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Market Commentary

Corporate Banking in 2021: What Financial Institutions Need to Know

While the year 2020 put an indelible stamp on the business community, it seems there is no stopping the rolling freight train of change in 2021. SMEs and corporations face a growing list of challenges as they confront both the COVID-19 landscape and the need to shore up profitability.

"Coalition and Greenwich Associates expects the total trade finance revenue pool for banks globally to have dropped to $49 billion in 2020, from $53 billion in 2019. In 2021, this will rebound to $52 billion, according to the forecast. By 2022 it will reach $54 billion, above the pre-COVID-19 level."

As financial institutions seek to expand into the lucrative commercial sector, they face their own set of difficulties as regulations and cost containment take center stage. Moving into 2021, banks should be primed to address several overarching challenges in the quest for SME business as well as the need for comprehensive digital capabilities to aid in expense reductions and efficiency gains.

Overcoming the trade finance gap

In 2020, the COVID-19 pandemic interrupted supply chains around the world and short-circuited business operations. The disruptions sent shockwaves through many industries, and when combined with shifting consumer demand, created cash flow concerns for SMEs across the globe.

As businesses struggle to recover from the impacts of the economic crisis caused by the COVID-19 pandemic, there are several factors limiting the odds of success.

Moving into 2021, banks should address several overarching challenges in the quest for SME business as well as the need for comprehensive digital capabilities to aid in expense reductions and efficiency gains.

First, the $1.5 billion global trade financing gap has had a tremendous impact on businesses, particularly smaller entities or those in developing countries. According to the International Chamber of Commerce, finance underpins eighty percent of world trade.[1] Additional research conducted by ICC predicts that it will take an additional $1.9 to $5 trillion in trade financing to return business activity to 2019 levels.[2]

Meanwhile, the number of trade finance applications rejected by banks increased twenty percent over the six-year period between 2013 and 2019, while the number of banks engaged in trade finance fell from ninety-two percent in 2014 to seventy-one percent last year.[3] The burden of regulatory compliance is largely to blame.

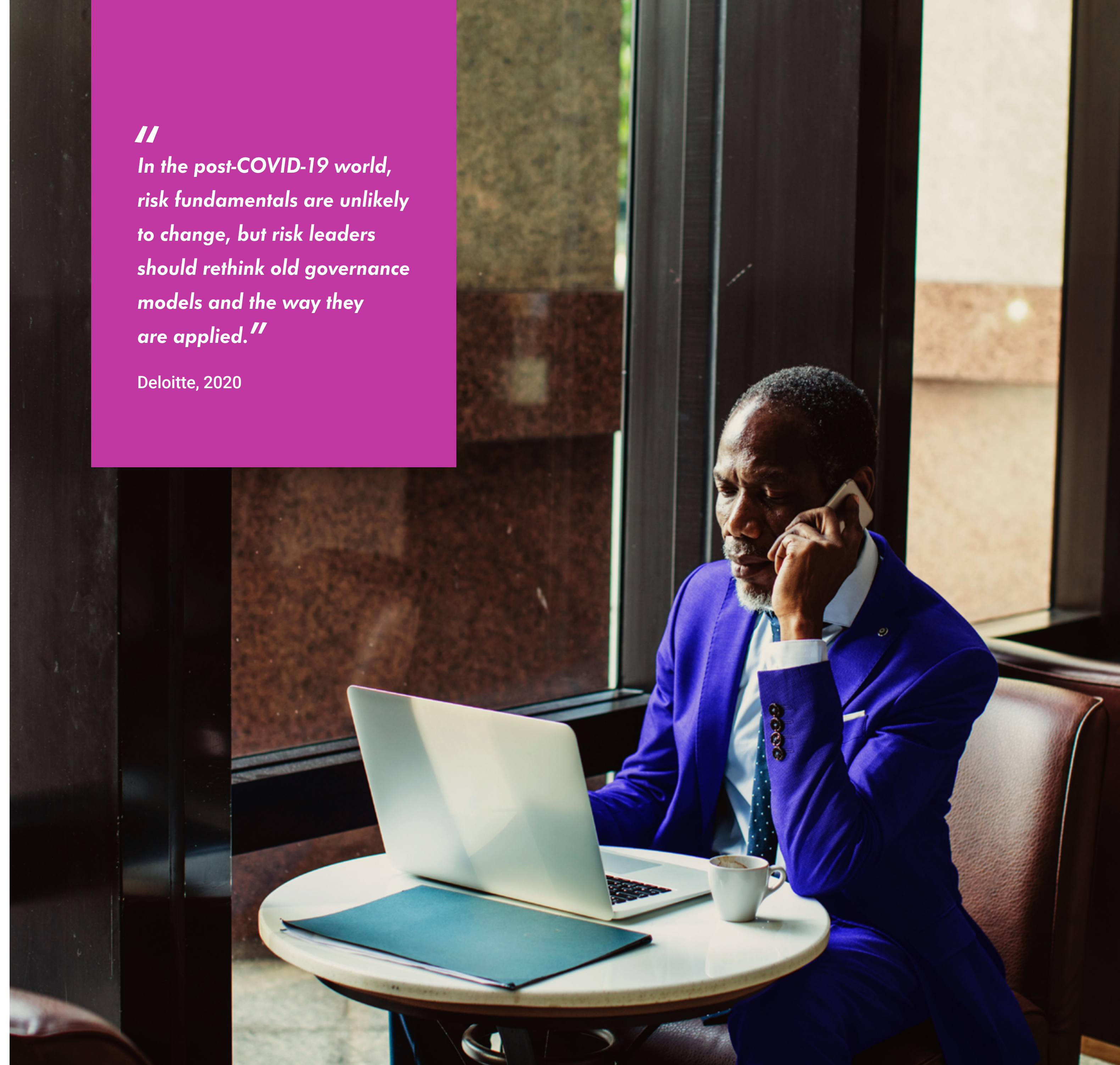
Know your customer (KYC) or anti-money laundering (AML) regulations, combined with the higher capital requirements introduced after the last global financial crisis, have pushed many financial institutions out of the global trade market.

