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TRADE FINANCE TALKS

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MENA'S TRADE TAPESTRY: WEAVING GLOBAL INTEGRATION

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How blockchain-based facilities can close the \$2tn global trade finance gap

Blockchain is by no means a silver bullet, and the term is thrown around so loosely that eyes often roll when it is brought up as a radical challenger to the global financial services system. However, the benefits of its real-world application within trade finance cannot be denied.

Persistent structural gaps within and between the world's economies will decisively influence trade in the years ahead. This was one of the key findings in the latest Future Of Trade report.

Change – and the reform processes that drive it – is challenging at the best of times, but it has been exacerbated by the longevity of the situation in Europe and the recent global banking crisis that has gripped the entire sector.

Despite these challenges, one gap that cannot be left unchecked is found in trade finance.

80% of global trade relies on finance, such as letters of credit and other short-term payment guarantees. This makes trade finance a crucial driver of economic growth.

The trade finance gap – meaning the unmet demand for trade finance through rejected applications – was measured at \$1.7 trillion in 2020 and is estimated to have surpassed

\$2 trillion today due to an increasingly hawkish stance on risk and inflation eating into lending limits.

This gap particularly hinders SMEs and emerging markets. SMEs tend to be the most credit-constrained and estimates project that half of SME trade finance requests are rejected, compared with only 7% for multinational corporations. Some 68% of companies surveyed also said they did not seek alternatives after being rejected.

The macroeconomic and financial backdrop is such that the trade finance gap will widen in the near term. Notwithstanding this, there is significant potential for digital technology to help close the gap – either via streamlining onboarding processes for SMEs, or by opening the sector up to new sources of liquidity.

Innovative platforms to address this challenge exist. One such platform is DMCC Tradeflow, a digitised system for registering the ownership of commodities stored in UAE facilities, which was



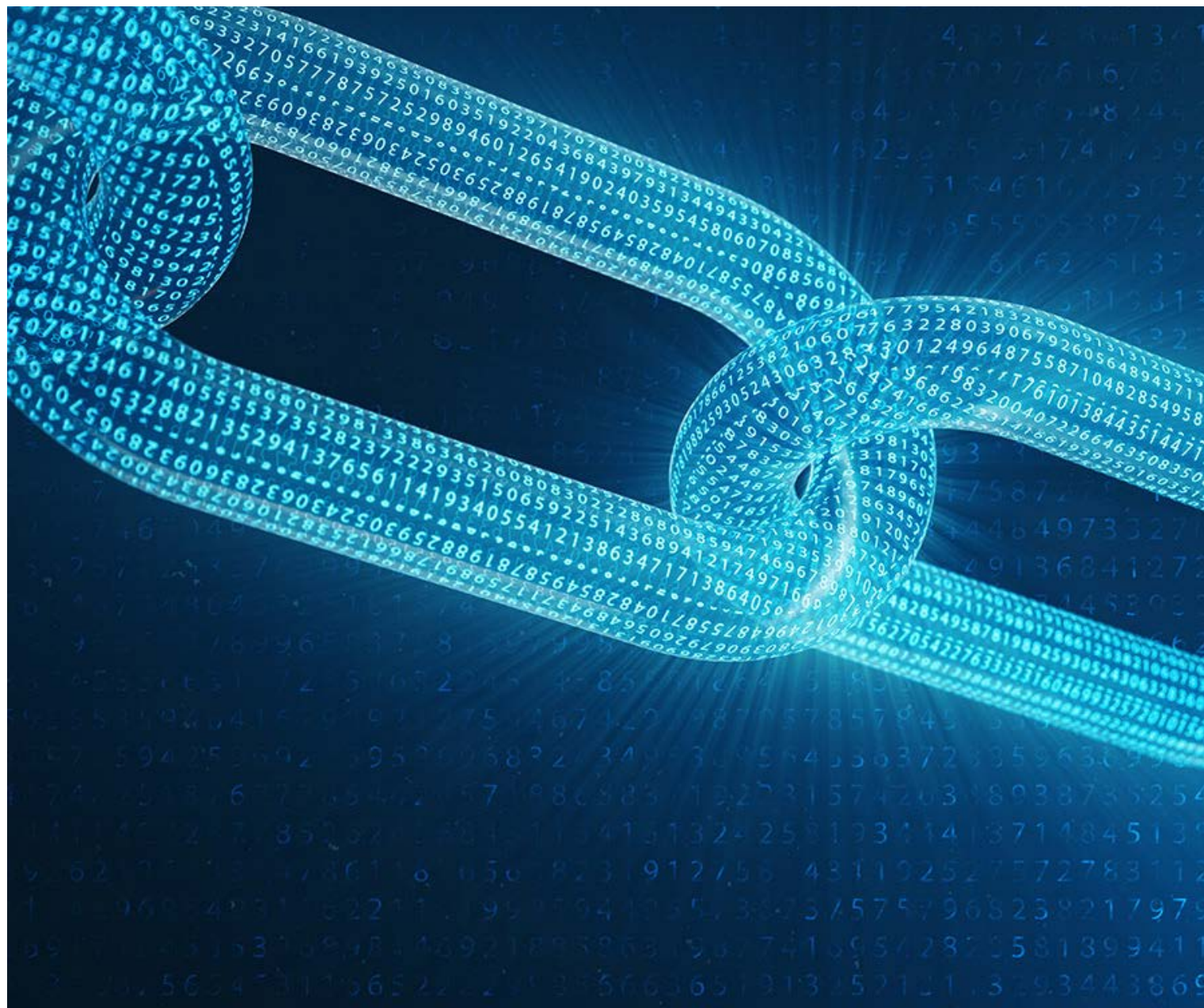
launched to address the crucial gap in the regional trade finance market.

