Benchmark Report

DEMICA

2024

Contents

"Banks aim to broaden their services, secure greater efficiency and visibility, and transform the user experience"

Matt Wreford
Chief Executive Officer

Welcome to Demica's third annual Benchmark Report for Banks in Trade Finance. Now in its third year, the report provides key insights into the way supply chain finance is evolving.

What strikes me this time is how trade flows reconfigured in 2023, reverting to a version of normal. Not the pre-pandemic world of cheap money, but an environment where inflation in most economies was declining or slowing as high interest rates took their effect. The full benefit of China's reopening after Covid lockdowns was also felt. Growth may be sluggish in developed economies, but the overall sentiment emerging from this year's survey findings is cautiously positive.

Supply chain asset growth continued around the globe – reported by 70% of respondents from the banks we deal with. Inflation was a major factor. Although the three-year asset growth trend is slowing, based on our report's findings, we should remember the surge in global trade in 2022 was never going to continue.

Relatively high interest rates were also a check on growth, with many teams reporting negative or neutral effects, and reducing, in particular, demand for payables finance. Receivables finance demand has held up, with banks in every region other than Europe looking to expand. With a larger, more mature market, European banks are looking to enter new markets.

Of course, global statistics always mask regional realities. For example, 85% of APAC banks saw SCF asset growth, compared with 56% in the US, where factors such as strengthening corporate bond issuance came into play. The Middle East, meanwhile, has huge room to expand supply chain finance as it starts from a lower base and is investing in major capital projects to power its economic transformation.

Continuing uncertainty

Uncertainty abounds, however. The conflict in the Middle East continues, destroying lives and menacing shipping in the Red Sea. At the time of writing, these events had not added significantly to the inflation caused by the continuing Russian aggression in Ukraine. But the effects were felt more keenly in Europe, where half our bank partners could see events had affected asset growth. Despite this, the Europeans remain broadly optimistic about asset-growth.

The early stages of more sustainable trade finance are also apparent. Almost all banks in this year's survey are planning to prioritise ESG in 2024 and involvement in ESG-related transactions has increased.

We saw a decrease in banks' technology investment in 2023. However, a substantial proportion foresee their budgets will increase and there are clear signs that more banks are aware their strengths are not in software development. This is one of the many encouraging signs for the forthcoming year for Demica.

Banks aim to broaden their services, secure greater efficiency and visibility, and transform the user experience. It is in these vital areas that Demica has unparalleled expertise – and where we will be collaborating with banks as the year progresses. To nobody's great surprise, the distributed ledger/blockchain technology balloon continues to deflate.

Looking ahead, 2024 is set to be a year when the persistence of high interest rates will focus banks on working capital solutions as a highly effective alternative to traditional credit. With political uncertainty continuing, supply chain finance is a lower risk option through its direct link to a visible commercial activity. It is an exciting time to be at Demica.

Geographical spread of respondents

Methodology

Demica surveyed banks operating in the trade and supply chain finance space around the world between November 2023 and January 2024.

The survey was shared with our network, and further shared by third-party organisations with their networks including GTR, BAFT and ITFA. The survey received a total of 169 anonymised responses from supply chain finance professionals in 31 countries across the Americas, Asia-Pacific, Europe, the Middle East and Africa.

Respondents were split across different teams and roles within trade finance banks, and the survey gathered responses from payables, receivables, factoring, securitisation, and technology teams.

Participants were asked 37 questions using a web-based survey, with survey logic built in so that some questions were only asked based on specific answers to previous questions. Not all questions were compulsory, and so not all questions were answered by all participants.

For the purposes of this report, the percentage of respondents selecting each answer have been rounded to the closest whole number, so in some cases won't add up to 100%. Further to this, some questions allowed respondents to select multiple options, and so the percentages provided will add up to more than 100%.

Disclaimer:

How participants describe their teams

Roles of survey respondents

01 Growth

“The long term shift from traditional trade finance to open account looks set to continue”

Maurice Benisty

Chief Commercial Officer

"The indications are that we are moving back closer to something like normal in economies such as the US – although not the normal of zero rates that applied up to the pandemic"

Asset growth

Growth in 2023 was significant with 69% of banks responding to the survey seeing growth in their asset sizes, continuing a trend of strong asset growth in our Demica Benchmark Reports.

Percentage of banks seeing asset size growth in Demica Benchmark Reports:

- 2023 – 69%
- 2022 – 78%
- 2021 – 82%

The year turned out not to be quite as high-powered as the unique post-pandemic conditions of 2022. Only a third of banks (32%) reported a significant increase in asset sizes of more than 10%, which is substantially down from the 52% achieving this level in 2022. In fact, it fell short of expectations among our banking community, 82% of whom forecasted asset growth for 2023 in our last benchmark survey.

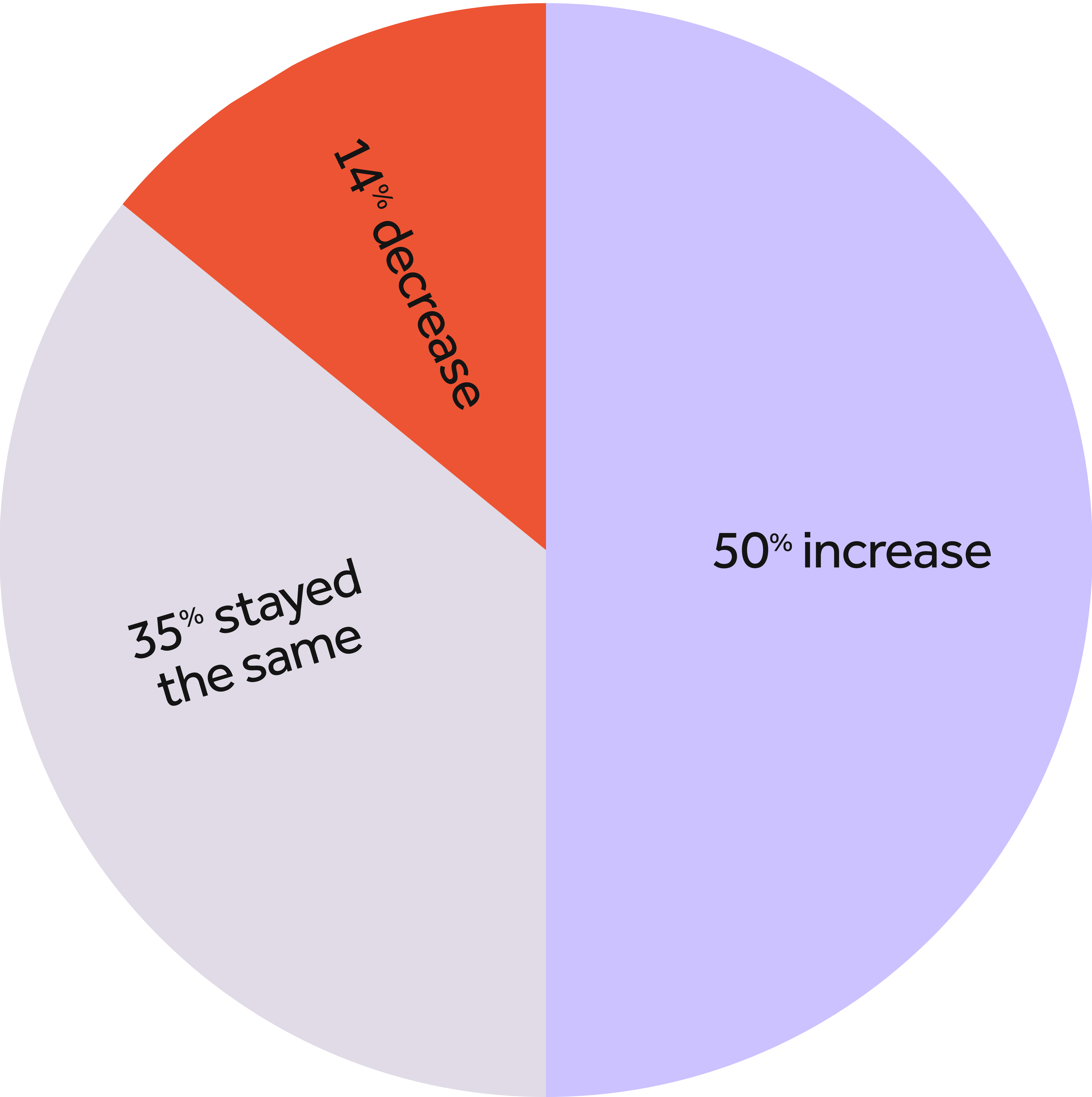
Headcount in trade finance is also closely linked to growth, and in 2023, 50% of teams increased in size, 36% stayed the same and 15% decreased. Again, this was slightly behind 2022, when, for example, only 10% of teams lost headcount. There is likely to have been some adjustment here after high levels of recruitment in 2022.

The indications are that we are moving back closer to something like normal in economies such as the US – although not the normal of zero rates that applied up to the pandemic.

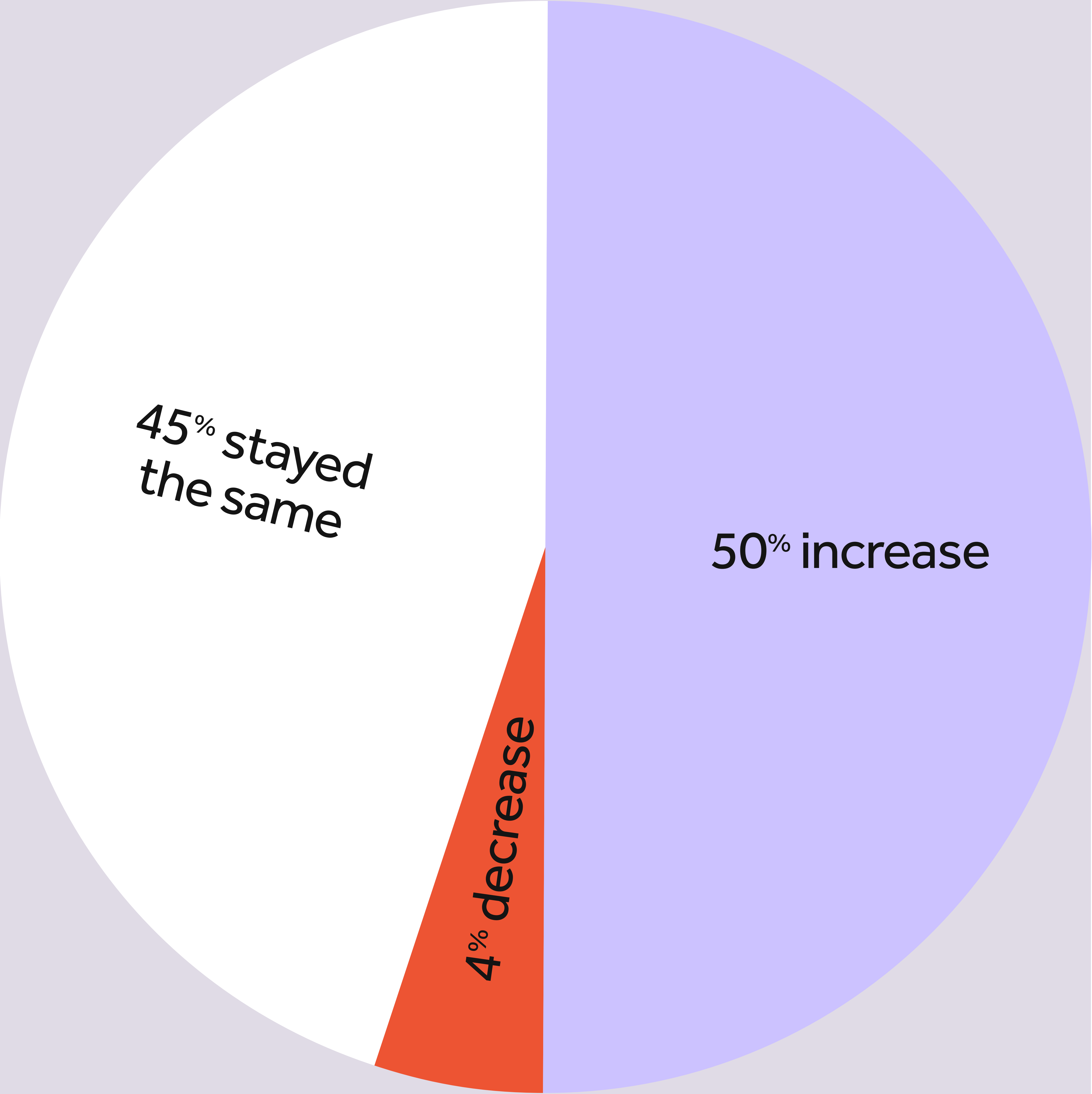
How have asset sizes in your department changed in the last 12 months?

Internal Structure & HR

How has your team's headcount changed over the last 12 months?



How do you expect your team's headcount to change in the next 12 months?



36%

1-2 days per week in the office

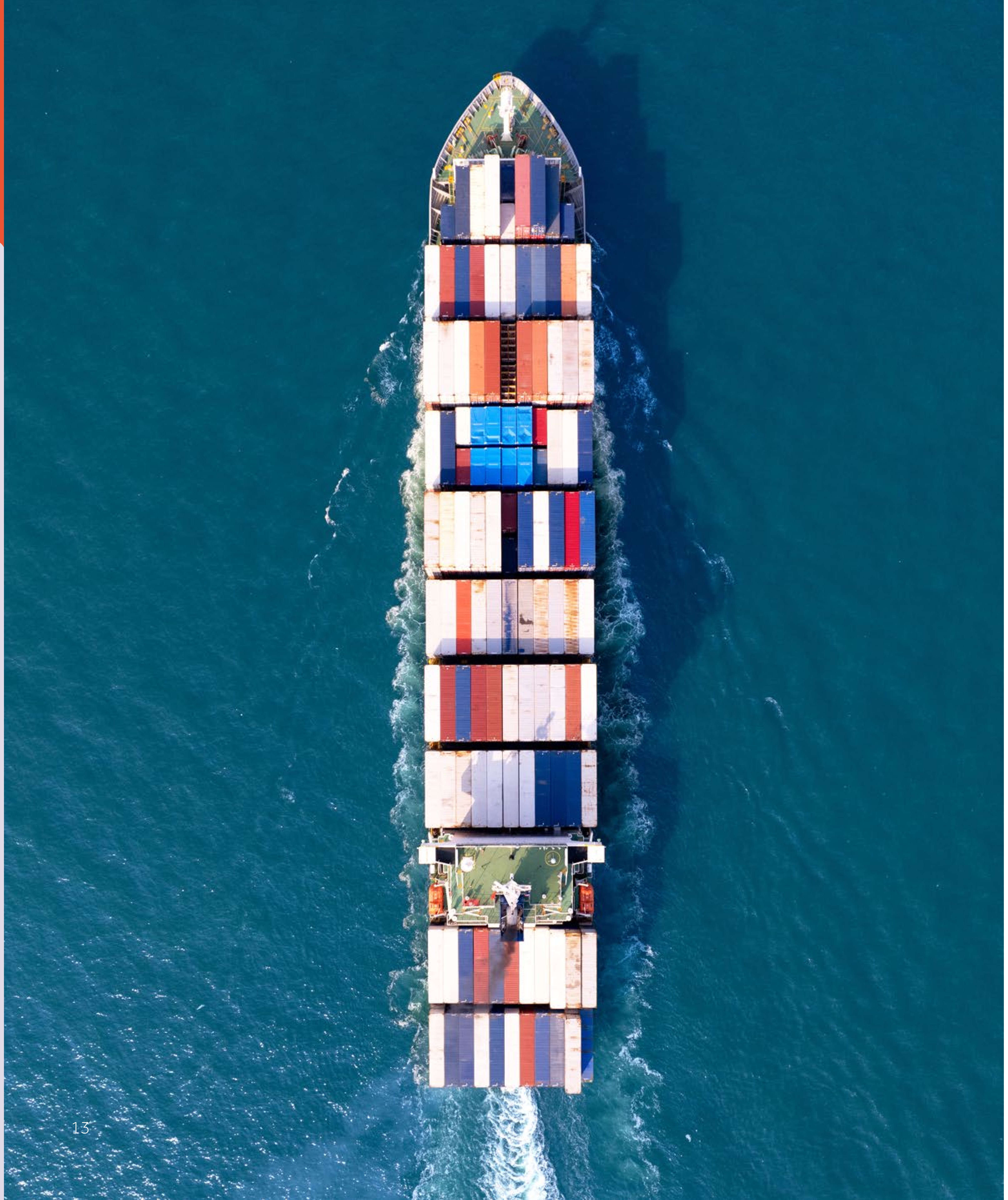
3% Fully remote working

11%

Fully office-based working

50%

3-4 days per week in the office



Inflation and interest rates

The biggest growth driver in asset sizes was inflation, despite steadily falling from the double-digit highs of 2022 in many major trading nations. Among banks taking part in this survey, 47% cited inflation as the strongest factor behind asset growth. Respondents said inflation had had more impact as a growth stimulant than interest rates and economic uncertainty (26% in each case).

Although many developed economies have low single-figure inflation (3.4% in the US in December, 2023) interest rates remained relatively high – and in countries such as Egypt and Turkey, extremely high.

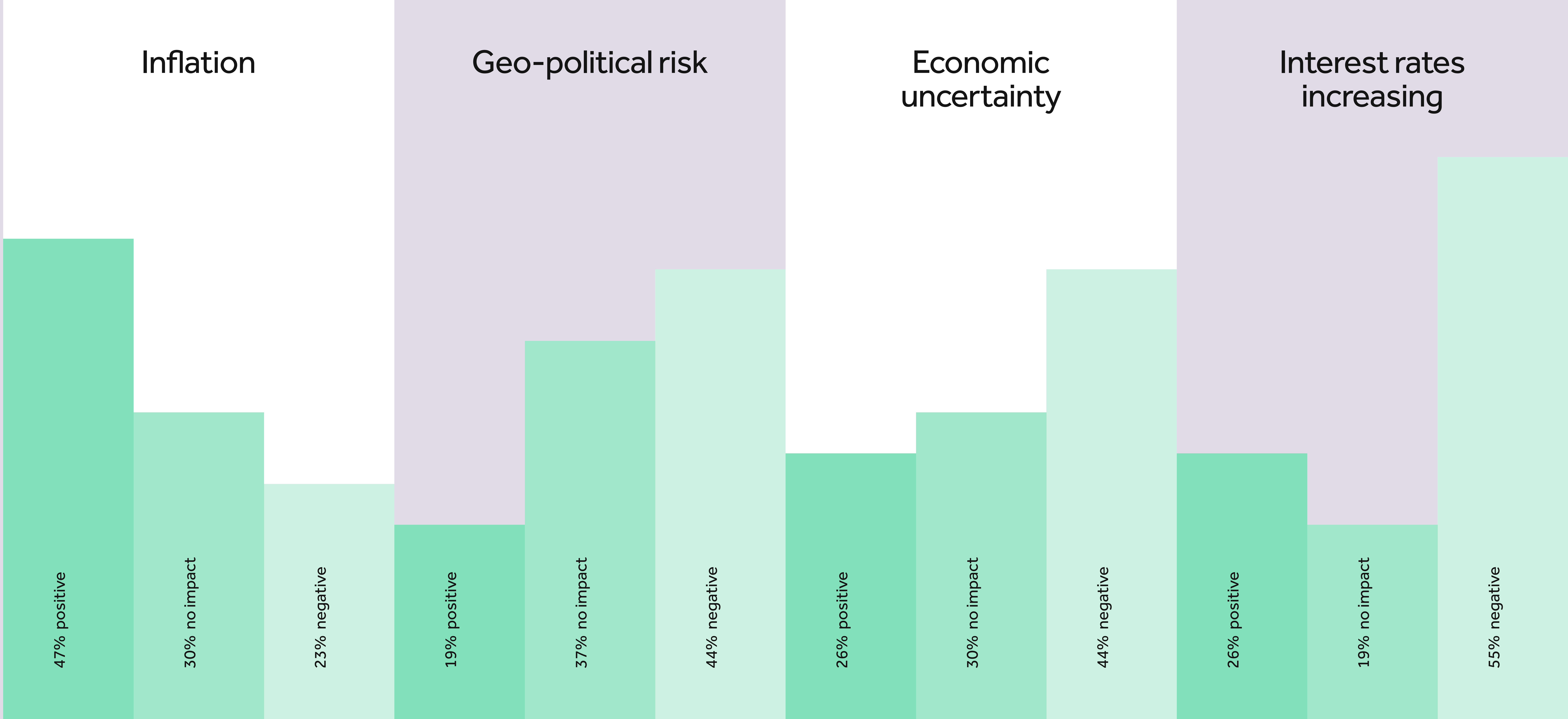
Interest rates were most commonly seen as the biggest negative on asset growth – selected by 55% of respondents around the globe. It was the cost of money that made companies more sensitive about debt, reduced business growth and led to a reduction in working capital requirements.

As we move into 2024, relatively high interest rates may persist in many economies due to the reluctance of central banks to lower base rates before inflation registers clear falls in their jurisdiction. IMF predictions are for global growth to stay at 3.1% in 2024, which will weigh on economic activity. Global inflation should fall to 5.8%, according to the IMF, but remains stubborn.

Geopolitical factors

Other very significant political and regional factors were at play over the last 12 months, with economies in South-East Asia continuing to benefit from the after-effects of China's lingering Covid rules and increased isolation. The conflict in Gaza and hostile activities in Yemen affected trade and tourism in the Middle East at the end of 2023. This will have contributed to the 44% of respondents from around the world who told us that geopolitical risk was a negative factor on asset sizes.

How did the following impact asset growth in 2023?



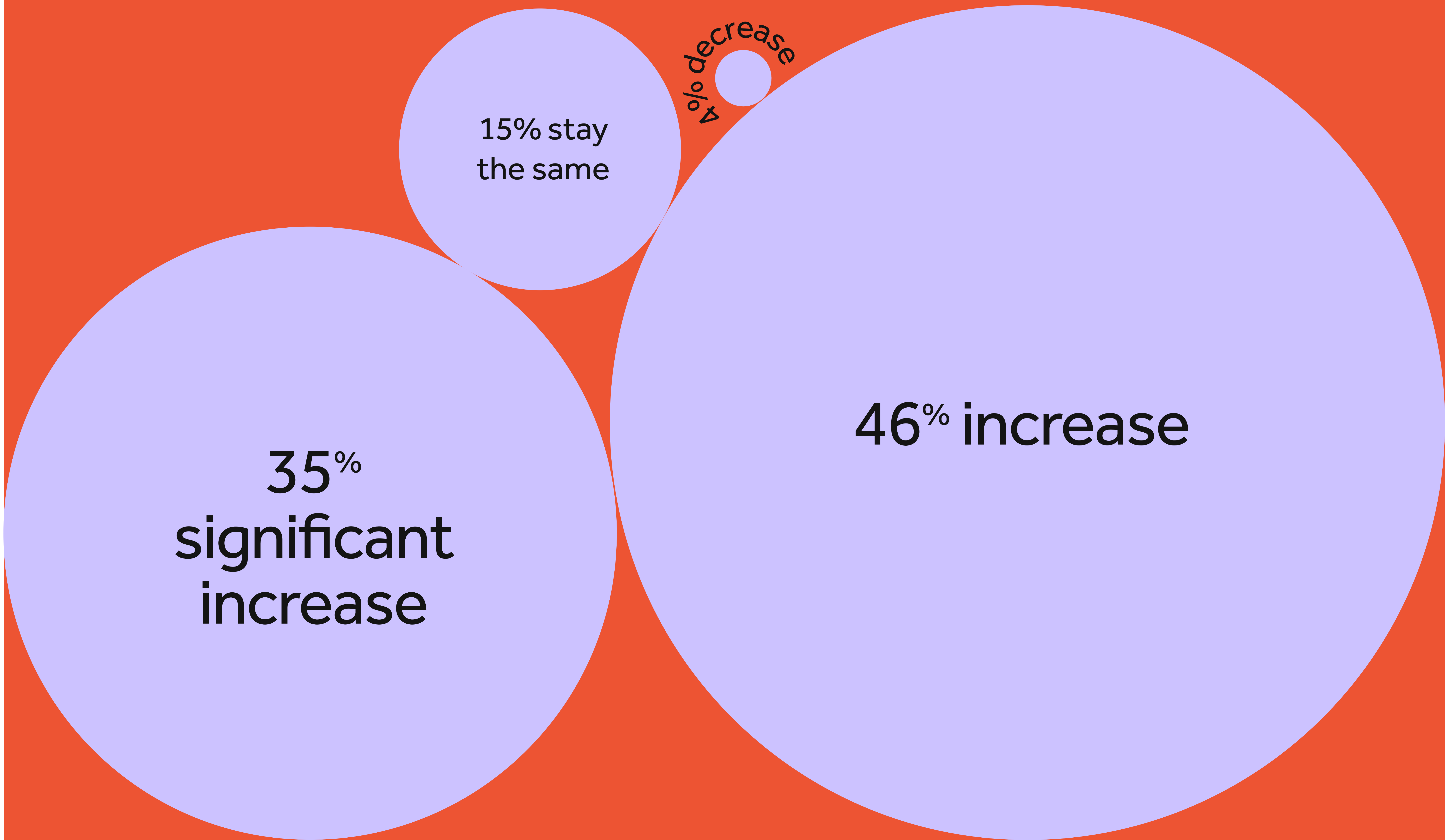
2024 – what lies ahead

If we examine our survey for indicators of how optimistic banks are for 2024, we can see that cautious optimism prevails.