A study conducted by Risk Management Association reveals that half of financial institutions spend 6 to 10 percent of revenue on compliance costs. The high regulatory price tag often reduces the number of services a bank or credit union can provide.

"If you have a lot of compliance-related burden associated with a particular product or service, a banker may decide not to offer that product or service or may offer it at a higher cost to the consumer to offset the related cost," said Bernard Mason, the association's regulatory liaison, in a statement to Bloomberg.

Basel III, for example, subjects financial institutions to higher capital and liquidity requirements. As a result, banks have allocated their capital to higher margin, lower risk transactions associated with large corporates and multi-national corporations. The resulting restriction disproportionately hits SMEs who make up a significant portion of the trade finance gap.

Looking toward 2021, financial institutions that can cost-effectively tackle the regulatory environment will find an open opportunity in trade finance.



> ***"In the post-COVID-19 world, risk fundamentals are unlikely to change, but risk leaders should rethink old governance models and the way they are applied."***
>
> Deloitte, 2020

Digital cash management solutions take center stage

Recovering from an economic shock as significant as the COVID-19 pandemic will require businesses to optimize liquidity management in order to improve cash flow. As a result, many companies will be seeking digital capabilities that simplify cashflow forecasting, but also the ability to predict and manage risk.

Digital solutions here will provide centralized access to data to improve both efficiency and accuracy, but will also use real-time inputs in conjunction with automated cash flow forecasting to monitor available liquidity and increase cash visibility. Real-time inputs will be particularly beneficial in the area of receivables management.[4]

Currently, few business treasures have a complete view of their accounts receivables and lack critical visibility into processes such as invoice management, payer reconciliation and invoice matching. Real-time data access provides an up-to-the-minute view of accounts, enabling businesses to optimize receivables such as collections or cash applications, reducing the number of days sales outstanding.

> *"90% of global trade is dependent on some form of bank intermediation to support products, financing or payments. World Trade Organization, 2020."*

In 2021, financial institutions that provide digital liquidity management solutions will be helping businesses recover from the current financial crisis while carving deeper inroads into the corporate banking market.

The year of the integrated working capital solution

Looking ahead to 2021, businesses will be seeking to even out their liquidity woes with integrated working capital solutions from their financial institution.

Currently, the World Trade Organization estimates that ninety percent of global trade is dependent upon some form of bank intermediation to support products, financing or payments.[5] Simultaneously, technology is changing the way trade processes are completed, opening doors to outside players, such as logistics companies, to enter the market.

Unhampered by banking regulations, these service providers are delivering a faster and more efficient operating environment and offering services at lower costs than traditional financial institutions.

To remain competitive, banks and credit unions will need to unify the complete suite of trade and working capital finance solutions under a single, streamlined digital solution.

For example, service-based exports are anticipated to grow $2 trillion over the next 5 years, according to a report by Western Union and Oxford Economics.[5] However, the SBA indicates that most banks do not provide working capital advances on export orders, making it difficult for businesses in this sector to begin or maintain international business operations.[6]

Supply chain finance is another area that is ripe for growth. Currently, only sixty-four percent of global banks offer these services, according to the International Chamber of Commerce. For regional and local banks, the numbers drop to thirty-eight percent and thirteen percent respectively.[7]

The lack of market penetration makes sense when you look at the challenges associated with implementation. SMEs expect supply chain finance solutions to fit seamlessly into the financial institution's overall working capital suite of services. However, financial institutions can find it challenging to integrate multiple legacy systems to achieve the seamless results that SMEs expect.

Another barrier to entry is the associated cost. Many SMEs are budget-sensitive, and for financial institutions, these products are only profitable when they are automated at high volume.

Fortunately, the growing use of cloud-based APIs are changing the landscape for banks and credit unions, making it possible to unify a suite of working capital solutions, to meet an entire range of business needs.

When businesses can unite a complete realm of services under a single umbrella, they are more likely to stick with a financial institution, opening opportunities for cross-selling, as well as the benefits associated with customer loyalty. As a result, adoption of API-enabled solutions should escalate in 2021 as businesses tackle the road ahead and demand greater flexibility and capability from their financial institutions.

For more information
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