It has witnessed a substantial year-on-year increase in transactions over the past decade, driving the platform's expansion and capabilities. With record-breaking transactions

reached in 2022, Tradeflow is a great case study of the ongoing appetite and need for innovative trade finance solutions.

Building upon this, one increasingly prevalent technology that addresses these root causes head-on is the blockchain. Blockchain is by no means a

silver bullet, and the term is thrown around so loosely that eyes often roll when it is brought up as a radical challenger to the global financial services system. However, the benefits of its real-world application within trade finance cannot be denied.



When it comes to trade, blockchain makes goods traceable in real-time, enhances trust by guaranteeing the security of payments and financing, facilitates the verification of digital quality and origin certifications, enables instantaneous sharing of information at different stages of trade, and helps improve how related public and private services operate.

To date, blockchain has played a role in reducing the amount of paperwork that facilitates global trade. Most trade finance activities involve a substantial

amount of physical paperwork 'hot potato' between the importer and exporter, their respective banks, shipping companies, receiving companies, local shippers, insurers, and a range of additional parties.

Blockchain networks eliminate this array of inefficiencies by serving as a shared ledger that all parties can access at any time to receive the information they need to keep the trade finance process flowing seamlessly. This is hugely beneficial in supporting the supply chain through reduced costs, error-free documentation, and much

faster transfer of documents between parties. By extension, this streamlines the onboarding process for SMEs.

This application is well known; however, it falls short of blockchain's true potential.

Signing into the future: Smart contracts are the way to go

One of the more exciting areas for the widespread application of blockchain technologies within trade finance is smart contracts. This is where the real value will come from.



Smart contracts refer to a series of digital agreements that automate the execution of a contract from outside the chain. Because the actions are automated based on pre-defined terms and conditions, this enables parties to collaborate, either much more efficiently through an intermediary like a bank or without one entirely.

In a typical trade scenario, this blockchain technology would allow digital agreements to be set up between two parties. The import and export banks would be able to review documents swiftly and without the need for

physical paperwork. The export bank would be able to approve the payment details and issue a smart contract to cover the terms and conditions and lock-in obligations.

The export bank would then be able to track the goods throughout the entire process as different parts of the smart contract's terms are met. Finally, the contract would be fulfilled once the payment was carried out, again, automated through the blockchain.

This automation is expected to save between \$15 and 20 billion dollars annually. But aside from

the savings generated, this would have an immeasurable impact on many underserved businesses impacted by the \$2 trillion trade finance gap by creating new, less constrained sources of liquidity that are still underpinned by trust and transparency.

As with any new technology, obtaining a critical mass for its adoption will be crucial, but the benefits of operational simplification, reduced risk, automated compliance, and faster settlement should be obvious to all. That being said, the largest potential benefit comes in the form of the vast untapped opportunities and markets that blockchain-based trade finance facilities would open up.

Progress is not linear: barriers to blockchain integration

There are, of course, barriers to overcome. Cost-efficient scalability is the most prominent, representing the main roadblock that blockchain's application in trade finance has faced. But a fully-functioning, scalable blockchain platform offers enormous potential and is becoming increasingly feasible given the continuous iterative development of the technology. Recognising this, leaders in the space, such as various consortia of banks, including Contour, and eTradeConnect, are driving real-world adoption of the technology, unlocking new opportunities for businesses and nations.

Ultimately, the shortage of trade finance through lack of access and liquidity is a major obstacle to trade growth and is a significant contributor to keeping poorer nations poor. The efficiency with which blockchain-based facilities can address this cannot be understated. ■