More than eight-in-ten (81%) of banks expect increases in asset sizes, of which 35% predict increases of more than 10%, and 46% anticipate growth by less than 10%. The long term shift from traditional trade finance to open account looks set to continue which underpins these still strong rates of growth. Half of all banks plan to recruit to their trade finance teams, which is positive and much the same as banks' headcount forecasts in last year's survey.

The persistence of relatively high interest rates and inflation in many areas of the globe will have a dampening effect on expectations, along with the geopolitical risk factors. Many countries including much of Africa, struggle with high food price inflation (57% in Sierra Leone and 70% year-on-year in Turkey for example) although supply chain finance remains relatively under penetrated in these markets which limits the impact on the overall market. Going into 2024 we see a reluctance from central banks to lower interest rates prematurely which has the mixed impact of suppressing growth whilst pushing corporates to look for lower cost funding sources.

How do you expect asset sizes in your department to change in the next 12 months?

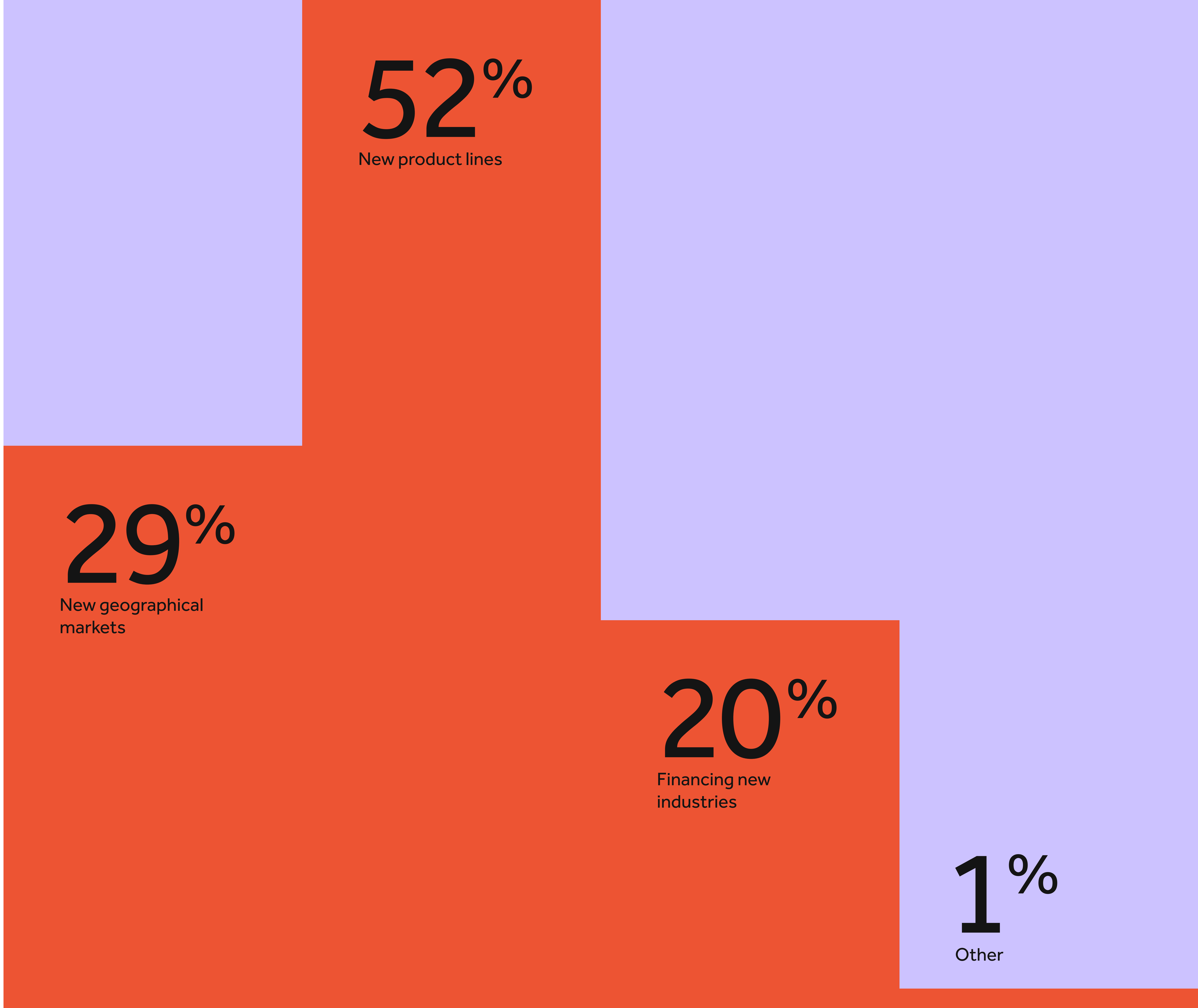


Are you planning to move into new markets? Which ones?

New product lines

Remaining optimistic, the results show 66% of all our respondents are planning to move into new markets, with new product lines most frequently cited (52%). More than a quarter (27%) view receivables discounting as having the highest growth potential in 2024, almost level with 26% focusing on payables. This is a slight reversal of last year's findings, when payables were more often seen to have growth potential.

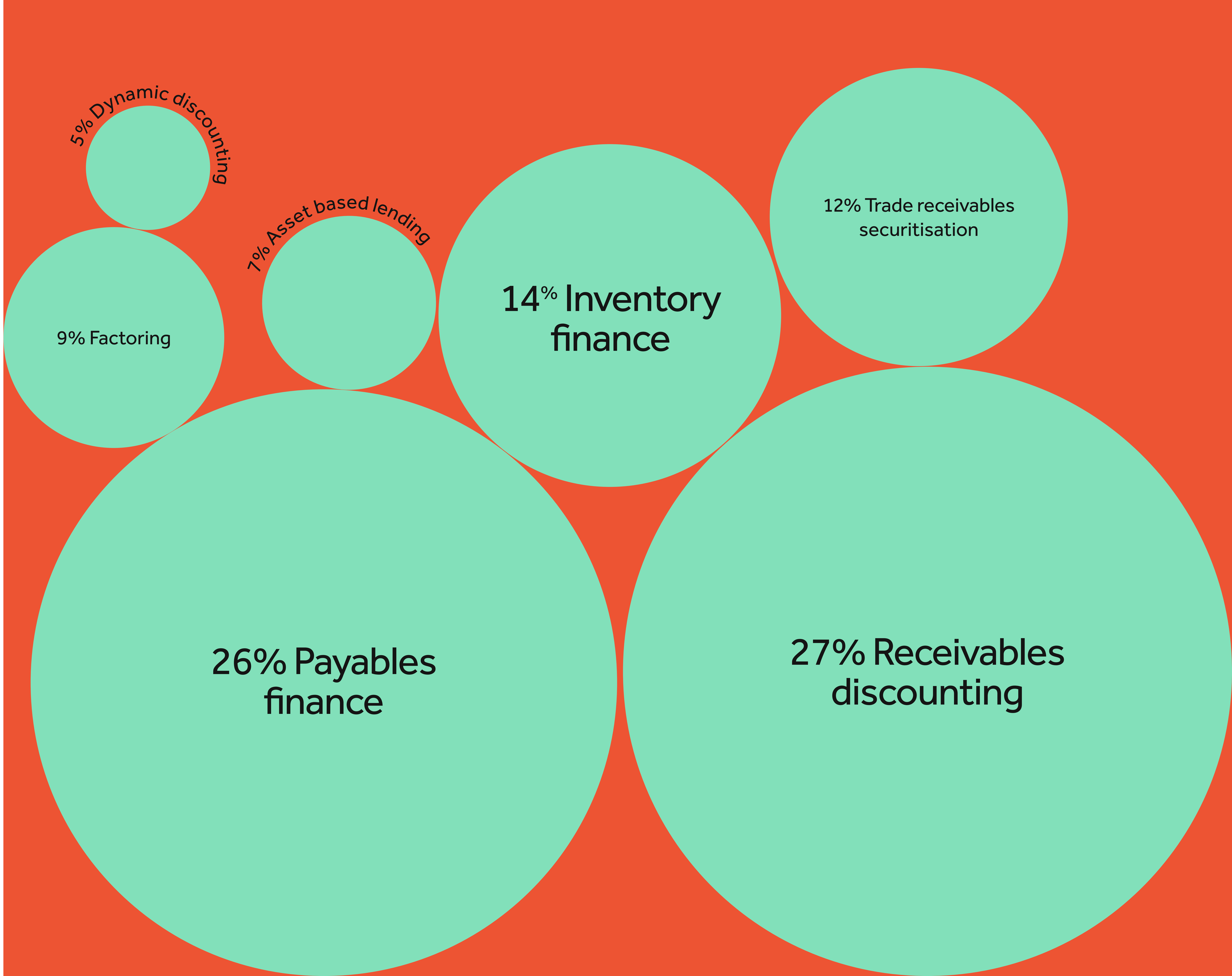
Banks have experienced reduced demand for payables, some of which we can attribute to a maturing of the market. But interest rates may have had their effect here too and continue to influence thinking about 2024. Suppliers may withdraw from programmes when they deem the cost too high. Receivables, by contrast, are an important financing tool for treasurers, particularly at sub-investment grade corporates who are under liquidity and cost pressure.



Which of the following products do you see having the highest growth potential within your organisation?

This is the first time that Receivables Finance has overtaken Payables Finance as the product with the highest growth potential. Last year 33% said Payables products had the highest growth potential and this has dropped to 27% this year, with utilisation of existing programs also coming down in line with falling inventory levels.

Receivables Finance is able to provide corporates with relatively quick access to low-cost funding which is attractive in a higher interest rate environment, and is a driver of higher demand from corporate treasurers.



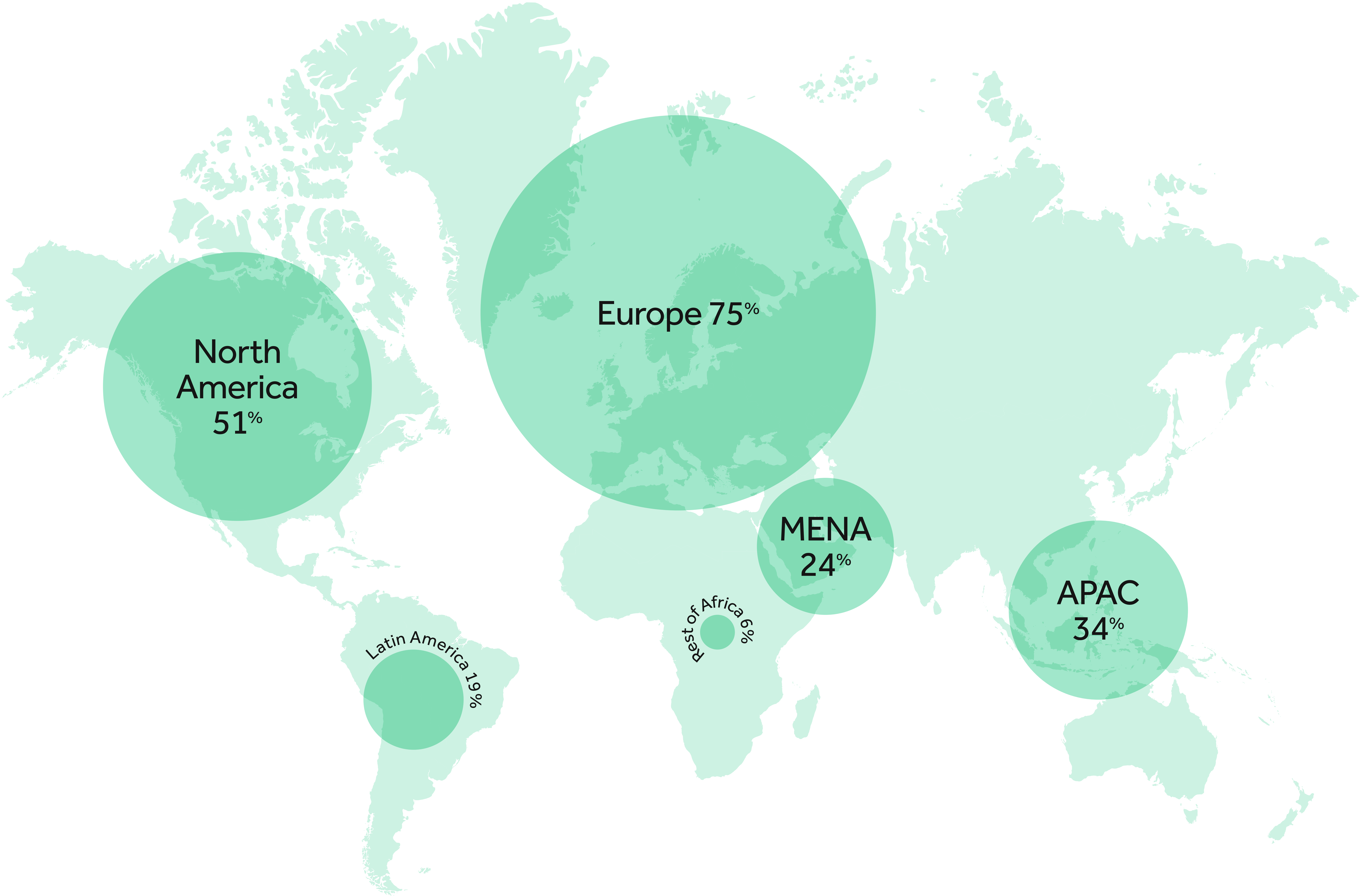
The year when embedded finance comes alive?

Embedded finance is likely to play a larger role as the year progresses. It is predicted to grow at 32% CAGR up to 2030 according to ResearchAndMarkets.

A report by Bain Capital predicts embedded finance transactions will exceed $7 trillion in the US alone by 2026. This is the buy-now-pay-later approach, offering terms to businesses at point of sale. The receivables resulting from these business models are primarily generated by technology-enabled businesses, with portfolios financed through trade receivables securitisations or innovative loan structures.

ResearchAndMarkets believes embedded finance growth in 2022 was dominated by the B2B sector, primarily in the US. There has been optimism around the ability for ERP system providers to embed access to finance in their software, enabling companies to realise liquidity through the sale of receivables. In Demica's experience, however, take-up is more likely in specialist platforms embedding finance in the workflow, as in our partner Sonovate, which provides solutions for the contingent workforce across recruitment businesses and consultancies. This could be an exciting area of progress in the next 12 months.

Which are your current key regions?



Matt Wreford

Chief Executive Officer

Risk Distribution

For the first time, this year we asked banks how they had distributed their SCF assets, to get a view of how the market looks from a participation standpoint, and how many banks are distributing the assets of their programmes with other funders. This part of the survey will be of interest to ITFA's Trade Finance Investment Ecosystem (ITFIE) Working Group. As Co-Lead of the Data and Technology workstream, I am particularly interested in helping support the development of this aspect of trade finance.

Payables and receivables origination and distribution

The great majority of banks (73%) distributed less than a fifth of their book and only 5% of banks taking part in this survey distributed more than 40% of their receivables finance and approved payables in 2023. This wasn't unsurprising, as it is only the largest banks that typically distribute a significant proportion of their book, but I was a little surprised to see that 22% of banks distributed between 21% and 40%. I believe this middle part of the market is growing as banks are selling down more, in response to anticipated regulatory changes, and more thoughtful views on credit underwriting. Anecdotally we know of a number of banks that are now financing debtors with lower credit ratings than previously, and are immediately distributing this risk to non-bank financial institutions. Together these suggest the market is slowly moving away from a buy-and-hold model.

Regionally, MEA banks are distributing the least, with 0% distributing more than 40% of their book and 71% distributing less than 20% of their book (compared to 56% and 54% in North America and Europe). APAC is leading the charge with the highest percentage of respondents distributing more than 40% of their book, 11%, compared with just 4% in North America and 3% in Europe.

The advent of Basel IV banking regulation last year, and its phased implementation, should provide stimulus for greater distribution of supply chain finance risk. More banks will understand that origination and distribution provide increased margins in a highly competitive and regulated market with high interest rates. Advances in platform technology can support this, providing the ease-of-use and integration that all parties now want, allied to the transparency that helps reduce risk.

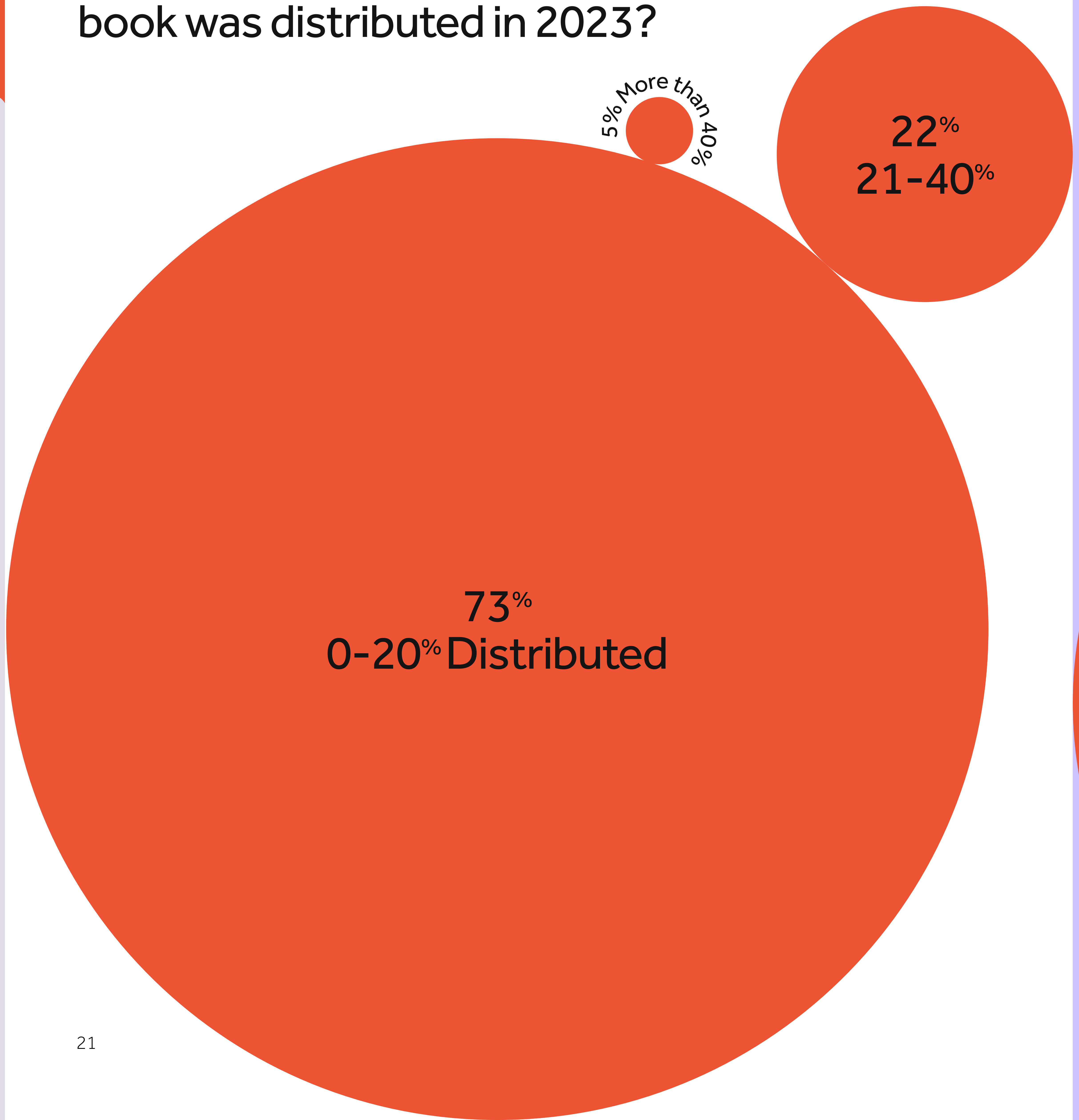
Percentages of books sourced from other banks

Participation in larger programmes originated by other banks is an attractive option for some banks, as it can spread risk across multiple transactions rather than bearing the entire risk associated with originating a single transaction. Furthermore, banks may require less capital than originating transactions, as they typically only need to fund a portion of the total transaction amount. While most banks surveyed (62%) sourced no more than 20% of receivables and payables from other banks or platforms, 18% had between 21% and 40% of their books from other banks.

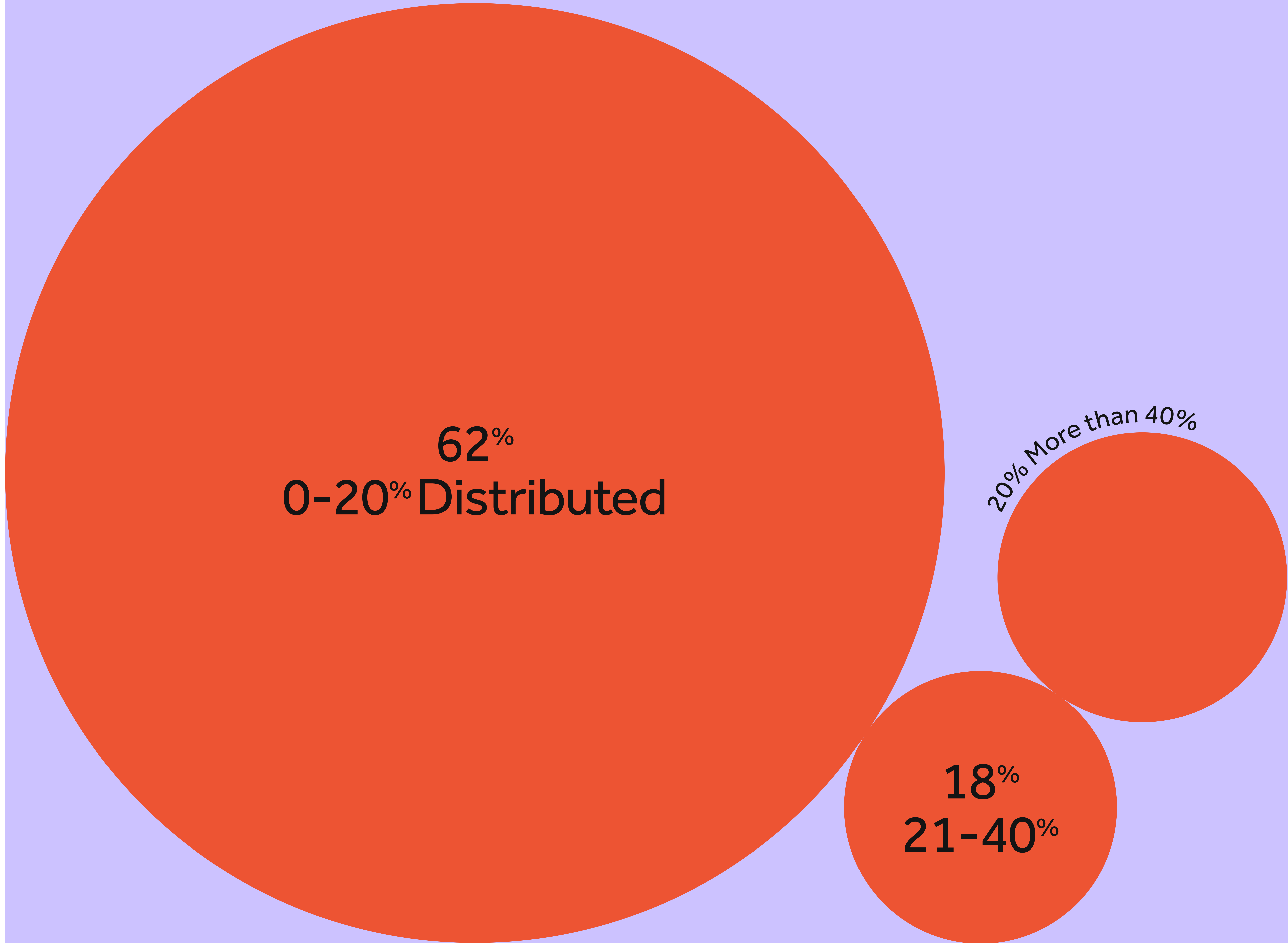
20% of banks had more than 40% of their books sourced from other banks, which suggests that there is a smaller group of banks who participate more actively than the wider market, and this is more often in North America (22% of respondents compared to 15% in Europe and 0% in APAC and MENA). Most banks are still more interested in the higher profitability, direct relationships and control over the portfolio that comes with originating and managing their own transactions.

