Adapting to change: The unfolding world of e-commerce trade finance

Market participants are increasingly using online marketplaces for trade finance services, but existing finance mechanisms are not all adequately positioned to support this growth and their working capital needs. Citi's *Pauline Kontos*, global head of working capital advisory, treasury and trade solutions (TTS) and *Bob Petrie*, director, TTS trade partnerships and innovation, discuss the vibrant e-commerce market, what its evolution means from a funding perspective, and how banks are rising to the challenge of supporting the digital trade finance business model to enable e-commerce to thrive.

Shopping online is a run-of-the-mill activity for many consumers, with business-to-consumer (B2C) online marketplaces, such as Amazon and eBay, established hubs for digital trade. Business-to-business (B2B) e-commerce, however, is relatively new compared to B2C and the dynamics of this segment are still evolving.

As is often the case, online retail developments in the consumer space translate to demand for similar solutions for corporates. As such, B2B marketplaces are gaining real momentum, and so are emerging markets' online sales. For example, Mexico's online sales increased by 24.6% in 2023, while India's surging internet and smartphone usage is driving substantial e-commerce growth, with reported online revenues expected to exceed US$100bn by 2027.[1]

When it comes to supporting merchants, online B2C marketplaces have become almost one-stop shops for the merchants selling on those platforms, with virtually everything needed to run their business taken care of, including payments, marketing, analytics and logistics. As a result, the firms that traditionally provided those services have been disintermediated or less relied upon. This one-stop-shop approach reinforces how online marketplaces are digitally driven and adaptable to needs, requiring a level of technical sophistication in order to plug into them.

As both B2C and B2B marketplaces scale, a reassessment of how they are supported and funded is taking place. With the relatively limited balance sheets of the majority of fintechs, there is a need for more robust offerings and lower costs of capital. Large financial services companies are increasingly an important option to help with access to liquidity and funding. Additionally, as regulators increasingly take notice, e-commerce marketplaces are looking for partners with more stringent risk and compliance practices. As such, banks are gearing up to provide the tools to ensure the e-commerce industry's growth prospects can be realised.

A dynamic market needs effective support

The case for banks to enter the world of e-commerce is clear. Firstly, their financial network will be paramount in providing practical funding to ensure working capital demands can be met as the industry evolves. As online marketplaces grow, merchants operating on these platforms will need to adapt to rising customer demand and their liquidity requirements will increase significantly.

Another factor is that e-commerce funding needs tend to expand globally far quicker than the needs of more traditional sectors. With fintechs often restricted by the geography in which they operate, large, international banks are better positioned to support the global reality of the industry. And that extends beyond liquidity bandwidth. While perhaps not as relevant to many merchants when marketplaces were in their infancy, having access to a wider suite of services and solutions – such as cross-border payments and FX capabilities – will become more valuable as the landscape, and their businesses, scale.

Elsewhere, regulatory scrutiny is naturally increasing in line with the growth of e-commerce marketplaces. Banks are well versed in regulation and compliance, and can apply effective risk controls within these environments, helping to facilitate the maturing industry in a way that fintechs would unlikely be able to do on their own.

Supporting the backbone of e-commerce

Supporting this rapidly growing market is not straightforward. Given that global trade has been built upon paper documents and manual processes, traditional financing solutions no longer cater to the needs of online marketplaces and their business models. Indeed, in these digital, fast-paced ecosystems, there is not an invoice or traditional payment term in sight. Traditional trade finance practices, therefore, need to be rapidly adapted to meet the unique requirements of e-commerce.

Furthermore, in practical terms, this is not about funding the marketplaces themselves. Supporting these ecosystems means providing trade finance to the merchants using them (as well as the buyers, with respect to B2B marketplaces). These sellers are typically small businesses trying to scale to fulfil the sizeable orders they are receiving as a result of joining a global online marketplace. In contrast, global banks typically work with a multinational corporate client base with strong credit ratings, and merchants' lack of transaction visibility and performance history makes performing credit assessments and providing funding far more challenging.

Hence, banks need to understand how they can most effectively navigate this burgeoning trade environment. As a key step, a number of banks are exploring how their existing trade finance products can map to e-commerce finance requirements, collaborating with internal commercial banking teams to leverage their expertise. Working capital loans, inventory finance and warehouse facilities, for example, are proving effective solutions. By applying them in conjunction with a trusted fintech partner, banks can extend these more traditional offerings to smaller businesses.

In addition to repositioning their existing product sets, banks are collaborating with fintechs to meet all of the changing needs within e-commerce and provide all of the required skillsets. Citi, for example, recently established a financing arrangement with SellersFi,[2] a global fintech, enabling the bank to extend its offerings to new clients and a whole new market.

"As online marketplaces grow, merchants operating on these platforms will need to adapt to rising customer demand and their liquidity requirements will increase significantly."

As banks become more embedded in e-commerce and marketplace financing, collaboration with fintechs is a logical strategy. The fusion of their capabilities – the speed, nimbleness and tech-savviness of fintechs, and the balance sheets, reach, expertise and experience of banks – will ensure the most effective functioning of marketplace environments as they mature and grow.

Fast finance for a fast-moving industry

Further helping to enable the financing of marketplace sellers is the digital nature of the online marketplaces themselves. These platforms have extensive data points that can help provide valuable insights into the activity of the merchants seeking finance. This digital information can help with integration and credit-scoring models, and underwriting decisions. Certainly, being able to deliver decisions quickly is essential for finance to be effective in this fast-moving environment, where working capital needs can change in a matter of not just weeks or days, but hours, due to a product "going viral" and creating spikes in demand.

The data that is available through these platforms is also driving changes within lenders' own credit underwriting models, with different variables or "alternative data" now being taken into account. This can include, for example, seller ratings and reviews, return rates and trends regarding the speed of converting orders into cash. As the amount of available data grows over time, AI's ability to identify patterns should become ever-stronger – thereby enabling greater understanding of individual business needs, and ultimately creating a truly streamlined, optimised funding process.

As banks embark on the journey into e-commerce and adapt to the requirements of the digital trade finance business model, this is setting in motion a new way of thinking and transacting. As business demands evolve, banks will also be challenged to implement innovative strategies across wider markets, with traditional forms of trade finance needing to be translated into a format that can be consumed within digitally native environments.

Certainly, significant change is coming and banks, like Citi, are poised to become the funders and facilitators of the future of e-commerce.

References

1. https://www.statista.com/forecasts/289770/e-commerce-revenue-forecast-in-india
2. Business Wire, SellersFi Closes Credit Facility up to $300M with Citi and Fasanara Capital, 2023