to-end solutions that address all relevant stakeholders.

The focus of banks and clients has traditionally been on extending payables and unlocking value on the supply (Account Payable) side. However, with GDP growth slowing globally, clients are significantly challenged in growing their sales. There is a heightened client focus to work on increasing both the quantum and breadth of sales, while positively impacting financial metrics like DSOs, free cash flow, and Return on Invested Capital. Customer financing is becoming an integral part of client’s sales and commercial strategy. Banks are partnering with clients to develop sales finance solutions focused on the Account Receivable side, allowing flexibility for client’s sales teams to market their products more competitively and widely with extended payment terms. By taking a multi-country portfolio-based approach, sales can be increased across borders and geographies with new clients being brought on with minimal risk impact. A collaborative risk sharing approach between clients and banks is critical to the success of such programs. We expect to see continued focus in the area of sales finance in the future, with increasingly digitized and innovative client partnerships.


In what ways is the role of technology changing in the world of trade?

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However, increasing regulatory demands to root out fraud, money laundering and other illegal activities are making trade more resource intensive. Banks are therefore now focused on digitizing manual, paper-based processes in trade and on finding technological solutions to address trade’s many challenges. Furthermore, recently we have seen the emergence of industry-led initiatives to modernize trade operations.

Digitization can be transformational: if client requests come to Citi in a digital format, then they can go through the system entirely digitally, significantly lowering costs, accelerating processing time and improving efficiency. But digitization also requires banks to invest heavily: scale is essential.

Citi has consistently developed new trade-related solutions over the past 25 years, investing heavily on new trade technology. Citi was an early adopter of Optical Character Recognition and machine learning technology which is extensively used in the back-office to recognize, segregate and extract information from trade documents automatically. Citi is also using OCR application forms for various products to automate transaction data capture thereby reducing turnaround times and enhancing client experience.

Now Citi is using artificial intelligence, machine learning and other technologies to help eliminate time-intensive, manual processes, provide valuable insights and deliver a clearer view of risk activity for clients. We have developed an advanced risk analytics scoring engine to accelerate the processing of global trade transactions while ensuring regulatory compliance. It does not replace human-based judgements about compliance but instead converts that process into a machine-based model that can be clearly documented and controlled. As a result, it will significantly increase the speed of transaction processing.

We continue to maintain our market leading position for Citi's Supplier Finance by constantly introducing value-adding features. In 2019, we introduced Citi’s Supplier Online Registration Application (CSOR) where the system employs a simple, secure, user-friendly set of online forms, an embedded document upload capability, and a click-through legal agreement (where applicable). This provides a seamless experience for suppliers to sign up for the Citi Supplier Finance program with ease.

Blockchain and other developments such as the Internet of Things also have the potential to impact trade in the region and globally. Citi is involved in numerous initiatives, both internally and with banks, fintechs and other partners. For instance, Citi is participating with six other banks in a joint initiative called the Trade Information Network to build the first inclusive global multi-bank, multi-corporate network in trade finance. The digital Network will address unmet demand for financing earlier in the supply chain by enabling corporates to easily and securely communicate trade information directly with their banks. Citi is also working with 15 of the world’s largest institutions, including banks, trading companies, an inspection company and an energy major to digitize trade and commodities finance through a blockchain-based open platform for commodity finance called Komgo to improve efficiency for clients.