This is interesting, as it's only banks who participate in our survey, not institutional investors. We take a firm view that this is trending upwards, as previously very few large banks were selling down to relatively few buyers, but the number of buyers seems to be rising over-and-above the number of sellers.

What % of your receivables finance and approved payables finance book was distributed in 2023?



What % of your receivables finance and approved payables finance book was sourced from other banks/ platforms in 2023?



Distribution to the non-banking market

The vast majority (83%) of banks surveyed distributed no more than 10% of their payables and receivables programmes to institutional, non-bank investors. Only 8% distributed between 11% and 20%, while 9% achieved more than 20%.

As previously stated, it is surprising that risk-distribution has declined in significance as a challenge from 2022 given that Basel IV regulations are now in force. In payables, risk distribution only features as a top challenge for 13% of respondents in trade receivables teams. As risk is rising, this may be due to an increased focus on growth through expanding banks' addressable markets and venturing into new product lines. **The market's getting more complex, and the involvement of institutional investors seems to be gaining significance.**

Sean Edwards

IFTA Chairman

"Investment in trade finance continues to grow, reflecting belief and enthusiasm for this line of banking"

ITFA's view on growth

The best surveys both confirm our hunches (not our biases!) and offer us an intuitive insight into what is lurking beneath the surface or on the horizon. So it has proved with Demica's 2024 Benchmark Report. With a focus on supply chain finance, 2023 could be characterised as a stable if relatively lack-lustre year, especially when compared to the profits and volumes from commodity finance, but which, nevertheless, set up the market for robust growth. However, as always, there are interesting nuances and pockets of development and change to pick up on.

The headline good news is that investment in trade finance continues to grow, reflecting belief and enthusiasm for this line of banking. A fairly consistent 50% of providers have increased their headcount over the last year and plan to continue doing so during the coming 12 months. There are similar aspirations in relation to the sizes of asset books and moves into new regions especially Europe, APAC, North America, and MENA. Engines are at full throttle and engagement remains high.

So what are the nuances?

Much of the growth is posited on developing new products (although a roll-out to new markets as mentioned above is still adventurous). Amongst the desirable new products are ...inventory finance, receivables finance and dynamic discounting.

Drivers for growth

For many banks, the first is genuinely new having been confined to specialist providers. Inventory finance (the "DIO" in the Cash Conversion Cycle) is one of the least developed finance solutions for improving working capital, so it's not surprising that attention has been drawn to it. Unfortunately, this is not low-lying fruit, or an easy tidbit to pick up, and requires infrastructure and knowledge to bring off successfully. In practice, we have not seen much growth here amongst ITFA members.

Receivables finance and dynamic discounting are more influenced by traditional and permanent structural factors. For these products, interest rates affect receivable finance positively as rising rates make the cost of borrowing higher and prompt quicker monetisation of receivables. Dynamic discounting, and some other forms of buyer-led finance, are relatively less attractive in a rising interest rate environment as the returns for deploying the buyer's own cash are more closely matched by money market rates. These tools and techniques should always be within a bank's power to offer, but it is arguable whether they can drive new growth, vulnerable as they are to external factors.

What's lacking in impact?

Almost as interesting, and capable of change fortunately, is what is NOT driving growth. While many more respondents have been involved in some form in an ESG-related transaction, credit limits have barely changed from the previous reports and the predominant answer when asked whether ESG would be prioritised in the next 12 months was "somewhat". There are numerous reasons for this, and the sector is still immature, ranging from fear of greenwashing to lack of specialist staff and systems. In ITFA, we have identified some other factors such as under-reporting or "green-hushing" due to a multiplicity of standards and potentially competing regulations.

Similarly, the change in SCF accounting rules has not been impactful, positively or negatively according to respondents. This may just reflect a time-lag as we have not yet reached the end of the first accounting period. Informal and anecdotal feedback shows a wide range of opinions, and the rule-change has sparked off some discussion in the employment of traditional trade instruments such as UPAS letters of credit and negotiable instruments all of which can give rise to early payment for a supplier whilst allowing credit to the buyer all within the comforting envelope of a trade instrument. ITFA has been exploring these possibilities vigorously, but we are far off a conclusion.

Banks and digitisation – are we wasting potential?

Digitisation and improved IT infrastructure is seen by many as a prerequisite to meaningful improvement and growth in the trade finance business. Respondents are fairly clear as to the benefits of digitisation, but the lens is relatively narrow and concentrated on operational savings. I have written and spoken on this focus before: real benefits will only accrue when we create inter-operability through networks either through one or a few successful platforms or a truly open eco-system and do not stop at the cost savings. Tech budgets are also being squeezed and banks, wisely or not, are moving responsibility for innovation to third party platforms. Their expectations are high: the platforms need to have the right certifications in place and bring in clients. More happily, banks are open to using multiple platforms so there is an inviting market for our new tech friends. As financial players, however, non-banks remain in the minor leagues.

What do I take away from this mixed bag? Firstly, there is real resilience and stamina. Secondly, however timorous, banks have not given up on finding new ways to do business. Following financial losses due to the failure of some trade platforms and a subsequent dip in confidence, it is not surprising that banks are on the side-benches of the digital transformation. Let us hope this is temporary and we don't throw away the momentum we have so expensively created.

02 Regions

Europe

Angel Blanco

Managing Director of Platform Solutions

> “High interest rates drive down demand for financing, but supply chain finance assets are resilient in the face of economic adversity in the rest of the economy”

Asset growth in a time of uncertainty

What stands out in this year’s survey are the impacts of the continuing war in Ukraine and the hostilities in Gaza and Yemen.

Half of the banks in Europe taking part in this survey (50%) said geopolitical risks had adversely affected asset growth throughout 2023, and 44% pointed to the same effect from the economic uncertainty that prevailed through the year.

The conflicts have affected the import of soft commodities, oil and gas, and encouraged corporates to bring their production or supply centres closer to consumers. Industrial space taken up by manufacturers in major European countries has increased as supply chain resilience and flexibility become imperatives.

The trend for inventory strategies to move from just-in-case to just-in-time strengthened as the year continued and will help shape how Europe copes with disruptions in 2024. In the days of very low interest rates, corporates were more willing to hold inventory, but the interest rate in Germany was 4% in December, 2023 and the cost of new loans to businesses in the euro area was 5.2%.

High interest rates typically drive down demand for financing, but supply chain finance assets are resilient in the face of economic adversity in the rest of the economy due to their link to underlying economic activity

More modest growth than 2022

Growth in asset sizes among our European respondents was more modest than in our last report a year ago. Over the course of 2023, 35% of banks saw substantial asset growth of more than 10%, and 41% saw growth of less than 10%. In our last report (covering 2022) we found 55% had assets that grew more than 10% and 27% had assets growing less than 10%.

Expectations remain reasonably high, however. A third of banks (33%) are expecting asset growth of more than 10% in 2024 and half (51%) foresee increases up to 10%. This is more than the 72% predicting growth last time, so faith in the European economy, and in the asset class, has increased over the year. In addition, more than half of banks in Europe in this survey (54%) plan to increase headcount in their trade finance teams.

New products spearhead strategies with receivables discounting taking the lead

Almost two-thirds of respondents (65%) plan to pursue growth by entering new markets. New product lines are the most prominent in these growth strategies for the next 12 months (selected by 55% of respondents). More than a quarter (26%) plan to enter new geographical markets and a fifth (20%) are looking to finance new industries.

If we look at the products respondents feel have the greatest growth potential in the coming year, we can see they are receivables discounting (selected by 28% of respondents) and payables finance (21% of respondents). This is a switch from the predictions they made in our last benchmark report, when at the start of 2023, more respondents gave priority to payables. The changeover reflects a lower appetite for risk, since receivables are a form of secure lending and involve more than one counterparty.

Product development initiatives

We can also see how banks are becoming more sophisticated in product development. Survey responses show they plan to launch inventory finance, asset-backed finance and dynamic discounting, combined receivables finance and securitisation solutions, and new capabilities in reverse factoring. The common denominator among new products such as inventory finance and asset-backed finance is they indicate conservatism about risk.

Nevertheless, our own experience of the market at Demica tells us banks are investing in the technology they need for product development.

In this survey, 61% of banks in Europe say they plan to change their technology within five years, which is an encouraging sign, and builds on progress evident last year.

Platform investment

For banks to offer tailored products effectively
For banks to offer tailored products effectively
requires the right technology so they can automate the complex and time-intensive processes involved in setting up, operating and monitoring funding programmes. Remember, a receivables finance programme may involve millions of items.

Technology helps banks avoid costly mistakes – purchasing the wrong assets or failing to make insurance claims, for example. A purpose-built platform gives banks flexibility in supply chain financing without adding to risk. And, with the European trade finance market so mature, banks must focus more intensely on operational efficiency and risk-reduction. In this environment, technology becomes a differentiator.

Technology is also how banks increase activity in distribution of programmes. Banks can share risk and avoid full exposure to a programme, picking up margin as an agent. Staying with a manual approach in such a competitive marketplace can place banks at a disadvantage. Technology enables banks to manage investor and corporate credit limits more effectively, thereby enabling an uninterrupted supply of credit to meet the requirements of the physical supply chain.

North America

Andrew Holmes

Head of Origination, Americas

> "The truth is that the emergence of near-shoring means we will not move back to pre-pandemic conditions"

Troubled waters for banks

After the high inflation and supply chain disruptions of the previous two years, trade flows in 2023 moved back towards something a little like just-in-time normality. The survey results show North America was actually a little behind other regions in this shift, especially APAC. The truth is that the emergence of near-shoring means we will not move back to pre-pandemic conditions.

Around the globe in 2023, 70% of banks in this survey enjoyed growth in assets. But in North America, as trade flows normalised, growth slowed and only 56% of banks said their supply chain finance assets had grown. Compare this with last year's report (covering 2022) when 75% of respondents from banks in the region reported an increase in asset size.

Slower growth came in a year when North America faced specific challenges. On the demand side, the physical economy worked through the spike in inventory from 2021/2022. This was especially evident in the precipitous drop in trucking volumes in North America. For example, fourth quarter shipment volume in the US was down 16% year-on-year, the largest drop in the US Bank Freight Payment Index's history. Consumers were spending on experiences more than goods. Outlook in the North American freight market was sombre with more positive news only expected in Q2 of 2024, according to the Freight Sentiment Indexes.

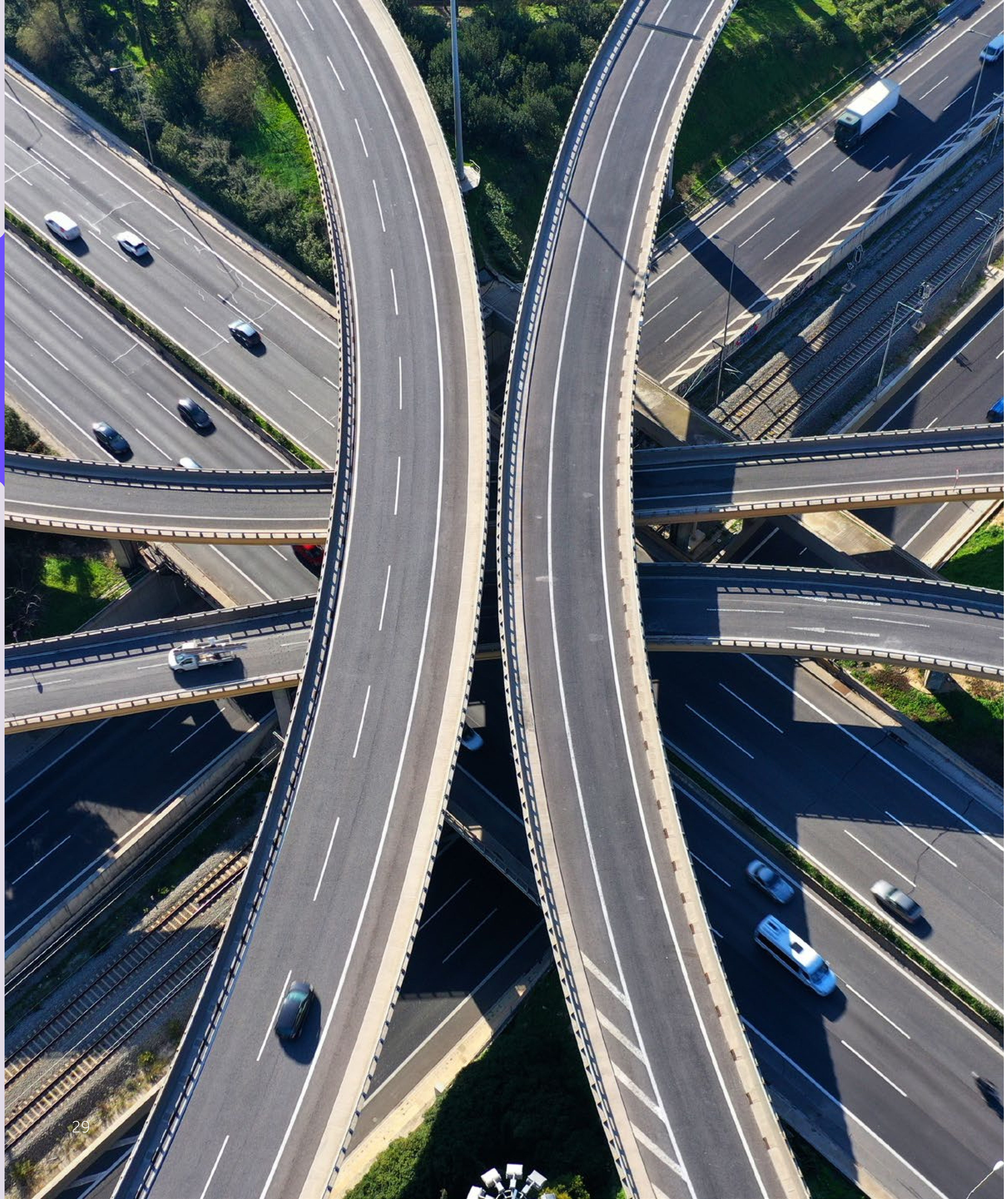
North America in a snapshot:

- 44% of teams grew headcount in 2023 and interestingly, only 3% were anticipating the layoffs that materialised this year (2024)
- 51% of respondents are looking at new products from across the range of inventory finance, embedded finance and vanilla receivables
- 28% of teams said payables financing had the highest growth potential within their organisation, which differs from last year's benchmark report when inventory finance was viewed as the shining star
- 67% of teams are working in the office three-to-four days a week with just 8% fully office-based
- After their home market in North America, more teams regard Europe as the key region (56%) than any other around the world

On the supply side, regional banks curtailed their appetites following the collapse of Silicon Valley Bank, impacting direct origination but also the distribution market for the larger money centre banks, which control the bulk of origination in North America.

Rising interest rates continue to dominate the media cycle in the US, with the market gyrating with every release of new Fed data. The Fed took rates to 5.25%-to-5.50% in July 2023, which is where they remained for the rest of the year. In the survey, 57% of respondents said rising interest rates had a negative impact on asset growth even though we did not see the economy slow down greatly.

Surprisingly, this was even higher than the percentage citing economic uncertainty and geopolitical risk (both 44%) as a drag on asset growth.



While banks' asset growth was subdued in 2023, the private credit firms continued to accelerate their expansion into trade finance.

Growth for new market entrants

Private credit growth has been widely documented in the past few years, to the point that the press is now speculating about a bubble. In trade finance, the private credit market has allowed products such as receivables finance to build penetration in the mid-market.

Several private credit vehicles with a mandate to fund trade finance transactions went from zero to several billion dollars of funded assets in 2022-23. These funds work with sponsor firms' portfolio companies to complement or replace existing facilities with receivables purchase products. They are quick to close and able to deal with distressed companies more nimbly than the banks securitisation desks.

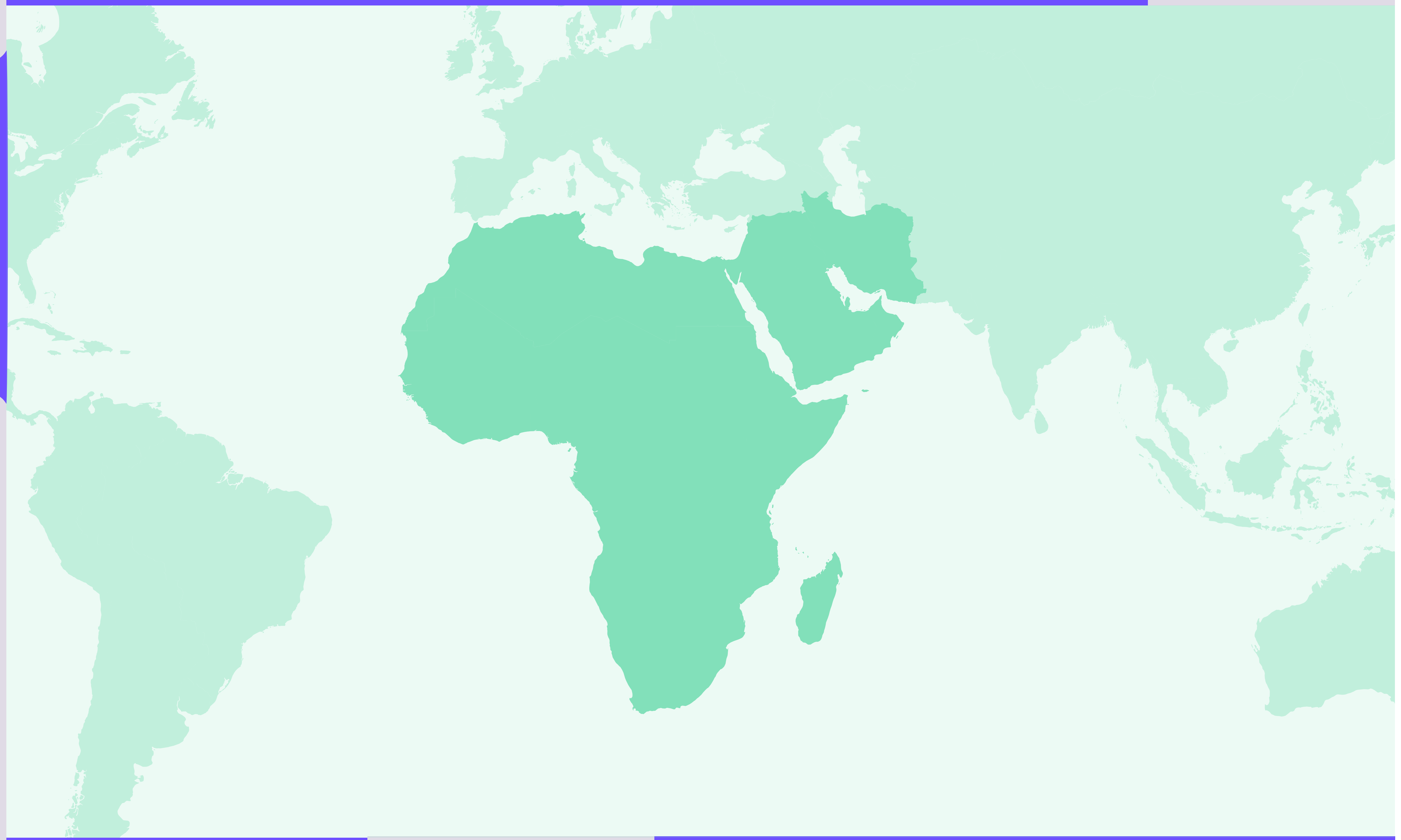
Embedded finance received a good deal of hype over the past few years, but in 2023 we saw a lot of anecdotal growth. While it is difficult to quantify the growth in a market with no standard metrics or products, we observed a number of large transactions and our funding partners said the same. Many fintechs that originally funded their books via warehouse funding lines are turning to the trade receivables securitisation market for a low-cost option that allows them to deconsolidate their funding portfolio from their balance sheet.

The slow march to technological improvements

Many banks continue to struggle with outdated technology, with 45% of survey respondents having implemented their trade platform 10 years ago or more. This seems to be a lot.

While Demica understands as well as anyone that the process of change within a bank is a long one, we were encouraged to see that 62% of respondents in North America would like to replace their trade finance platform within one-to-five years. Our clients tell us that customers are demanding a smooth experience on the technology side, and there is less tolerance for human error and laborious processes. With 50% of North American respondents talking about plans to roll out new products, the role of technology will continue to grow.

MEA



Carlos Grassl

Director, Platform Solutions

"Partnerships and collaborations are pushing forward the opportunities to provide access to working capital finance to a broader swathe of the continent's businesses"

In 2023, the global economy displayed remarkable resilience despite facing challenges such as the delayed effects of widespread interest rate hikes, persistent high inflation, and geopolitical tensions, which are expected to limit growth in 2024. Businesses are navigating an environment characterised by increased economic fragmentation, supply chain reconfigurations, rapid digital transformations, and the evolving implications of climate change and related policies.

The Middle East and North Africa (MENA) region has emerged as a focal point in global trade dynamics, propelled further by recent geopolitical shifts. With the inclusion of new members in the BRICS alliance in January 2024 and initiatives by regional powerhouses like the UAE and Saudi Arabia to diversify their economies beyond oil through developments in services, smart cities, spending on information and communication technology, the region is entering a new phase of socio-economic development aimed at deeper international cooperation.

These developments are pivotal in empowering local exporters to enhance their global competitiveness, thereby boosting their contribution to domestic GDP and accelerating economic activities to the benefit of both exporters and their buyers. The ongoing conflict in the Middle East raises questions about the severity of its impact on regional trade, underscoring the complex interplay between geopolitics and trade in the region.

The MENA region's expansive public sector infrastructure demands are driving substantial procurement activities, thus stimulating supply chains and financing needs. In response, various government initiatives and collaborations have introduced new supply chain finance mechanisms for government suppliers, aimed at providing more liquidity sources. Additionally, the region is adapting to transformative shifts in global trade by recalibrating supply chain strategies, establishing itself as a strategic hub to leverage trade opportunities across Asia, Africa, and Europe, and embracing sustainable supply chain practices to meet Environmental, Social, and Governance (ESG) commitments more cost-effectively.

Asset and headcount growth

Asset growth remained strong in the Middle East and Africa throughout 2023, with 60% of the region's banks in the survey reporting increases of more than 10%. These banks anticipate that this trend will persist through 2024. On the other hand, only 8% of teams witnessed declines in asset levels.

Despite MEA's export of goods and services representing a modest c.7% share of global exports of goods and services, the region is repositioning strategically to boost its global trade presence via economic diversification, steadily changing its mix of exports as manufactured goods begin to replace oil exports. For banks, this will translate into a significant opportunity for asset growth. Putting things into perspective, the Middle East accounted for 0.3% of world factoring volume in 2022, according to the FCI, while Africa accounted for 1%.

In Africa, partnerships and collaborations are pushing forward the opportunities to provide access to working capital finance to a broader swathe of the continent's businesses. For example, the African Export-Import Bank

(Afreximbank) has partnered with Demica for a world-class supply chain finance platform to execute on the bank's strategic objective of reducing the trade finance gap in Africa, especially for the SME segment.

When it comes to where or how they will grow their supply chain finance activity, MEA banks are still focused on their own region – selected as a key region by 93% of banks. Only 14% regard developed markets such as Europe and North America as key regions. However, expansion into new territories is high on the agenda with more than 40% planning to move into new geographical markets. Many of these banks now have the resources to expand, where more than half of teams (57%) in the survey expanded their headcount in 2023 to meet demand. Open account trade has increased in the MEA region in line with the rest of the world, prompting banking institutions to increase their internal resources to meet demand for trade finance solutions. Most banks (86%) also expect their headcount to increase or stay the same in 2024, which is a sure sign of confidence. For three successive years we have seen more than half of participating banks increase their headcount.

New product lines planned

In another sign of the robust demand for supply chain finance solutions in the region, almost two-thirds (64%) of MEA banks in the survey plan new product lines. Over the recent years, the region has seen a wave of early adopters pioneering the deployment of supply chain finance products, often in partnership with fintechs, while "Day 2" adopters are now entering the market.

More of them see payables finance as having the highest potential for growth (42% of banks) than receivables discounting (25%). Africa has reported strongest growth globally in volume and funds in use for payables finance at 29% and 30%, respectively. Although there is a strong focus on payables, MEA teams still view receivables as the product with the second highest growth potential. Survey participants also claim to explore forms of embedded finance.

Interest rates – mixed views

Over half of all respondents (55%) considered asset growth to be held back by interest rates, reflecting a substantial increase on the 33% taking the same view last year for the MENA region.

Inflation in the Middle East was nearly 13% in 2023, and varied across the region – hitting 35% in Egypt, for example and less than 2.5% in Saudi Arabia. Across Africa inflation was c.21% (and is projected to run to more than 14% in 2024).

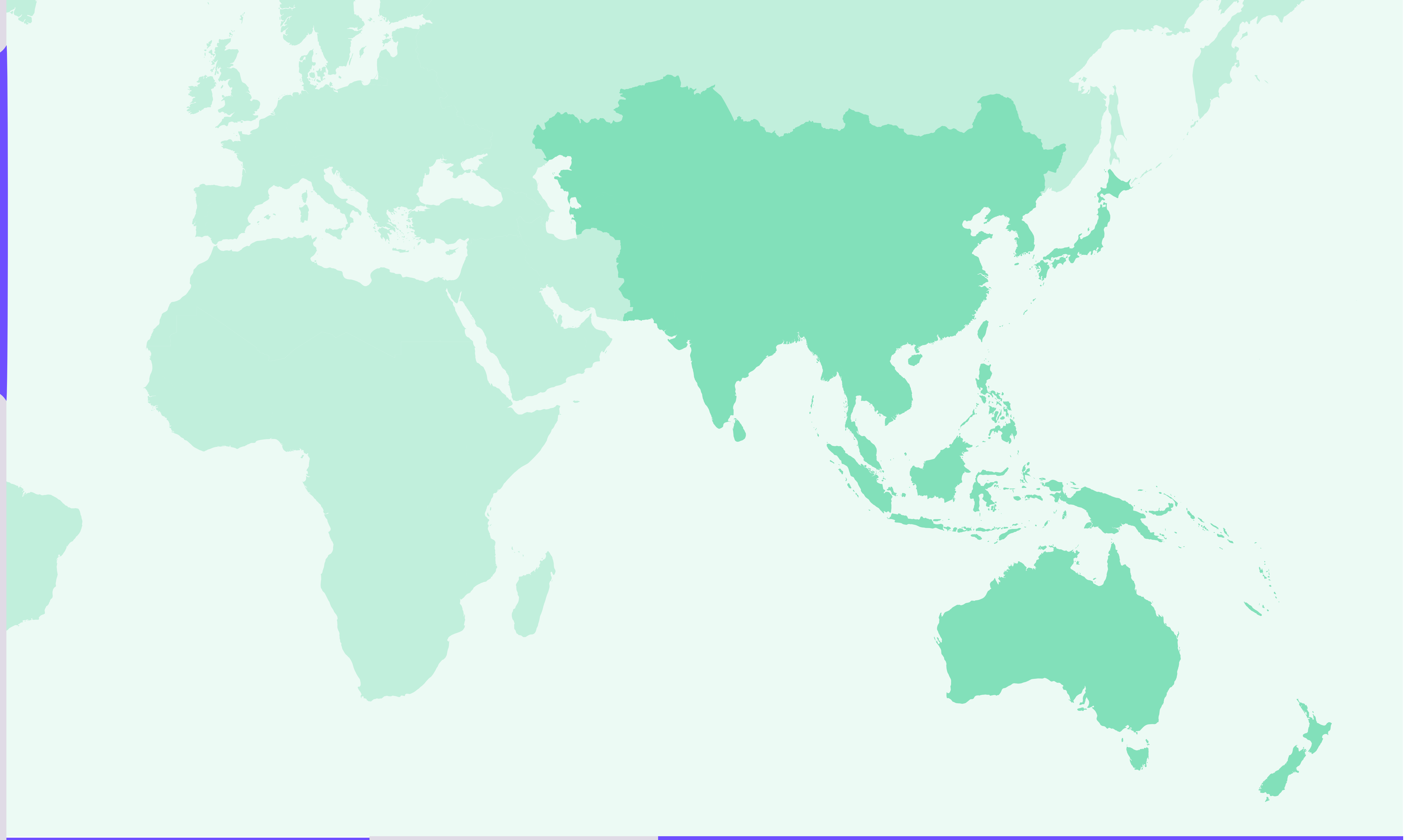
Despite high levels of inflation experienced across the region, more than 80% of MEA banks in this survey do not see inflation as the main driver behind the asset growth in 2023. This is in contrast with an even split on the subject in last year's survey.

Back to the office

Finally, we can see that fully remote working practices have come to an end in the region and hybrid policies have been adapted to include more office days. Half of all teams are now wholly office-based and 43% are spending between three and four days in the office.

This year we are including all Africa with the Middle East in our regional reporting (MEA), whereas last year we only included North Africa (MENA) so direct comparisons need to be qualified.

APAC



Guillermo Egoavil Cisneros

Head of Product Discovery

"The potential of APAC has caught the eye of many banks around the world"

The main APAC trend in this year's data is one of growth. There was a high level of agreement on this topic – 85% of APAC banks in this survey saw supply chain finance assets grow in 2023, with more than a quarter growing by more than 10%. This was better than the global average of 70% experiencing an increase in asset sizes.

No bank from APAC reported a decrease in values. And what is striking is that all respondents (100%) expect the growth to continue into 2024 – which again is much higher than the global average in this survey data (81%).

Almost all our respondents from the APAC region are product managers (90%) with the remainder in specialised sales, giving us the views of people who have technical knowledge. Their outlook is in broad alignment with analysts' views about the continuing expansion of supply chain finance globally. Research and Markets, for example, is projecting global supply chain finance growth of more than 9% CAGR to 2027.

It's not just within APAC that there is optimism about growth. The potential of APAC has caught the eye of many banks around the world. Among respondents from other regions, 31% expect APAC to be a key region over the coming year, compared with 24% in our last report. The upward trajectory foreseen by our respondents is in line with the continuing economic resurgence of the APAC region. As noted by S&P Global Market Intelligence, economic growth in APAC strengthened in 2023 reaching an estimated 4.5% year-on-year. The final ending of COVID restrictions in China and rapid economic expansion in India were important factors. The IMF estimates APAC will have contributed two-thirds of global growth in 2023.

Politics, inflation and interest rates

The feeling among 85% of our APAC respondents was that supply chain finance asset growth would have been higher had geopolitical risk factors not come into play from Eastern Europe, the Middle East and from friction over the status of Taiwan.

The great majority of respondents (86%) viewed inflation and increased interest rates as either neutral or negative in their impact on asset growth over the course of 2023. This matches views expressed in the Asian Development Bank's 2023 Trade Finance Gaps survey, in which 64% of banks said tighter credit, due to higher interest rates, remains a barrier to servicing trade finance. And yet within this same ADB survey, 76% of banks said demand for supply chain finance will increase over the next two years.

Team growth

The fact three-quarters (75%) of respondents in this survey said their teams grew or remained the same is another sign of growth. The data also shows most organisations will continue with the budgets they have or benefit from increases. The cautious optimism looks set to continue – none of our respondents expects to see a decrease in headcount over 2024, which is a difference from last year when 15% expected to see numbers drop. Hybrid working continues but three-quarters of respondents are back in the office a minimum of three days per week, including 25% that are fully office-based.

Expansion

In terms of business development, APAC banks are ambitious. Three-quarters (75%) of respondents from APAC banks say their institution will move into new markets – geographically or by industry. Half (50%) are planning to launch a new product, with much diversity on display. The range of products covers inventory finance, distributor finance, and early payment programmes. Geographical expansion, however, is concentrated within APAC, since only a quarter of APAC banks said they view one of the other global regions as a key market.

Risk distribution

Distribution of risk in supply chain finance remains low in APAC. Only 29% of respondents said their bank was distributing more than a fifth of their receivables and payables finance book. And less than 15% of participants were sourcing a fifth or more of their assets from participation in other funders' risk distribution programmes. This is significantly lower than the global picture, in which 40% of respondents said their bank sources at least 20% of assets from such programmes.

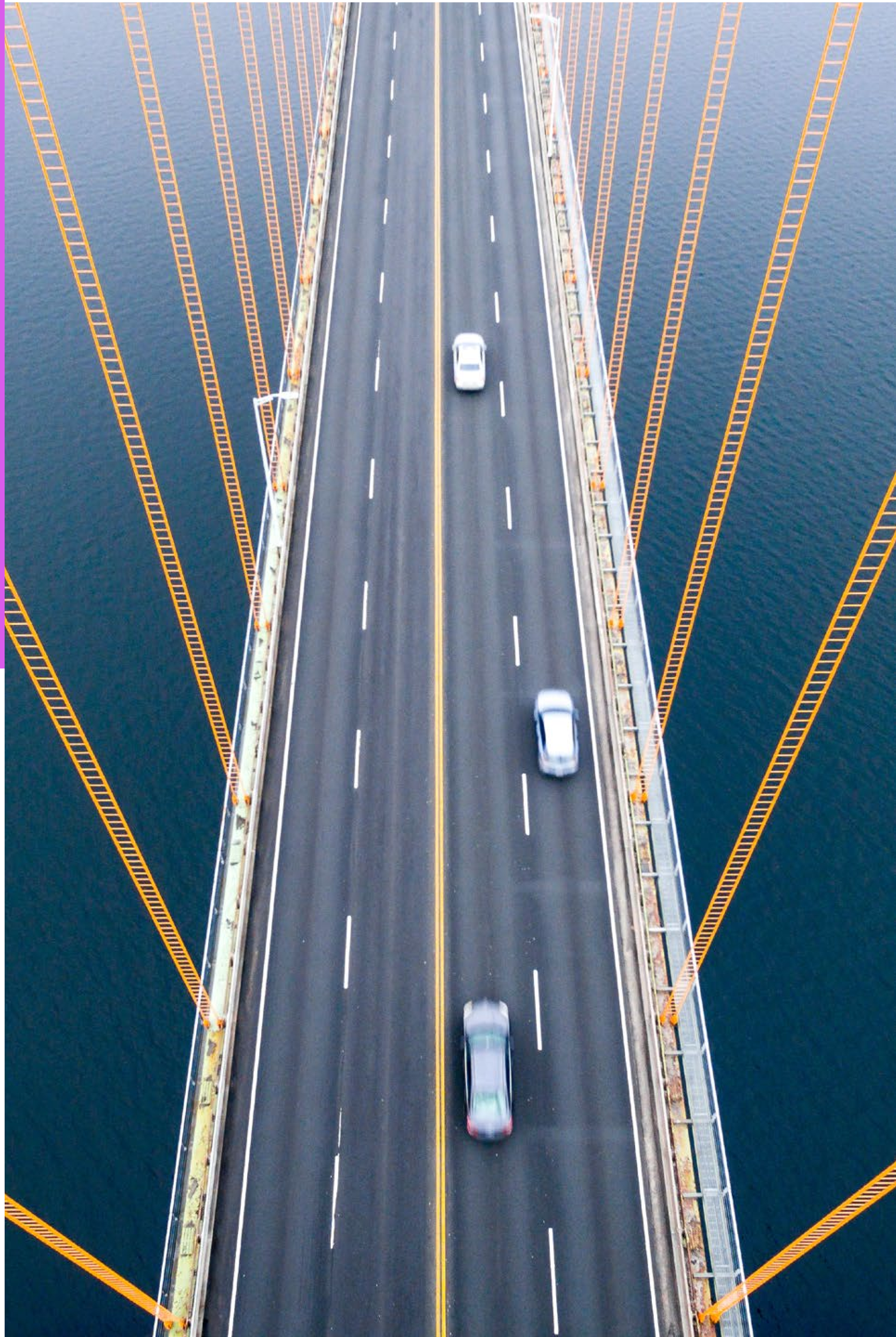
Technology

APAC banks have the advantage of using comparatively new technology. More than 80% of respondents said their supply chain finance platforms were implemented within the last five years, compared with the average of 43% in this survey.

Having newer platforms makes it less surprising that less than half of the banks participating expect to replace them within five years. The good news is that around a third of participants saw increases in their technology budgets through 2023, and for half of the remainder they were flat. A third of participants expect their budgets to decrease, however.

Technology matters in this region. In the ADB report cited above, banks pointed to technological advances in automation and digitalisation as among the most significant factors behind the anticipated increase in supply and demand for trade finance.

03 Products



Ajinkya Bhave

Head of Product Delivery

"Banks do not always understand the challenges faced by suppliers, many of whom have little or no exposure to payables financing and are unlikely to understand it without guidance"

Disclosure rules begin to impact payables finance

What stands out this year is more banks believe changes to accounting disclosure rules will affect their payables finance programmes. From 4% last year, the figure has climbed to 15%. This may not sound much, but it is a significant change.

Last year's low figure was surprising, given the administrative consequences of these new rules. The increase is likely to be a welcome sign that more people in supply chain finance are paying full attention to the changes. If they fail to, the rules could pose a significant challenge to the expansion of payables.

- **The new requirements** came into force in January (2024) and were issued in May 2023 by the IASB (International Accounting Standards Board). In the US, the FASB issued updates in September 2022, requiring disclosure of supply chain finance terms and obligations in quarterly and annual reports.
- **The IASB rules** require the presentation of aggregated information about terms and conditions, liabilities, range of payment due dates and more. The challenge of gathering all the information can seem daunting for the entities involved. Funders must disclose how much is outstanding in terms of the payables, and how much is discounted. They will need slick reporting tools so they can provide the data in a timely fashion for the corporates to share with their auditors. Funders will have to give their corporate clients information annually on the number of assets funded or current outstanding assets.

Compared with last year, significantly more respondents believe demand has stayed the same despite or because of the new rules – 67%, compared with 53%. However, optimism is less common. There are far fewer believing the new rules have increased demand. This is now 6%, down from 21% in last year's report. Indeed, 27% this year believe the disclosure rules have depressed demand for payables finance products which is little changed on the prior year. It seems fewer banks feel the increased transparency resulting from the rule changes has been a plus for payables so far.

Have the new accounting disclosure rules changed the nature of the payables finance product you offer to your clients?

97% No

2% Yes

Other challenges

More broadly, the survey results this year show the top three challenges for payables teams remain the same as last year:

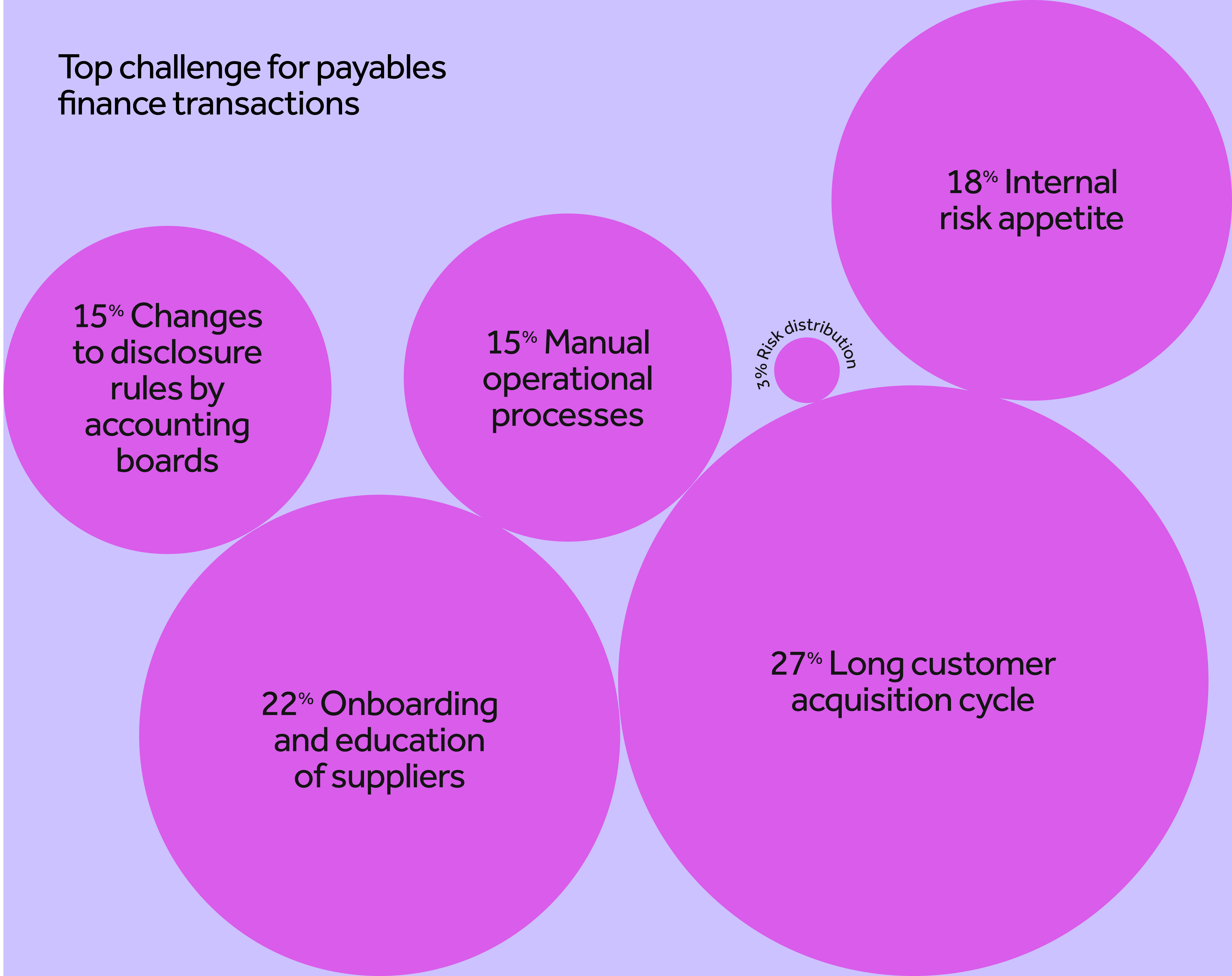
1. Long customer acquisition cycles – 27% this year compared with 22% in 2023
2. Onboarding and education of suppliers – 22% this year compared with 20% in 2023
3. Internal risk appetite – 18% this year compared with 20% in 2023

The percentage citing long acquisition cycles has increased, which is not entirely surprising. Long acquisition cycles are a well-established, if unwelcome, feature of many payables programmes.

Technology

Technology is often, but not always, a barrier to the start of the cycle – especially in relation to integration. When a funder offers a payable finance product, the corporate buyers must achieve integration with their ERP systems so they can extract the relevant data for placement on the funder's platform to enable discounting by suppliers. Depending on the type of ERP system, this integration can take a long time. Banks need a platform with easy integration capabilities.

Top challenge for payables finance transactions



Onboarding

Onboarding is the second hurdle. This remains a challenge to the expansion of payables financing because if suppliers fail to sign up to a platform, then early payment cannot take place – it is as simple as that. Despite payables finance having been in use for more than 20 years, wider understanding of its benefits is still lacking.

The data suggests banks do not always understand the challenges faced by suppliers, many of whom have little or no exposure to payables financing and are unlikely to understand it without guidance. Better use of onboarding tools with automation is called for accompanied by an explanation of the benefits – including acceleration of payments through faster processing on a platform that eliminates the time-wasting use of emails for the transfer of KYC documents and statements.

Orchestrating payables

Payables have many components which must come together harmoniously like the instruments of an orchestra. If they are orchestrated effectively on the right platform that can interoperate with ERP and other systems, the effect is to transform the uptake of payables finance, shortening the acquisition cycle. This in turn changes the relationships between companies and their suppliers, creating valuable dialogue that delivers long-term benefits.

How changes to disclosure rules by accounting boards have impacted demand for payables finance products

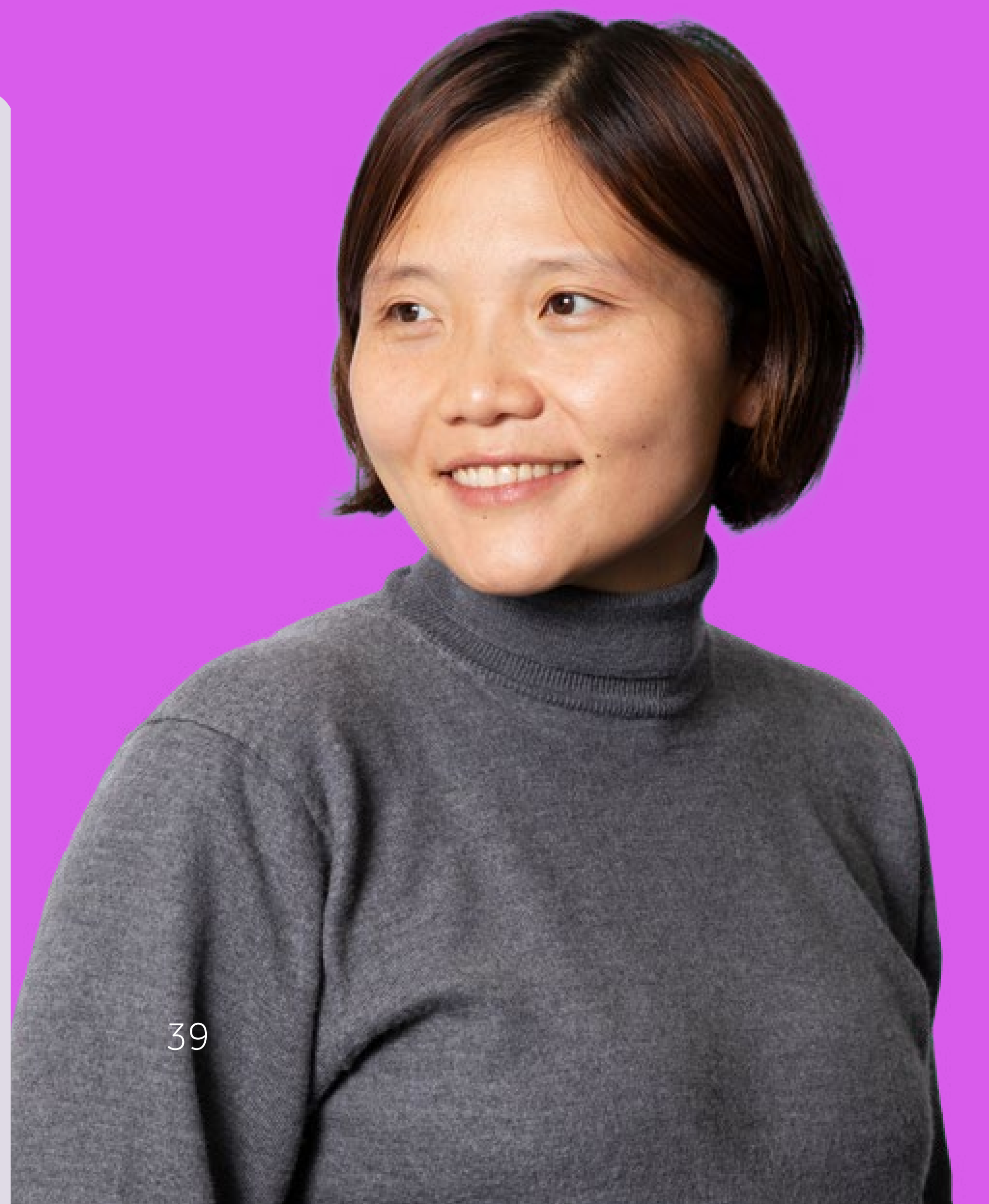
67%
No change

27%
Decreased demand

6% Increased demand

Jiameng Yu

VP of Product



Trade receivables

If we're looking for signs that globalisation is still very much alive, we can see them in this year's survey results.

When trade receivables teams were asked for their top challenge, expansion of the addressable market was most commonly cited (selected by 38% overall). Last year expansion was also most frequently cited as a challenge, but with a significantly lower percentage (27%).

This is an encouraging sign that the momentum of globalisation predicted in 2023 is continuing. Few people will have expected a repeat of 2022's global growth of more than 18% (according to the FCI 2023 annual report) but if globalisation was expiring, then banks would not think it worth their while seeking expansion.

The figures for the regions are:

- North America – 45%
- Europe – 27%
- APAC – 67%
- MEA – 50%

The exception among the regions is Europe where, alongside expansion of the addressable market, the same percentage (27%) also cited keeping pace with new products on the market as their top challenge. This is likely to be a sign of the maturity of trade receivables financing in Europe and North America. In Europe, trade receivables teams could also have their eyes on new products or other innovative initiatives, given the level of uptake already achieved, and the current climate of higher interest rates and stubborn inflation in lacklustre economies.

The growth potential in the less mature markets of APAC and MEA, however, is immense, and banks in these regions may have ambitions to extend their receivables financing products further down the supply chain. On the other hand, they may believe expansion is their chief challenge because of more intense competition.

Other factors that come into play to create regional differences are the macro-economic questions of political and economic stability. Currency risk, the nature of the prevailing regulatory and legal frameworks and the availability and credibility of information are also important factors, along with language barriers.

Last year the next two most common challenges after expansion were monitoring-and-reporting (17%), followed by mitigating operational risk (15%). This year operational risk-mitigation has moved up into second place, cited by 21% of respondents.

Monitoring-and-reporting requirements are the downstream consequences of receivables transactions. Since transactions can involve hundreds of thousands of items, the data volumes are very high and extremely difficult to master without automation and analytics tools. Banks need to integrate platform technology to meet these requirements and to enable themselves to scale. Growing the market is likely to remain a severe challenge for banks without the advanced automation and reporting capabilities that a leading fintech can provide.

Risk-mitigation

It's here that we can see regional divergence. Whereas operational risk-mitigation is second in the US, at 30%, it barely features in APAC or MEA and is a top challenge for only 20% in Europe. Perhaps we should view the data in a different way.

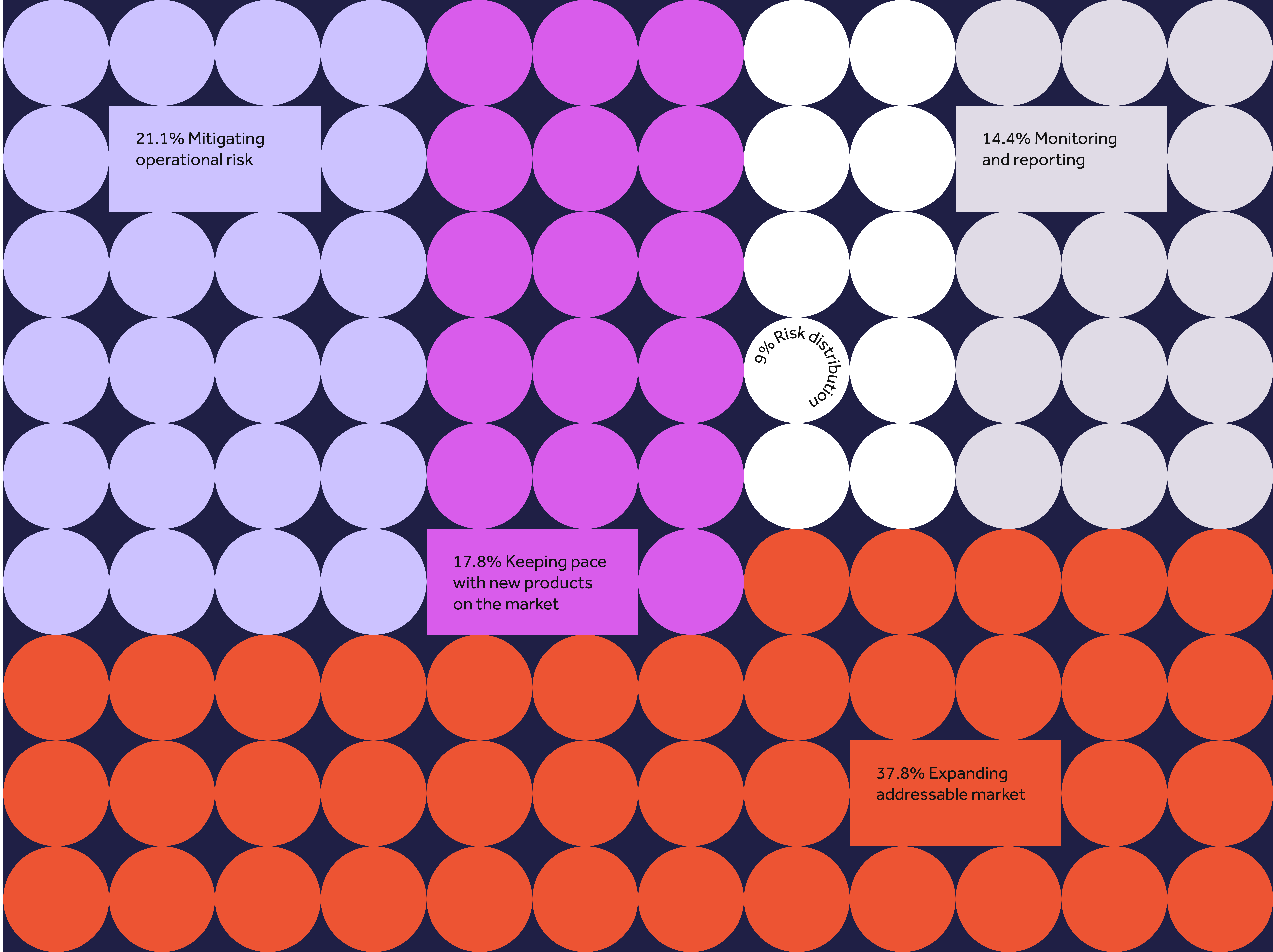
Since mitigating operational risk and monitoring-and-reporting are both aspects of the execution and ongoing maintenance of receivables transactions, it is useful to combine these two figures. This tells us that more teams in Europe (36%) are concerned about these aspects of current transactions than other matters on the trade receivables dashboard. The automated collection of data has significant impact here in reducing the burdens on receivables teams in terms of time and resources. Demica's ready-to-use analytics tools streamline the continuing risk management of programmes with easy-to-use monitoring of important metrics including ineligibility, ageing and dilution.

Risk-distribution and Basel IV

It is surprising, however, that risk-distribution remains absent from the list of the three most commonly cited challenges, falling from 14% last year to 9% this year. Surprising because Basel IV banking requirements came into force in January last year, giving banks more reasons to distribute the risk of assets rather than buy-and-hold. Yet this is consistent with answers to another question in this year's survey about the percentage of receivables and approved payables that banks' teams have distributed. This showed 73% of respondents had distributed no more than 20% of these assets in 2023.

What is the top challenge for receivables teams?

Nevertheless, Basel IV is set to change the profile of almost all trade finance products including receivables. Downstream operational difficulties are likely to affect teams implementing receivables finance products, so this is an area where we would expect the percentages facing challenges to increase. Being in a good position to handle and share the data will give receivables teams a definite advantage as Basel IV kicks in. Since a receivables transaction can cover thousands of items it is important for banks participating in redistribution to understand the assets and be capable of monitoring the components for serious and costly mistakes.



Eric Li

Head of Competitor Analytics - Banking Research at Coalition Greenwich

"Payables has historically been the most popular product, generally outperforming Receivables Finance, however, we may be seeing a change in the market"

Payables and Receivables Finance products are long-standing and integral solutions within trade finance.

Payables Finance has been a substantial and successful asset class for over a decade, and Receivables Discounting has been on the market even longer. Both have enjoyed tremendous growth in recent years versus other "traditional" documentary trade finance instruments.

Payables has historically been the most popular product, generally outperforming Receivables Finance, however, we may be seeing a change in the market. 2023 Coalition Greenwich data shows the years-long growth of both products slowing, and, for the first time, Payables Finance being outperformed by Receivables Discounting.

More generally, the utilisation of existing programs has come down, as have inventory levels, with the biggest drivers of this being the actions of Central Banks and macroeconomic conditions such as the pace and level of interest rates rising globally. This, coupled with the reduced liquidity in the USD market, which has restricted dollar access for non-USD denominated corporates, has made these financing programs less attractive. While demand for financing is generally lower, we also see a shift in funding from USD to local currencies.

Industry Revenue Trends

On the supply side, the one-off spread adjustments from LIBOR to SOFR continue to impact the banking industry, although these impacts have overall been well-contained. To address the rising funding cost concerns faced by corporates, financing providers have also explored embedded hedge options, though these measures have failed to gain enough traction to become the industry norm.

Over the past 12 months, regulation has also been a key topic. As most market participants predicted, changes to disclosure rules, by accounting boards, have not changed the industry landscape too much. Industry experts also noticed that the program penetration rate varies significantly by region. This should prompt providers to examine their footprint more closely and enter new markets where necessary. Once disclosure is fully synchronised, this will open up more opportunities for providers as rating agencies care not only about debt ratios, but also having a healthy number of financing providers.

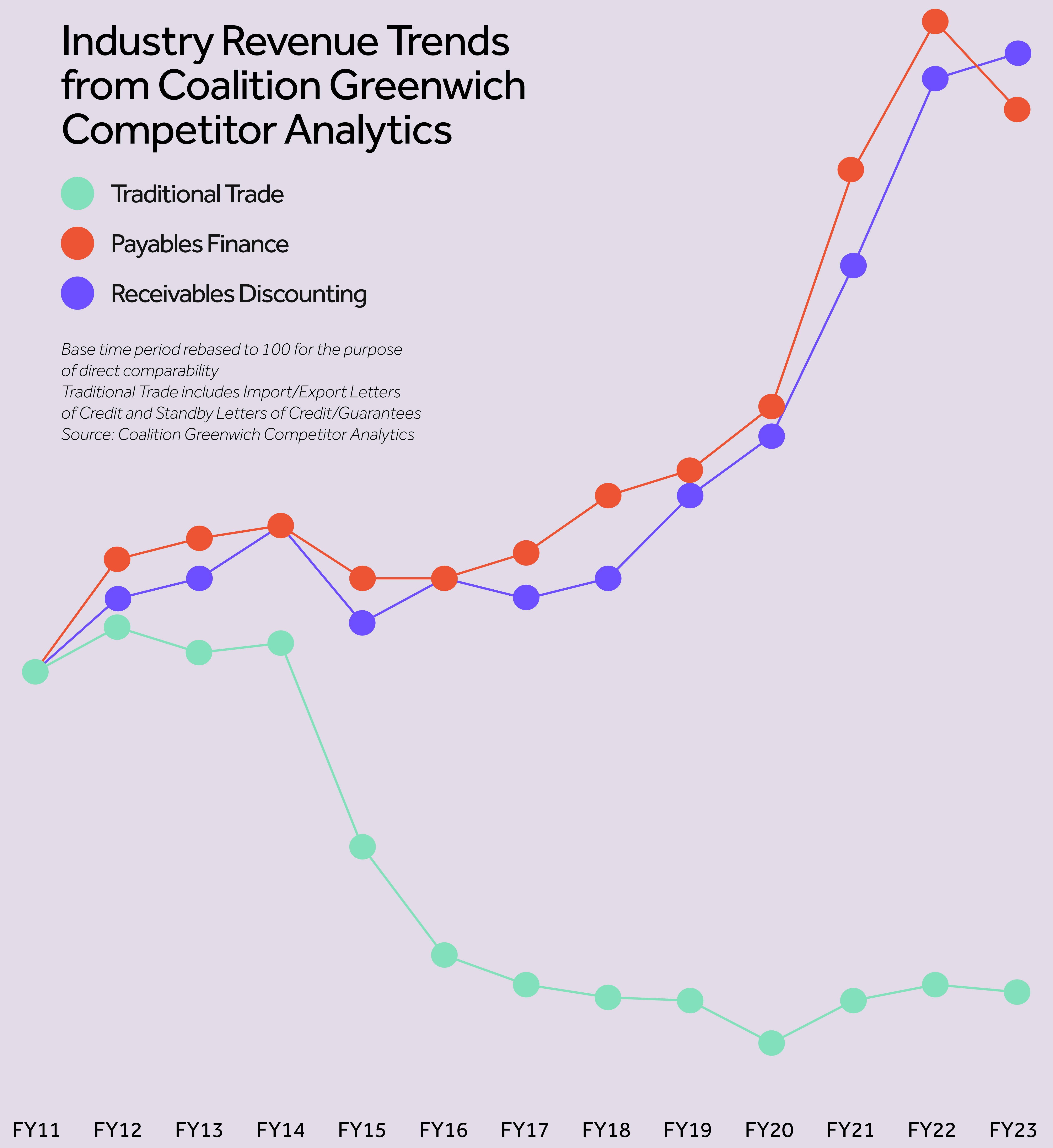
The Basel IV reforms are also looming over the industry. While we still lack final details in some jurisdictions, the general consensus is that this won't impact Payables Finance or Receivables Discounting as much as Traditional Trade products.

Looking ahead, what is in store for the industry?

Corporates are focusing on protecting their supply chains, particularly their smaller tail-end suppliers, during the high interest rate environment and the impact of geopolitical risks. This will continue to underpin industry growth, which we expect to be more profound in underpenetrated regions due to in creased adoption.

We also see liquidity improving steadily over the course of this year so far, which, coupled together with expected cuts to interest rates, would clearly be welcomed by the market.

Lastly, the new payment terms proposal by the European Commission will evidently lead to further debate. It is not the first time the industry is facing challenges and, as they have in the past, providers will certainly come up with more innovative program structures to continue to support their clients.



Markus Musielak

Managing Director, Working Capital Structuring

"More than half (53) of banks said the length of time it takes, and the resources required, are the most challenging aspects of setting up transactions."

"There is now greater diversification [in the market], with increased interest in inventory finance and asset-based lending"

Securitisation – challenges in execution and reporting

In this year's survey, respondents highlighted growing challenges around execution of transactions and the evolution of regulation and reporting requirements.

More than half (53%) of banks said the length of time it takes, and the resources required, are the most challenging aspects of setting up transactions. Half (50%) also said the length of time was the top challenge for their corporate clients.

The results reflect how the process of arranging and launching deals in securitisation involves multiple work streams which include:

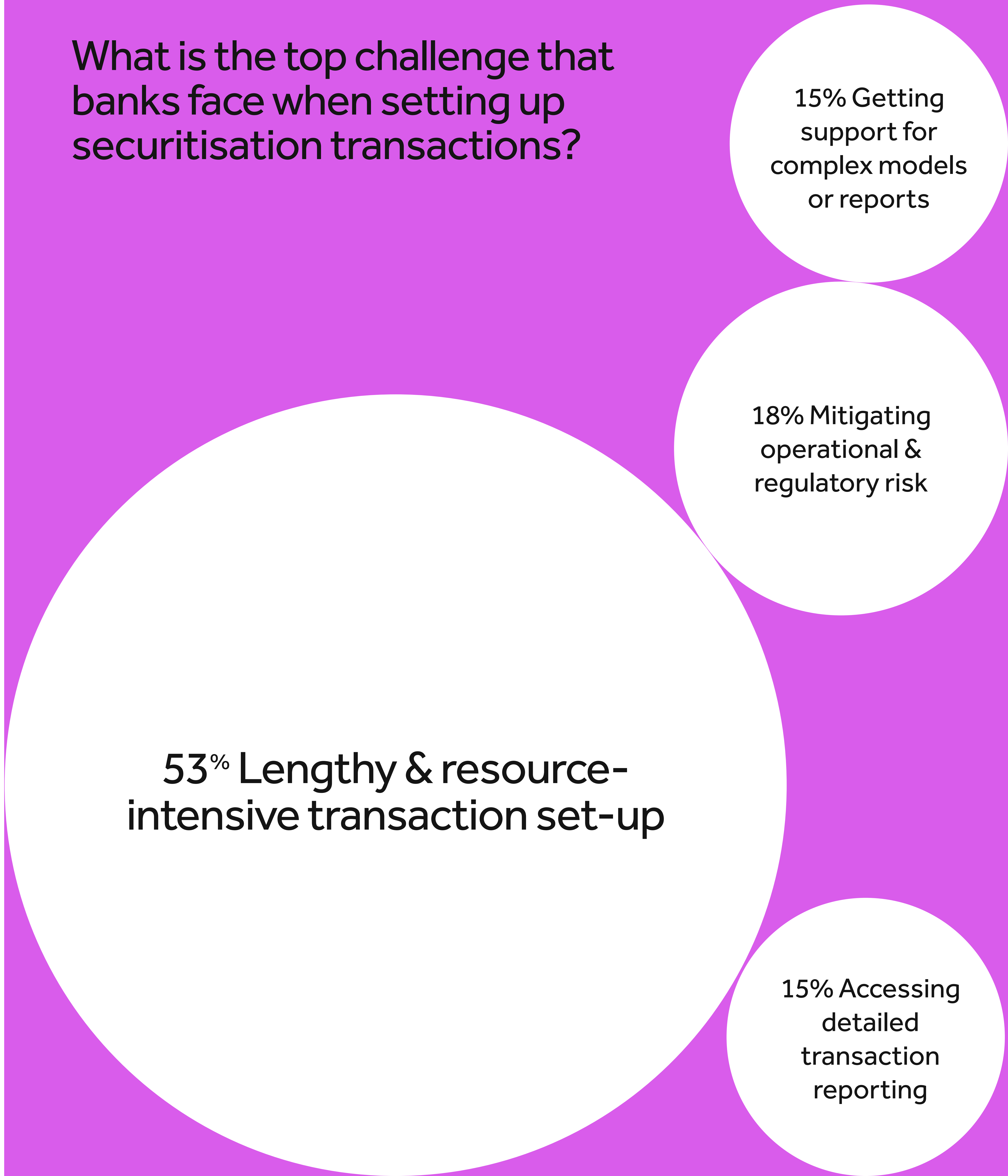
- Detailed analysis of data and structuring the deal to the required risk level
- Close collaboration with clients to align operational adjustments to create an efficient funding programme
- Sourcing and appointment of numerous qualified transaction parties
- Commercial and legal due diligence
- Drafting and negotiation of transaction and ancillary documents
- Setting up detailed reporting to support monitoring of programme performance

Almost 30% of respondents this year mentioned transactional reporting and complex models as the main challenges in transactions. The requirements banks and their clients face in this regard have certainly grown. The set-up of reporting is part of the execution process and can be time consuming. Once a transaction is live, periodic reporting becomes business-as-usual for the transaction. In addition, reporting is required under the regulations and guidelines of the European Securities and Markets Authority (ESMA) STS (simple, transparent and standardised), and SRT (significant risk transfer) strategies.

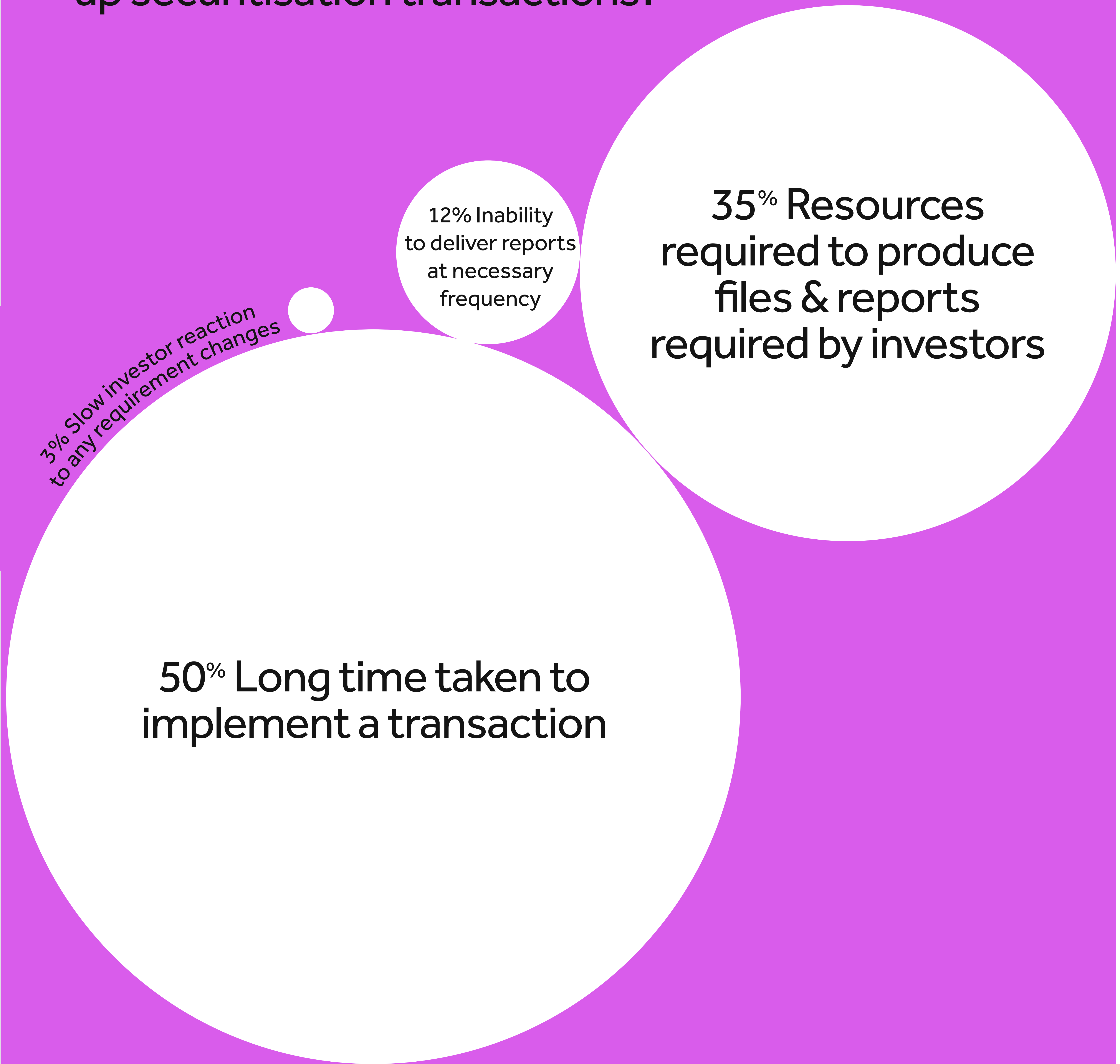
Reporting is complex and covers numerous elements integral to the transaction, including the performance of the revolving portfolio of assets (servicer report), the calculation of the transaction waterfall components as well as the ESMA regulatory requirements. Trade receivables are one of the main asset classes in private STS securitisations. STS verification enables investors to obtain preferential capital treatment on their securitisation exposure and makes transactions more attractive to investors.

To benefit from an STS classification requires the incorporation and verification of numerous simple, transparent and standardised elements into the transaction structure. Compliance is often confirmed by an additional, independent, third-party agent authorised by the regulator and appointed by the transaction parties. Ensuring compliance with the key principles of STS regulation and dealing with an additional transaction party for verification adds time to transaction preparation, execution and on-going operations.

What is the top challenge that banks face when setting up securitisation transactions?



What is the top challenge that your corporate clients face when setting up securitisation transactions?



Regulatory changes

The requirements set by ESMA and the securitisation regulations continue to evolve with a firm focus on simplification.

For instance, ESMA is consulting on proposals for the revision of the Disclosure Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS). The aim is to streamline the information required and simplify the reporting templates including the quarterly annexes. Arrangers and originators are waiting see what the impact of these changes will be, with the current lack of clarity putting additional pressure on teams to use technology in the securitisation reports more effectively.

Addressing the operational and regulatory risk of deals is also important, forming the top challenge for 18% of banks' securitisation teams. What all these responses tell us is that automation of data extraction and reporting processes is the most effective way to free up resources of corporates and investors.

The corporate aspect

Examination of the challenges facing corporate originators shows us they struggle to access the time and resources necessary for the set-up of transactions. More than eight-in-ten banks (85%) said these two areas are top challenges for their corporate clients.

Arrangers usually work closely with their corporate clients to structure transactions, however the provision of the necessary portfolio information is typically expected from the originator corporate.

Servicing structured finance transactions and creating smooth operations are resource-intensive processes for corporates that can require additional work streams. In the case of very large transactions, this sometimes requires extra, trained, personnel.

More than a third of respondents (35%) this year said corporate clients also struggle to produce the files and reports required by investors. Another 12% said corporates are unable to deliver reports at the necessary frequency.

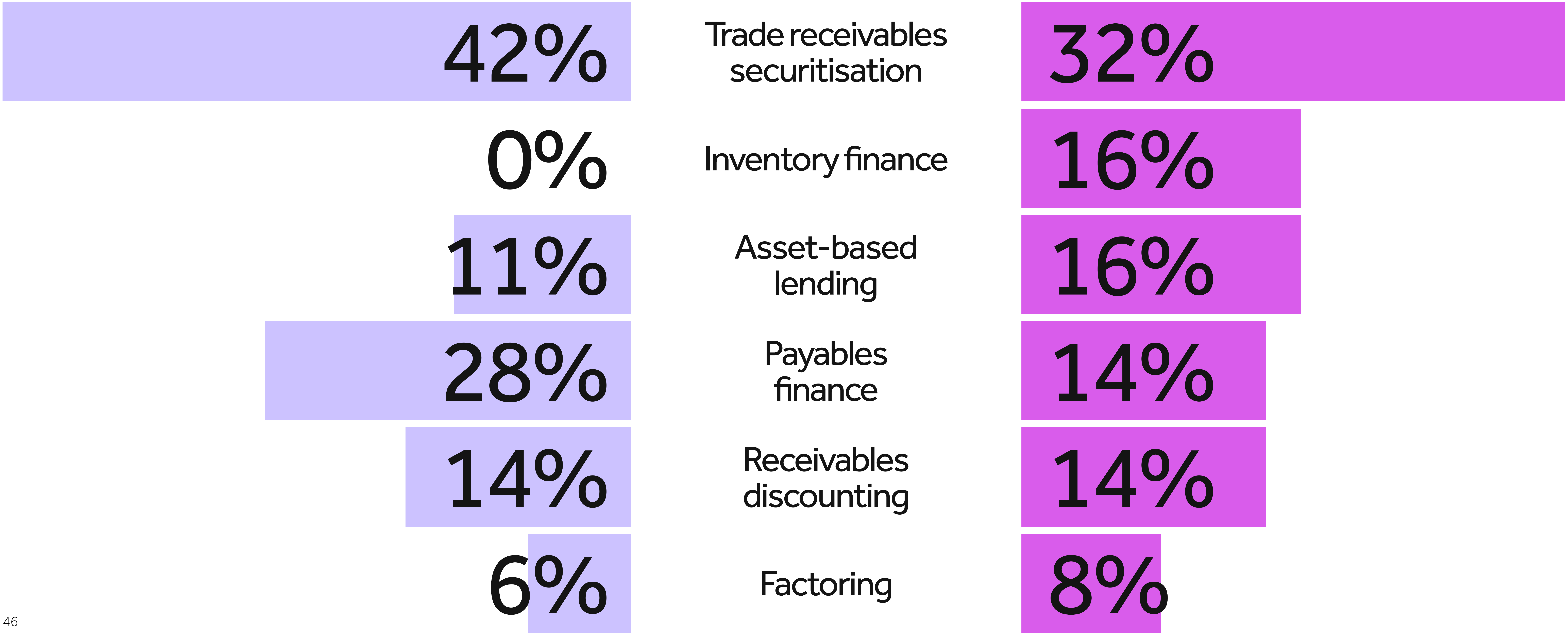
Extracting the data relating to receivables in a systematic way, particularly with high frequency revolving portfolios, presents real challenges for respondents. Additional performance views may be required in the transactions servicing report to meet corporate or other requirements that are outside the standard ESMA methodology.

This is also an area that technology addresses, enabling efficient reconfiguration of reports based on the underlying receivables data.

What products securitisation teams see as having highest growth potential within their organisation

Finally, we can see from this year's survey that trade receivables securitisation retains its top spot when securitisation teams were asked which product is likely to have greatest growth potential within their organisation. We can also see there is now greater diversification, with increased interest in inventory finance and asset-based lending. Product diversification indicates growing interest from end-borrowers and corporates in structured finance. This is again likely to create pressure on resources.

2023 2024



04 Technology & Security

"Many trade banks know they must update their technology to keep pace with changing demand, increase internal efficiency and support growth and product development"

Kishore Patel
CTO

David Scholefield
CISO

Technology & Infosec

Several technology trends are visible in this year's benchmark survey. Firstly, the effects of the slowdown in many economies constrained some banks' technology budgets, which in turn affected their investment in new solutions, platforms or upgrades.

Secondly, the constraints did not affect everyone. Some institutions are already prepared to replace what they installed within the last five years, whereas others are stuck with solutions that are a decade old or more.

And thirdly, we can see that investment in technology is now predominantly with third-party providers, rather than in-house developers. Banks have come to understand their own expertise is in areas other than software development.

Budgets

This year, the percentage of banks seeing increases in their technology budgets fell from 47% to 41%. Fewer banks' budgets stayed the same – 43% compared with 45%. And 16% of banks saw their technology budgets cut compared with 11% last year.

The expectations expressed in last year's survey were not entirely fulfilled. More than half of banks surveyed (51%) were predicting their technology budget to increase.

Yet there is still plenty of optimism, with 39% of our respondents saying they expect to see technology budget increases in 2024. We can assume the projects put on hold due to tight budgets in 2022 will receive additional allocations this year – a trend we have picked up on in our own conversations with banks.

How has your technology budget changed in the last 12 months?

16% Decrease

41% Increase

43% Stayed the same

How do you expect your technology budget to change in the next 12 months?

16% Decrease

39% Increase

45% Stay the same

Replacement cycles & reliance on ageing technology

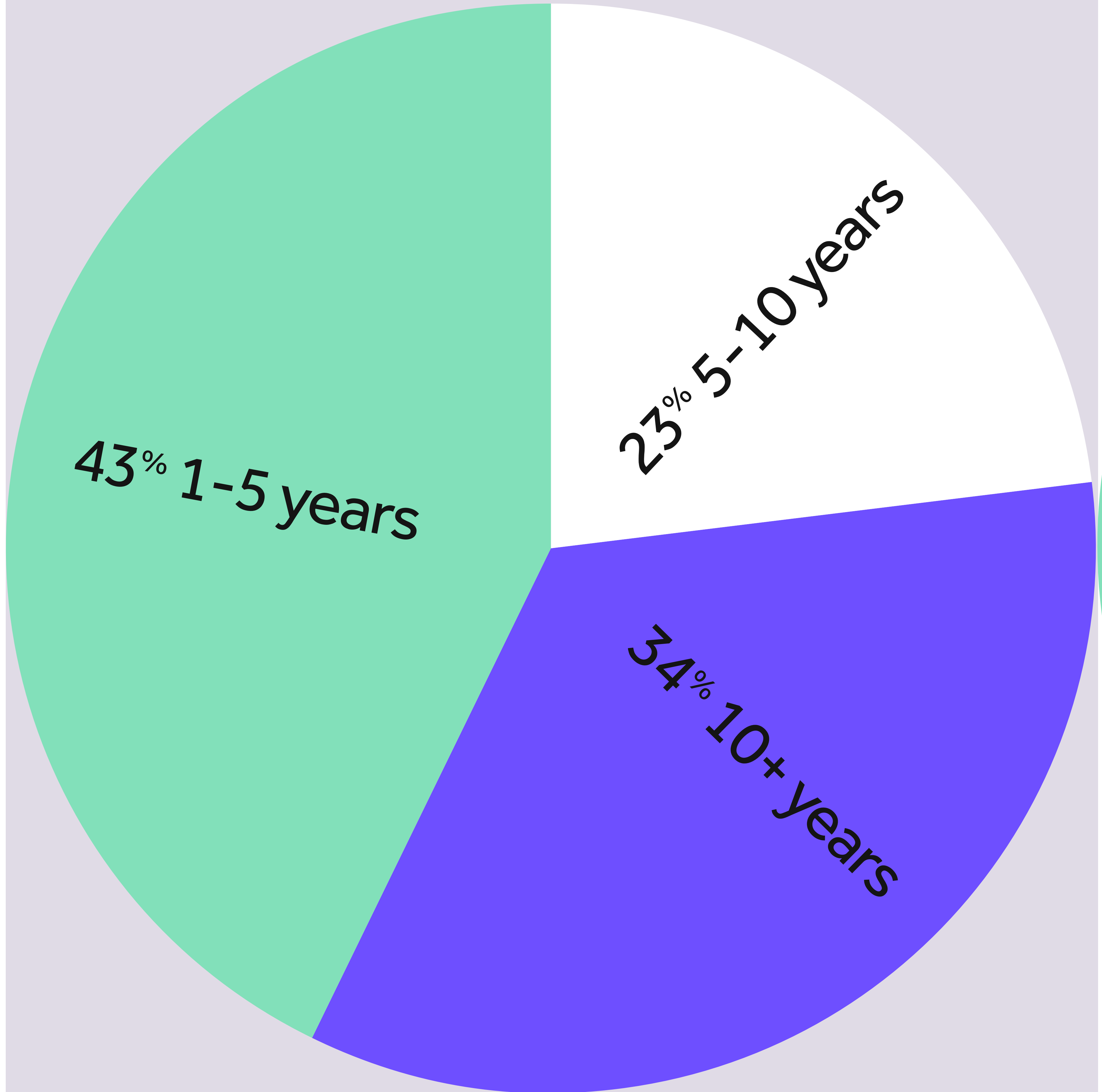
Banks aim to replace their existing platforms every five-to-10-years and in the survey 58% still have that ambition for 2024. In fact, this number is only slightly less than those who expressed the same intention last year.

On the other hand, a concerning number of banks are operating with platforms that are over 10 years old. This figure doubled from 17% last year to 34% this year – and is doubtless another effect of budget constraints, even if that does not account for the entirety of the increase.

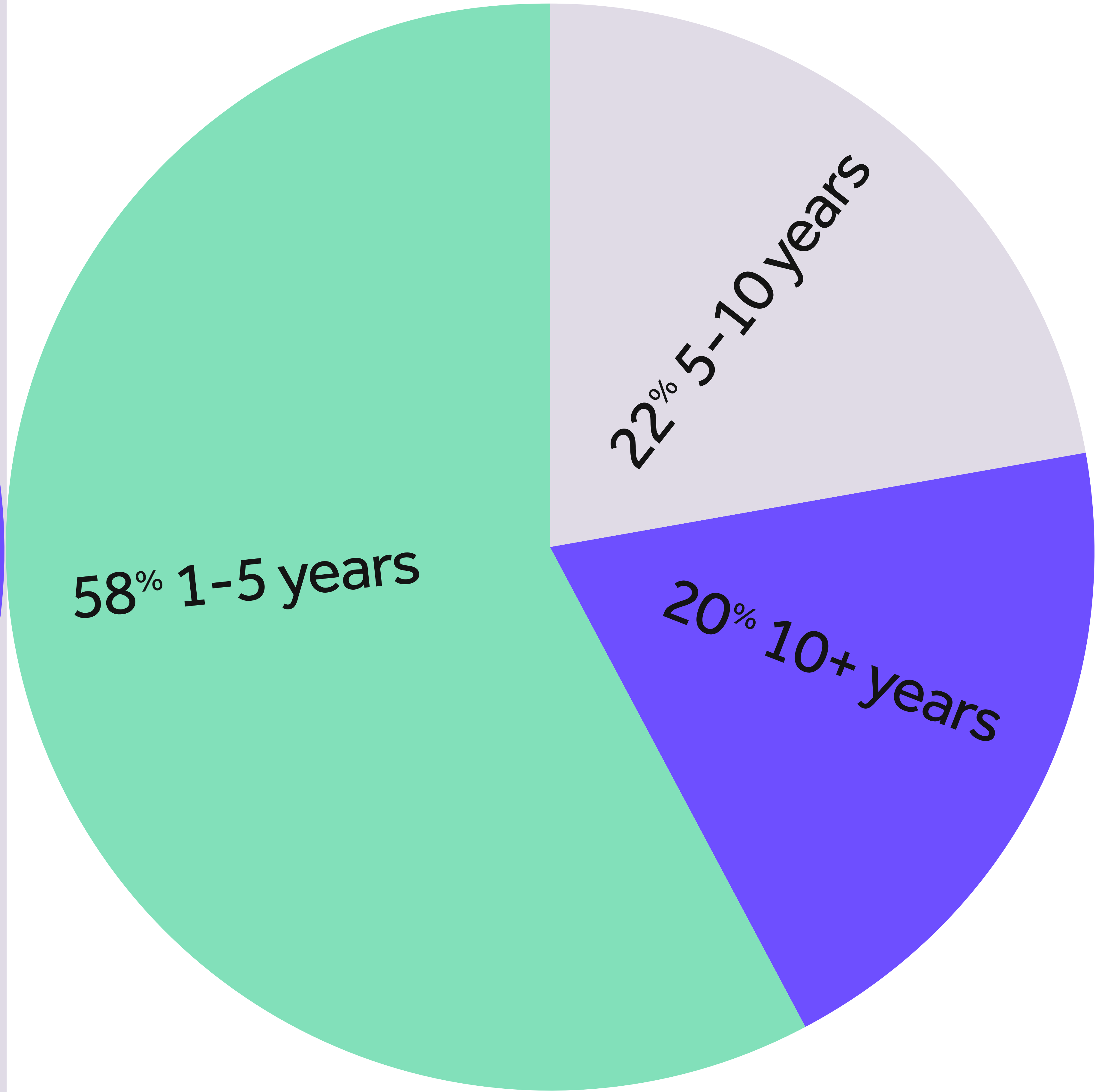
Many trade banks know they must update their technology to keep pace with changing demand, increase internal efficiency and support growth and product development. In the findings we can see banks that replaced their platforms in the last one-to-five years are predicting they will replace the platform within the next 10 years, highlighting the need for trade banks to remain current.

What is driving this is the need to reduce operational costs and to provide a more digital experience to their end-customers who want more self-service. This is why we are seeing platform-replacement projects executed under banks' digital transformation strategies.

How long ago did you implement your current trade finance technology platform?



When do you expect to replace your current trade finance technology platform?



Investment shifts to third-party technology

There has also been a clear shift in investment priorities towards third-party technology providers. Some 62% of respondents said this is now their investment priority, and only 38% say they are prioritising in-house development. Compare this with last year when it was a 50/50 split.

We believe this shows that technology teams are no longer questioning the decision to buy versus build. Technology budgets are limited and therefore banks' priorities are to focus on their core systems. If a third-party provider can deliver what is often a superior product without impacting a bank's technology budget, then it allows the business to deliver solutions customers want.

The focus must be on serving changing customer needs. Banks, after all are not software houses. Third-party providers are usually technology vendors with the expertise and resources to develop, adapt and maintain the platform. We know integration with legacy systems can be complex and so in-house development is more centred on this area and the improvement of middleware.

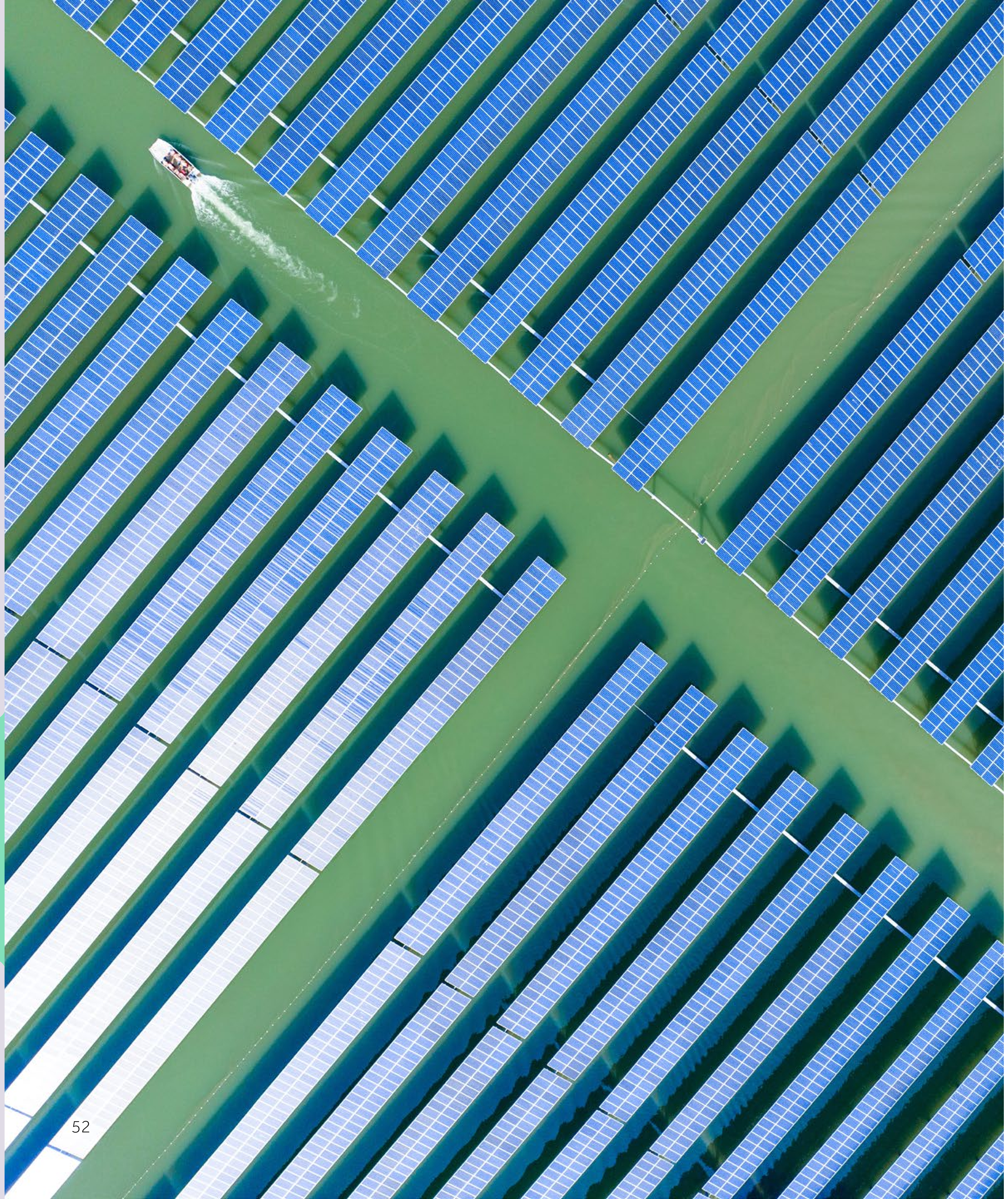
Banks also realise that third-party platforms are improving their security and boost their ability to achieve compliance with ever-more stringent regulatory reporting requirements. Integrations with ERP systems and the cloud, and the move to open banking all demand a change in security posture. Banks can no longer view security as pulling up the drawbridge.

62%

Working with third party providers

38%

In-house development



Platform strategies

This year's findings confirm the trend for banks to use more than a single trade finance platform. We found 41% use multiple platforms, depending on clients' requirements – almost the same percentage as last year. This is no surprise.

We know banks are working with fintechs to replace their legacy platforms and are therefore likely to have multiple products available. In these cases, the question is how long they will keep these multiple platforms. While banks deploy third-party solutions to fulfil the urgent need for better CX/UX they are also winding down their legacy solutions. It is noticeable too, that the percentage using a single in-house-developed platform for all transactions has now fallen to 7% from 11% last year.

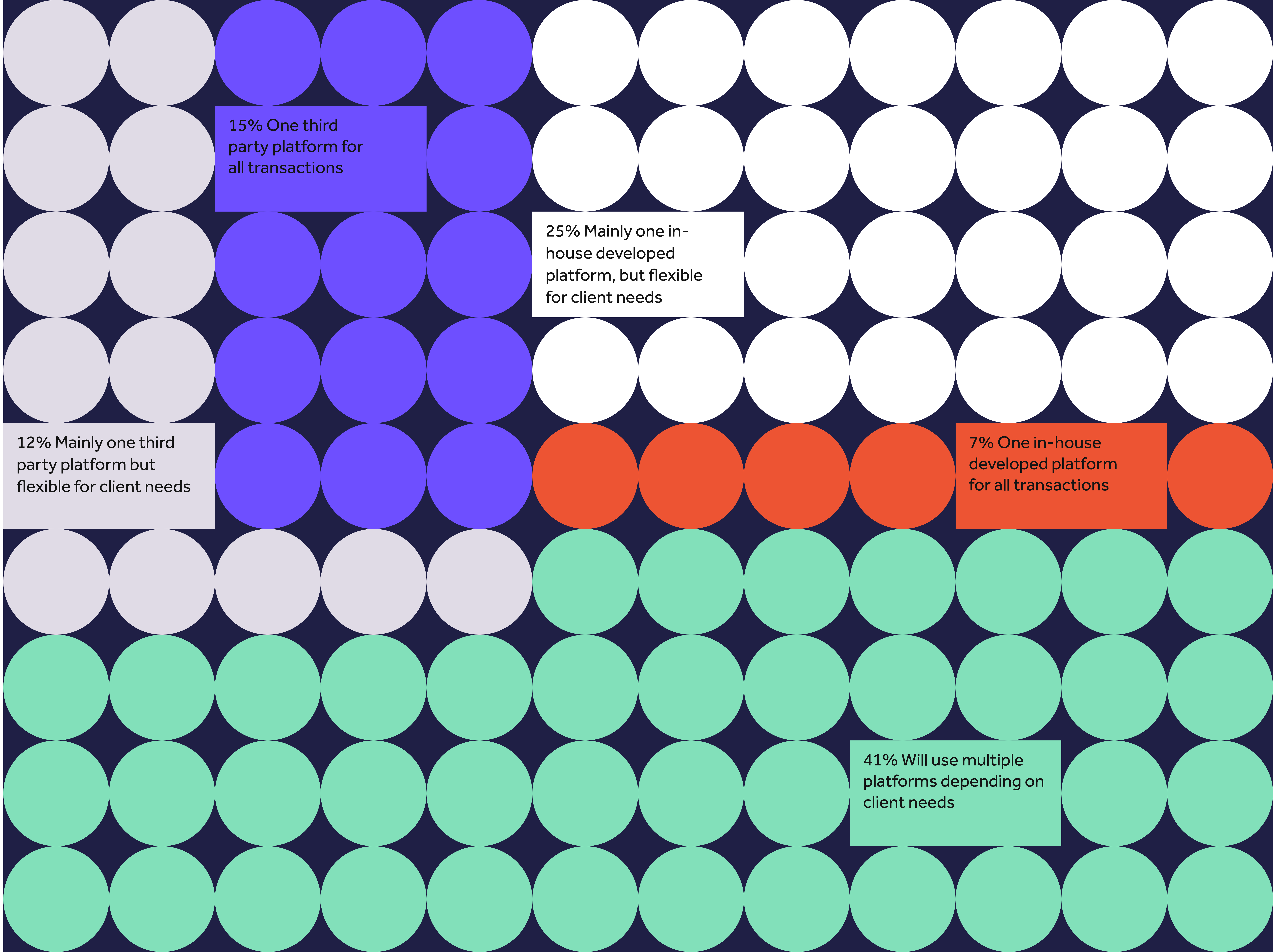
There are more reasons for using multiple platforms. One is that different trade products are managed by separate teams or areas of the bank, each of which may have their own platform. And we know some larger banks use multiple platforms for the same product, perhaps to bridge gaps in functionality or for a specific region.

At Demica we find banks with existing third-party platforms approach us to fill in gaps in functionality such as receivables finance, early settlement, retention management or cost allocation. They may deploy our platform alongside their existing solution, helping penetrate new markets.

The majority (59%) of banks in this survey clearly still concentrate on a single platform – either entirely or more flexibly. Banks usually have a complex ecosystem of critical systems that need to be fed with data from upstream platforms. The cost of integrating multiple platforms significantly increases the cost of in-house development and therefore most banks focus on one platform. For years banks have been working on replacing the integration layer between their internal critical systems and external systems to make it easier to introduce new platforms into their ecosystems.

The flexible approach to having one main platform is now more widely in use (38%) than reliance on one platform for every transaction (22%). This is a change from last year when the two approaches were both in use with 30% of respondents. The balance between in-house and third-party development is now slightly in favour of in-house. Nearly a third (32%) were developed in-house, and 27% are third-party platforms.

Does your bank use a third party trade finance platform/ service?



Features banks want in their trade finance platforms

Instead of spending time on the phone or writing emails to banks, customers want to log in to a portal and immediately gain access to information that enables them to make a decision. Banks know they must provide a better user experience. In this survey, 27% of respondents named improved CX/UX as the feature that is the main priority for their trade finance platform.

But this was narrowly outweighed by the 28% who want to see operational efficiency improve.

It's no surprise that these two features are as high on banks' lists of priorities as they were last year. As banks deploy platforms that create a digital experience for their customers and increase self-service, they address both aims. We know from banks that customers want a level of digital experience that enables them to make better choices and have more control in how they manage the products they receive from their bank.

Last year, however, only 9% of banks taking part in our survey said the launch of new products was a main priority for a trade finance platform. That has now doubled to 18%, as banks prioritise new products in response to customer demand. At Demica, we see banks wanting to provide receivables finance products alongside their existing approved payables product, or a bank-backed dynamic discounting facility using early settlement capabilities in their approved payables product. They are extending these new products into new regions, with Demica creating new features which banks can offer to their customers to create competitive advantage.

7%
Replace end of life technology

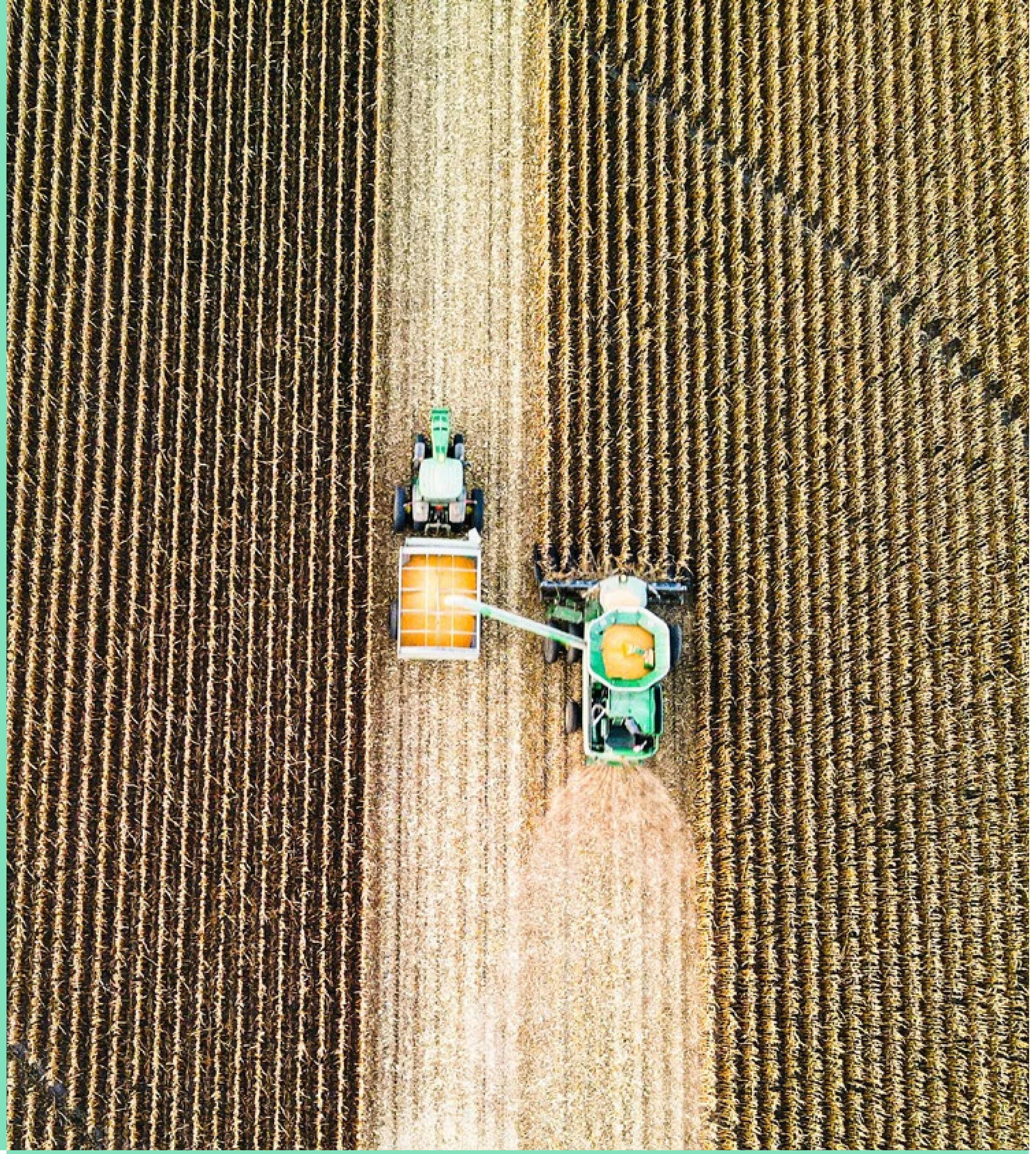
17%
Launch new products

19%
Improve functionality for existing productsuser experience (UX)

27%
Improve customer experience (CX) / user experience (UX)

28%
Improve operational efficiency

New technologies



"Banks are cautious about technology out of necessity"

The primary focus of banks' technology spending has been on integrating with their clients' ERP systems. But there are two other important points to note first in this section too.

DLT takes a dive

The first is the decline of distributed ledger technology (DLT). Last year 32% of respondents reported they were using DLT in live transactions, but the percentage has now fallen to 22%.

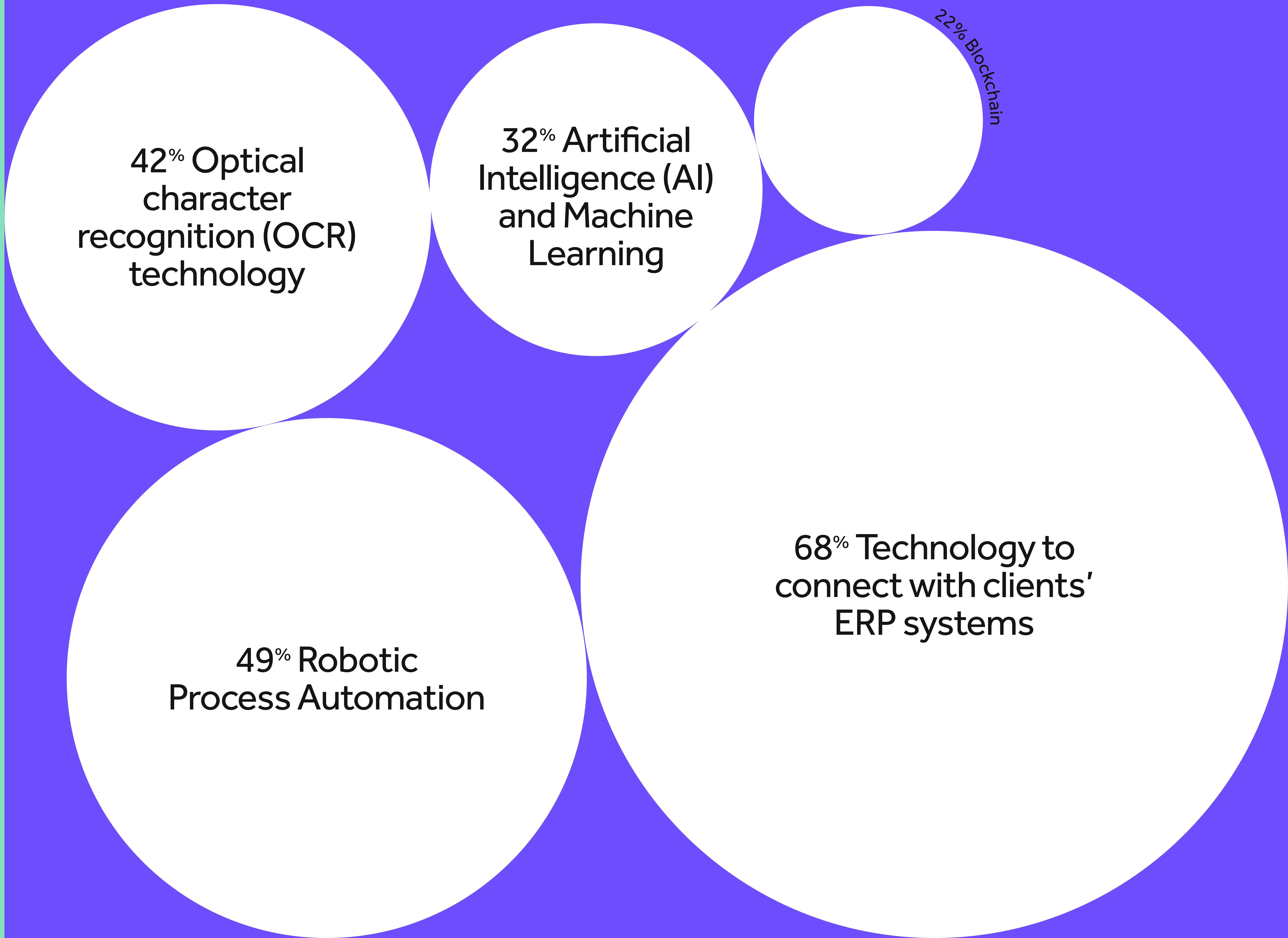
Many of the DLT proofs-of-concept that 46% banks were running in 2022 appear not to have converted into live transactions. This is reflective of the wider collapse of enthusiasm for DLT – the technology that underpins blockchain. DLT-backed platforms such as Marco Polo Network, we.trade and TradeLens have either ceased or been shut down, raising questions about the commercial viability of the technology in trade finance. There is still a place for DLT in documentary trade but not for open account. We can see vendors shifting to more traditional technologies.

AI is on the up

The second point concerns the increase in deployment of AI and machine learning in live transactions, which has gone up from 25% last year to 32% this year. This steady but unspectacular growth is line with our expectations. Banks are cautious about technology out of necessity, but the technology giants have been releasing their Generative AI services such as Microsoft OpenAI, Google Vertex AI and Amazon Bedrock. We predict this technology will change the way banks manage risk and help to automate operational tasks. We expect to see this increase over the next few years as new technology solutions are created using these services.

The use of RPA (robotic process automation) and OCR (optical character recognition) has also increased slightly. As we observed last year, banks are automating manual processes to improve operational efficiency and reduce operational risk. AI/ML integrated with RPA should help to automate more tasks that currently require human intervention.

What are you using for live client transactions?



ERP integration is increasingly critical

The focus on gaining access to data from customers' ERP systems is critical for trade banks. On the one hand, customers do not want to spend money building complex integrations with the banks and on the other, banks want to reduce the time it takes to onboard new customers onto their products.

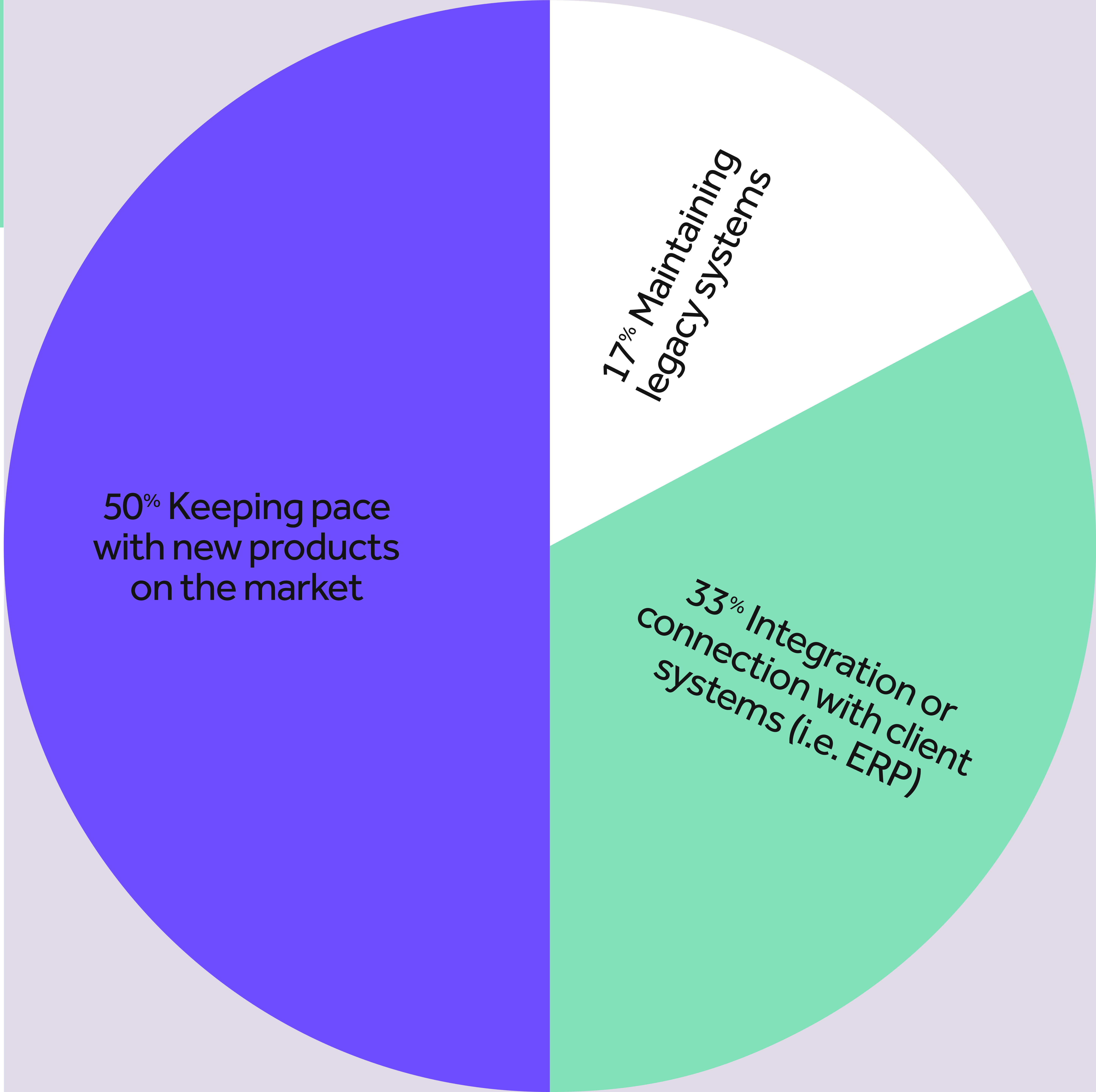
These technologies are more readily available either directly from the ERP providers or through third-party integration add-ons. We predict more banks will utilise these services over the next few years especially in Europe and North America where the big ERP providers such as SAP, Microsoft, Workday and Sage have a large market share.

A third of respondents said integrating with client ERP systems is the top challenge for their technology teams. But this came second to the 50% for whom keeping pace with new products is the main challenge. The maintenance of legacy systems is the third most commonly cited of the most urgent challenges.

These latter two are linked. Banks find their customers approach them for products they currently do not have, such as dynamic discounting or receivables. Providing these products is difficult when relying on systems that have been in place for a long time and which require complex maintenance amid scare skills and a brain-drain through employee retirements.

File-based vs API integration

As banks complete the implementation of their middleware solutions they are increasingly moving away from the traditional file-based integrations to real-time API integration. File-based integrations often require work both within the bank and at the vendor to accommodate the file. Vendors that have an API strategy provide a standard set of APIs to allow the banks to directly integrate with the vendor in a much more robust way.



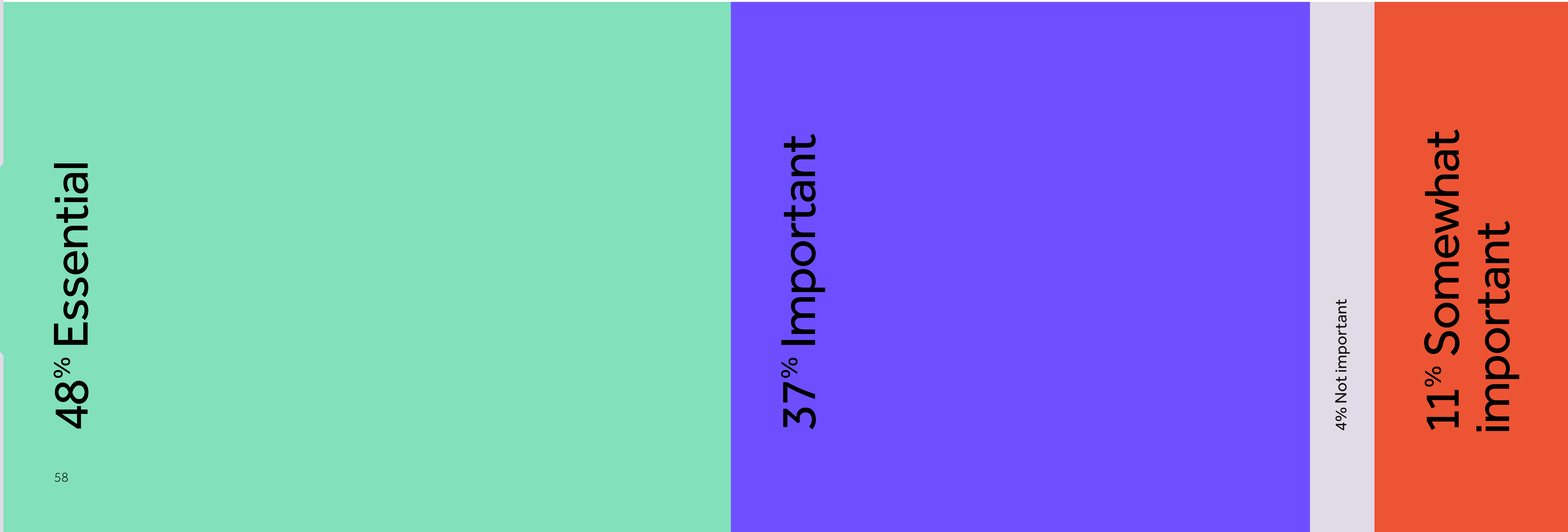
Security

In this report we find banks' views on the relative importance of information security certifications has undergone a slight downward shift compared with last year. The percentage of respondents regarding ISO 27001 and SOC 2 Type 2 as "essential" has declined from 50% last year to 48% this year. But the percentage regarding these certifications as "important" has gone up to 37% from 28%. Overall, 96% of respondents regard information security certifications as essential, important or somewhat important this year, compared with 93% last year.

The figures confirm what we have been seeing more broadly. The global pressure from regulators for due diligence and external auditing of the security certifications of suppliers is increasing constantly. Progress among banks is slow but steady.

As we move forward regulators will want to see more evidence of due diligence, as is required in the US under the NIST framework, the SEC regulations and FedRAMP programme, and in the EU under NIS2 and the Digital Operational Resilience Act. The only surprise in this year's benchmark security findings is that we have a rump of 4% who do not think ISO 27001 and SOC 2 Type 2 have any importance. This may be because of differences in security certification around the globe.

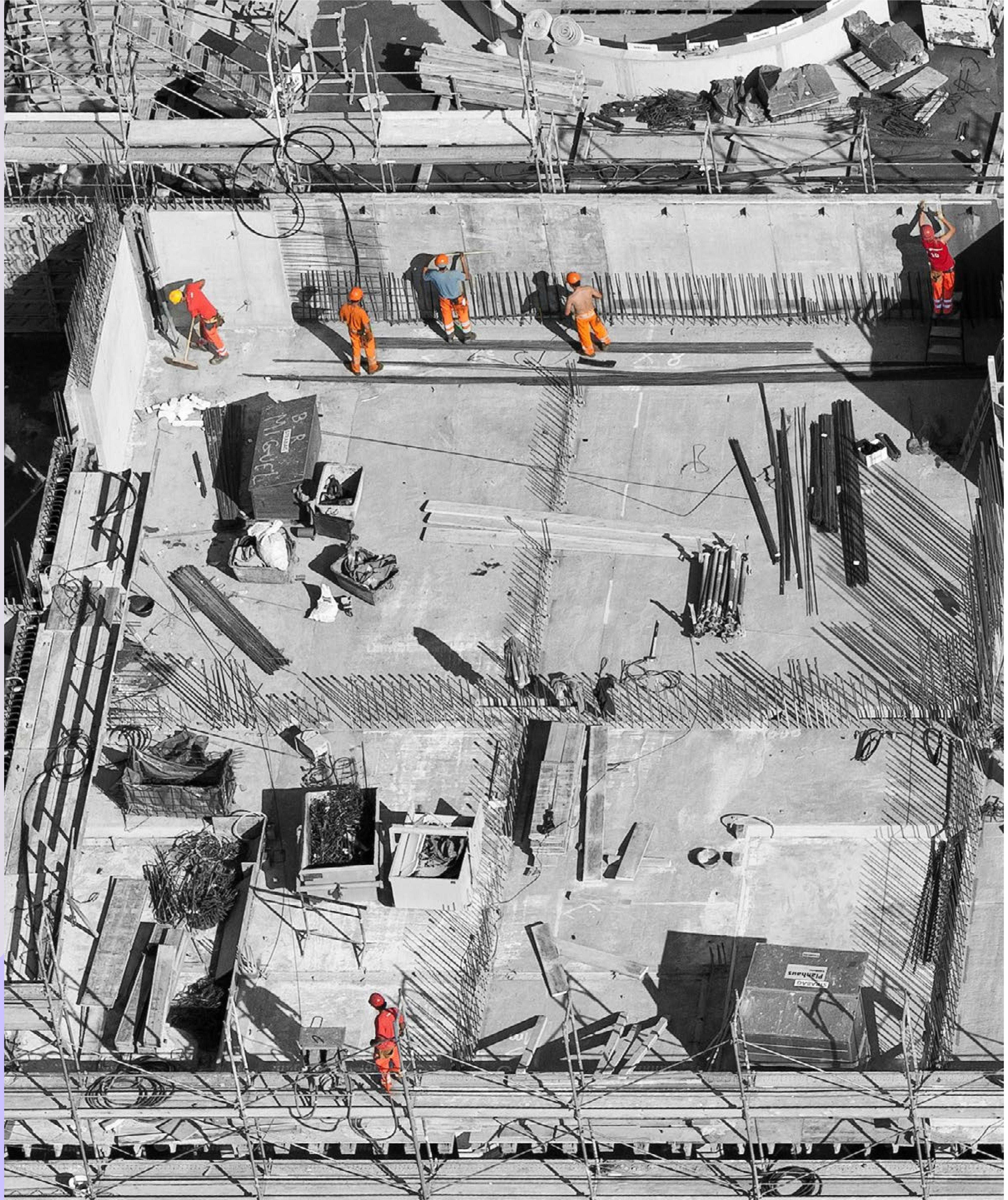
With such heavy emphasis from regulators, it is clear the future is one where banks are unlikely to entertain any supplier which cannot demonstrate compliance with globally-recognised security standards. I'm pleased to say that Demica has always been ahead of the curve in this important area, having commenced compliance work in 2011.



05 ESG

Shikha Kalra
Senior Director

“Global financial institutions must balance the needs of clients and investors with the wider societal aims”



Prioritising ESG

Sustainable finance has been right at the centre of the global push to address Environmental, Social and Governance (ESG) concerns. In this year's benchmark survey, 90% of banks plan to prioritise ESG over the next 12 months – up from 85% last year. This is not a surprise - ESG requirements are only going one way and the financial institutions are aware. There is also a shift in mindset happening here. The funders can no longer take a passive approach. They must proactively work with their clients on this topic. Without making real efforts at the transactional level, it will be difficult to show progress on ESG targets.

Through the ability to involve millions of corporations in the value chain working capital and trade finance can play a critical role here. However, the involvement of many companies in the supply chains also makes this one of the more complex product groups to integrate sustainability aspects within the product design.

A dense thicket of ESG regulations and other related developments

As ESG has climbed up the agenda, a plethora of initiatives has emanated from the UN and EU, and individual nations. In Europe, for example, the terms of the Corporate Sustainability Reporting Directive (CSRD) will be kicking in for all the large firms from next year and will eventually also, including smaller businesses as well as subsidiaries of non-EU businesses with significant activity. The European Commission has put in place the Sustainable Finance Action Plan (SFAP) to channel more funding to environmentally sustainable economic activities. Under the plan certain legislative proposals were adopted including the EU taxonomy. Also worth mentioning, in March 2024, the members of the UN-convened Net-Zero Banking Alliance (NZBA), which includes 142 banks across 44 countries, representing 41% of global banking assets[1], voted to adopt a new version of the 'Guidelines for Climate Target Setting for Banks'. This vote represents the commitment of the members to reach net zero by 2050 or sooner. The guidelines state that members shall publicly disclose targets (including clients' Scope 1, Scope 2, and Scope 3 emissions) and report annually on progress. On the other hand, greenwashing and misleading environmental claims are very much on the regulatory agenda as well. For example, in March 2023, the European Commission published its proposal for the Green Claims Directive. The Directive aims to address misleading environmental messaging across EU markets. It is fair to say that ESG as a topic is remarkably vast and the related regulatory landscape across the world seems widely scattered.

[1] *Net-Zero Banking Alliance, UN Environment Programme*

Personal involvement leaps up

A sign of the growing importance of ESG is the increased percentage of survey respondents who have been involved in ESG-focused transactions. This has leapt up from 43% last year to 62% this year and is the first time in the three years of the benchmark survey that the majority of respondents have had personal involvement. A high percentage of European respondents was engaged in ESG transactions in 2023 (66%), which reflects the ESG policy and regulatory focus at play in the European region. This is a big jump on the 40% of European respondents in last year's benchmark report.

A third of respondents (33%) cited payables transactions as areas where they were personally involved, and a fifth (20%), receivables. This is a reverse of last year when receivables finance transactions were slightly higher than payables on this count.

62% Yes

38% No

33%
Payables finance

20%
Receivables finance

9%
Other

Have you used ESG ratings services (e.g. MSCI, EcoVadis, Coriolis) actively when evaluating a transaction?

22% Yes

78% No

Measuring the ESG performance and the use of rating agencies

However, the percentage of banks actively using ESG ratings services when structuring a transaction remains relatively low (22%) – and has hardly changed from last year (23%). EcoVadis and MSCI were among the products most commonly used, with the evidence of the results suggesting a number of large corporates are using ratings to structure SCF transactions to incentivise suppliers.

To gauge progress on ESG, data is key. Key Performance Indicators (KPIs), ratings or disclosures, all require data. There are significant challenges that need to be overcome here - data capture, its modelling, benchmarking, and reporting. A corporation reporting on data, needs to first identify the data source and then find a way to access the same on a regular basis, for ongoing consistency in reporting.

In 2021, International Sustainability Standards Board was set up and it published inaugural ESG standards in 2023. However, there remains an absence of clarity on standards and the precise reporting requirements to which banks and their clients must adhere. If anything, the reporting landscape is highly fragmented. Notably, some trade finance industry bodies are making an effort here. International Chamber of Commerce (ICC) has developed a framework for principles and standards for sustainable trade finance. Amongst other initiatives, International Trade & Forfaiting Association (ITFA) has recently proposed a Sustainability Audit Council to establish a common standard for ESG disclosures, articulate the common standard to regulators and establish an independent and approved audit mechanism for compliance based on common standards.

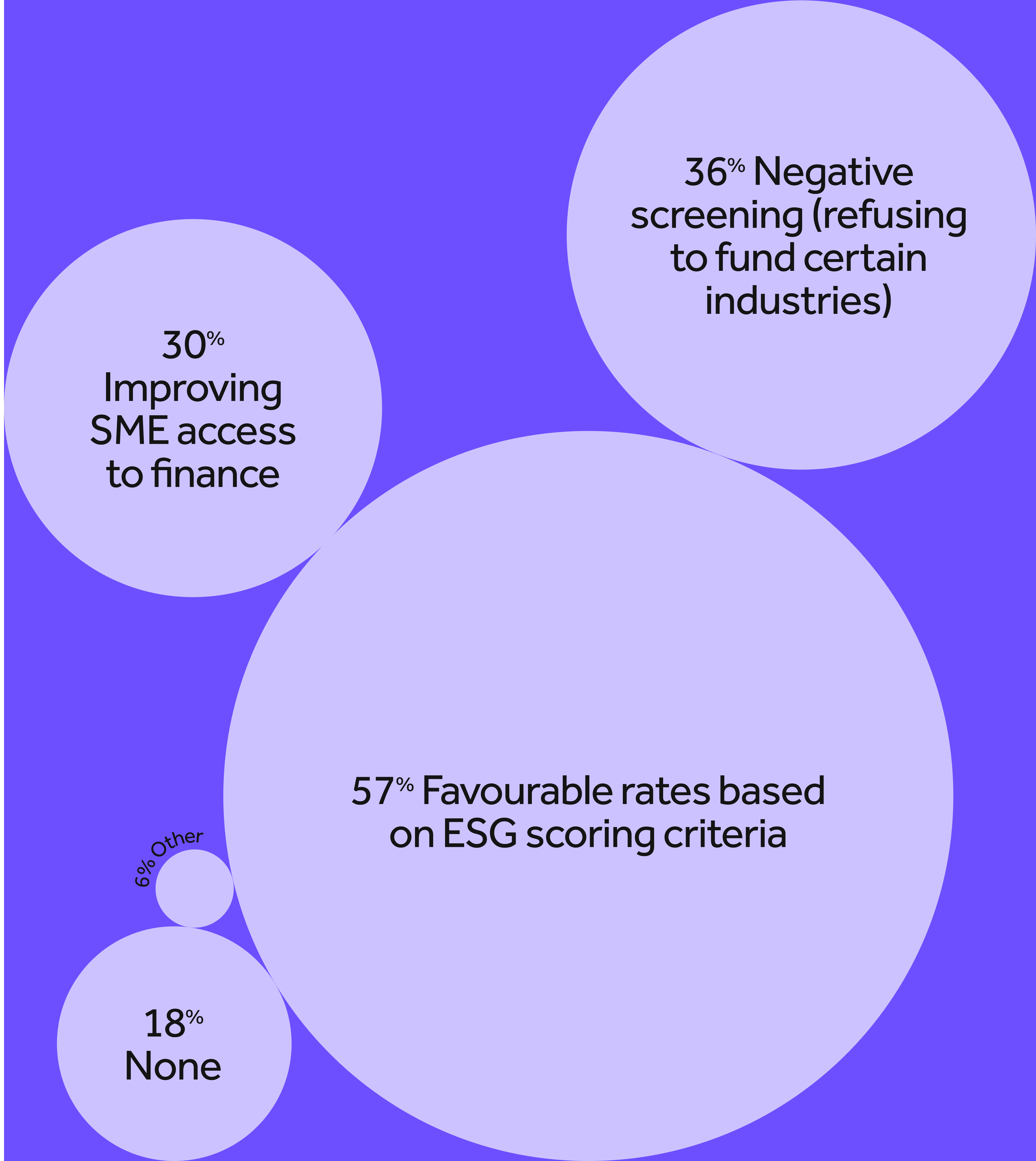
[1] *2023 Trade Finance Gaps, Growth, and Jobs Survey, ADB Briefs, NO. 256, September 2023*

How banks drive ESG forward

Global financial institutions must balance the needs of clients and investors with the wider societal aims around mitigation of climate change, environmental protection, facilitation of SME trade, and promotion of social justice. Banks differ in the approaches they take towards ESG in the product space, with some scrutinising the use of proceeds, while others focus on assets or have KPIs based on tracing programmes.

- This year's results show the main focus of banks seeking to drive ESG compliance in trade finance transactions is the use of ESG scoring criteria for provision of favourable rates. Some 57% of banks identified this mechanism as one they use – an increase on 54% in last year's benchmark report and 47% two years ago.
- The next most frequently deployed tactic is negative screening, selected by 36% - up from 33% last year and 23% in our 2022 report. This strong growth trend is not surprising as lenders want to avoid funding certain industries, such as coal and are reducing (and in some cases, keeping constant) their lines accordingly.
- The global trade finance gap reached $2.5trillion in 2022[1]. We note that three-in-ten banks (30%) are also seeking to expand access to trade finance for SMEs – a vital tool in closing the trade finance gap in countries where smaller businesses are the bulk of suppliers. But this was a slight fall on the 33% in last year's findings, taking the figure back to where it was in the 2022 report.
- 18% of banks have no area of focus for increasing ESG alignment in the trade transactions they facilitate.

In some cases, survey respondents have referenced investments in technology in this area, and that they are supporting clients in supply chain mapping. One European bank, for example, has announced an initiative relating to mapping of carbon intensity in supply chains.

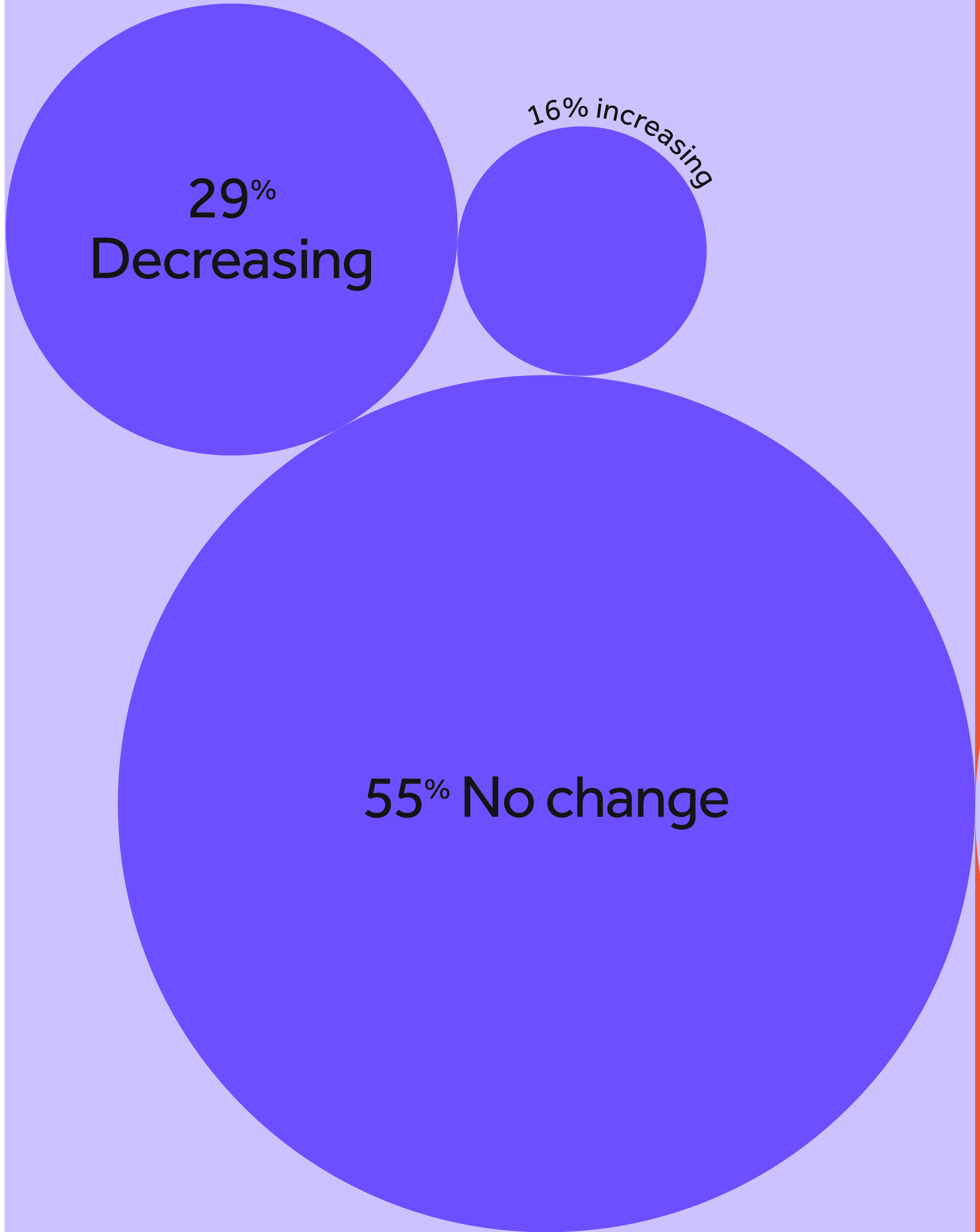


Risk departments and ESG

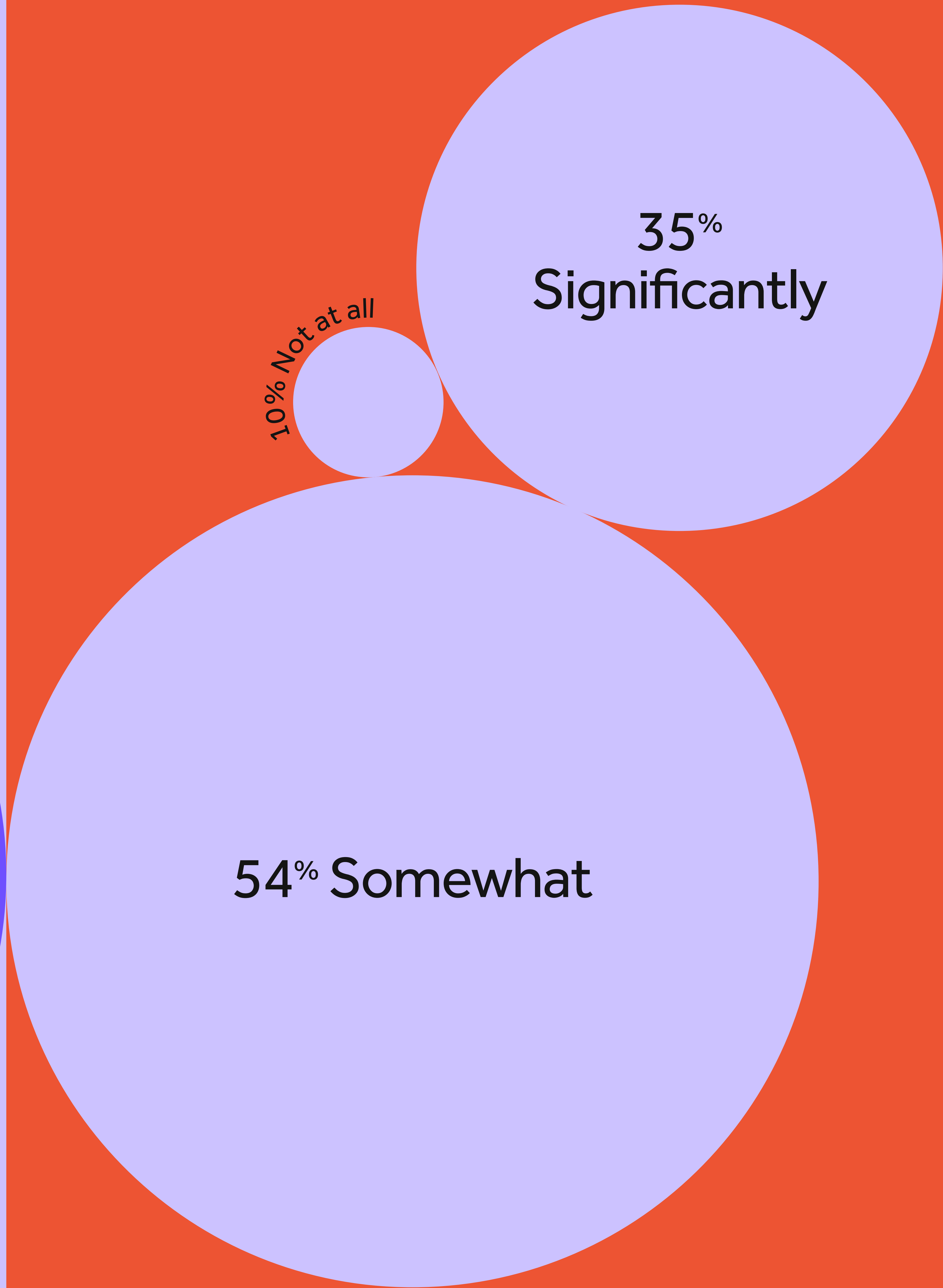
We also notice how broader macroeconomic factors are at play when banks' risk departments reconsider increasing or decreasing their limits on financing sectors that are not ESG-friendly. Most (55%) said there was no change and 29% said they were decreasing (up from 24% last year).

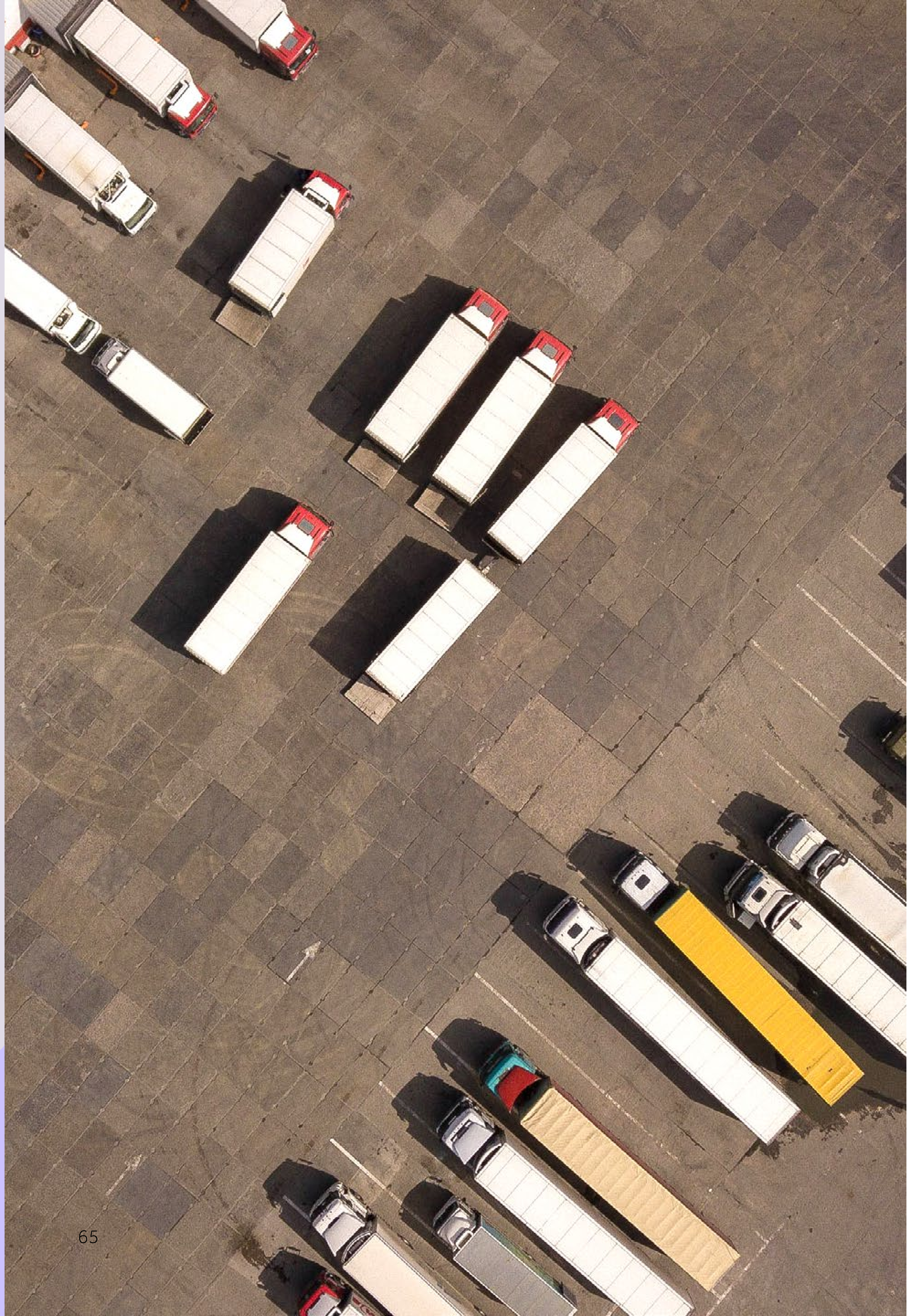
This fits in with Demica's experience through the year. Banks must understand and measure their exposure to industries with poor ESG credentials, but the fact remains that the global economy will be reliant on fossil fuels for years yet, and financial institutions cannot suddenly axe all involvement. Some 16% said their risk department is actually increasing limits on non-ESG transactions, which was surprising.

Is your risk department increasing/decreasing the limit on non-ESG-friendly sectors?



How much does your department expect to prioritise ESG in the next 12 months?





A work in progress...

Based on the survey results and our own collective experience of dealing with the working capital finance market, here at Demica, we can share some thoughts and observations.

Interest from Funders in ESG-Friendly Industries:

- Clients from renewable or ESG-friendly industries tend to attract high interest from funders initially. However, further engagement depends on due diligence and risk assessment.

Interest from Funders in ESG-Friendly Industries:

- Clients from renewable or ESG-friendly industries tend to attract high interest from funders initially. However, further engagement depends on due diligence and risk assessment
- While there's no specific regulatory capital incentive (yet) for ESG-linked transactions, funders often bear the cost of discounts offered in such deals

ESG in Payables Transactions:

- We have observed payables transactions being underwritten in which a corporate selects its suppliers and tracks compliance against ESG criteria agreed with the funder/s
- ESG-linked payables transactions are more prevalent in the market compared to other working capital finance products. This makes sense because large buyers can influence their supply chains and encourage suppliers to meet ESG metrics for better financing terms

Receivables' Finance – the debate and the opportunity

- In the realm of receivables finance, especially trade receivables securitization, there's an ongoing debate between the "use of proceeds" approach versus compliance of underlying assets. While both have merits, monitoring compliance with underlying assets presents its own set of challenges as referred to in a previous section (Measuring ESG performance...)
- At Demica, we take pride in our platform's capabilities. When a corporate can provide access to specific data on ESG metrics on an ongoing basis, our system can identify and report on such compliant assets within the asset pool. This can empower platform funders to make informed financing decisions aligned with transaction ESG criteria we are also aware that in various cases financial institutions have identified and focussed on industry specific Key Performance
- Indicator (KPIs) for transaction structuring. ESG linked margin ratchets are then built into transaction documentation based on reporting of such KPIs. This is common for Sustainability Linked Loans (SLL). This may also be relevant particularly on the receivables' financing side and for corporates in transition industries
- I would, however, argue that even though payables finance provides a sensible place to start, the opportunity to influence the global supply chains with sustainable receivables finance is far greater. When a receivables' book of a company is financed, it is the essence of the business that is financed, given that receivables touch every facet of a company's operations

The integration of ESG principles within working capital finance products therefore remains a 'work in progress' for global financial institutions. We will continue stay watchful and look forward to further opportunities to be part of the evolution of this dynamic space.

Matt Wreford

Chief Executive Officer

"It's a year of big market shifts as trade receivables finance has become the asset class with the most growth potential"

Thank you for reading Demica's third annual Benchmark Report for banks in trade finance, I hope you have found it useful. For me, the report paints a picture of a supply chain finance industry that has weathered some storms and is set to adjust to lower inflation in most regions of the world.

It's a year of big market shifts as trade receivables finance has become the asset class with the most growth potential, taking the top spot from payables, largely as a response to rising interest rates. For receivables product teams, expansion of the addressable market is the biggest challenge – indicating that globalisation is alive and well.

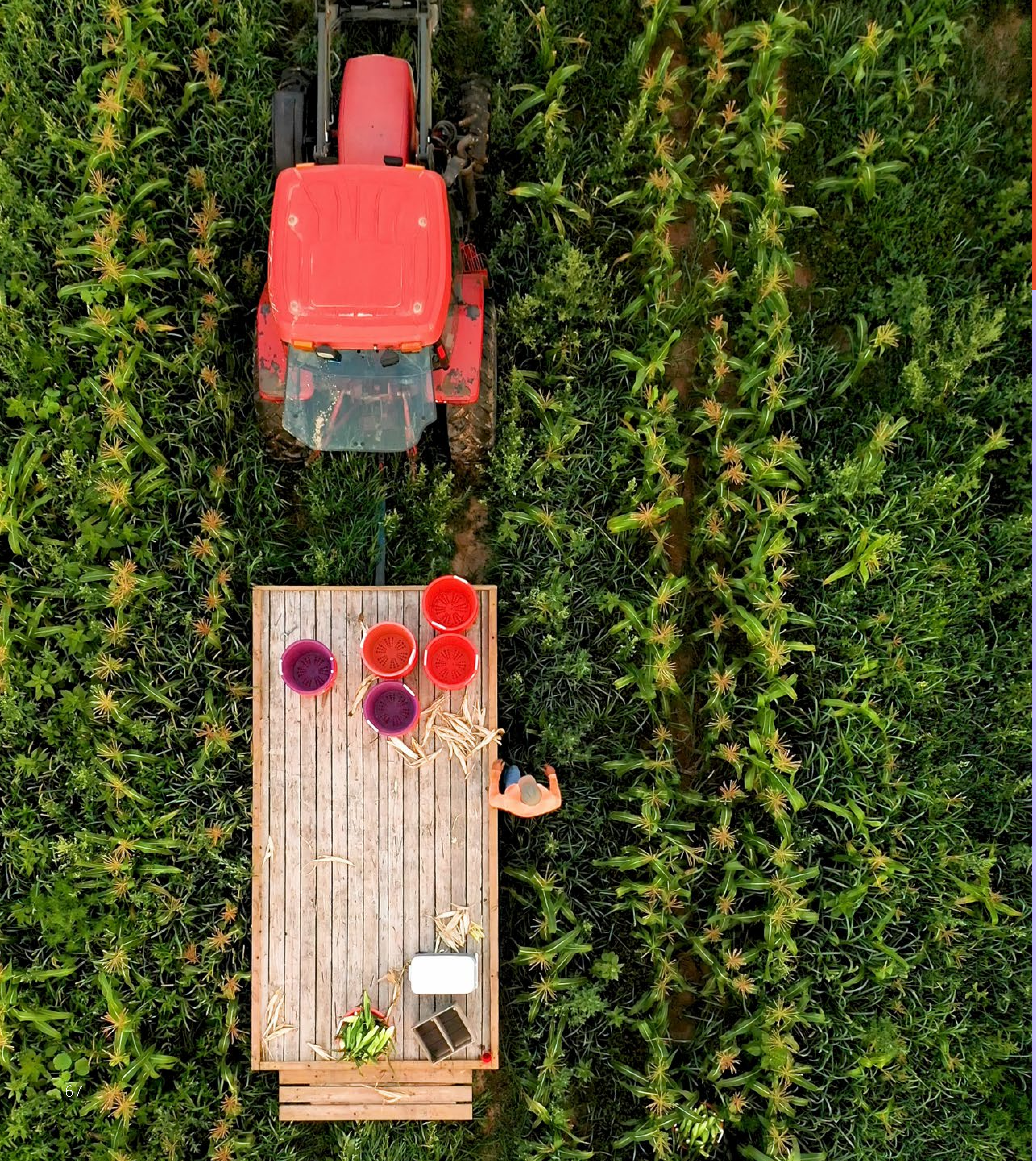
While asset growth benefited from inflation in 2023, high interest rates restricted investment by banks and choked back demand a little. The continuing political uncertainties, amplified by conflict in the Middle East, also affected confidence and have encouraged near-shoring in Europe. That could have longer-term ramifications in the types of trade finance products sought as more than half of banks seek to enter new product lines.

There is much discussion and concern over "greenwashing", the practice of overstating and exaggerating a business' ESG credentials, and it's very interesting to see that, in trade finance, the banks are putting their money where their mouths are. ESG is beginning to play a bigger role in transactions, as most respondents (62%) have been involved in an ESG-focused transaction – a big swing compared with last year where less than half of respondents had encountered an ESG-focused transaction.

Technology investments are also set to rise after a more challenging year for budgets. Over time this will improve cycle times through deployment of more efficient onboarding tools, help address reporting challenges and deliver an improved user experience. Regulation, as ever, throws up its own hurdles for banks, which I believe they can surmount through proper preparation and utilising the technology solutions available on the market.

We are already well into 2024 and over the next 12 months we expect to see our respondents' cautious optimism borne out. Expect increased transaction values and the adoption of supply chain finance solutions in more areas of the globe – especially APAC and MEA. In some areas, however, high interest rates may persist as inflation proves difficult to tame.

I also offer my thanks to our expert contributors to this report, whose insights are an essential ingredient in its success. Many thanks to Sean Edwards of ITFA and Eric Li from Coalition Greenwich for their invaluable contributions.



Special thanks to our commentators

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