# ITFA CYPRUS 2024: CAN THE RECEIVABLES MARKET OVERCOME THE OBSTACLES TO FASTER GROWTH?

***Contributed by Michael Bickers, Managing Director, BCR Publications Ltd – September 2024***

One of the sessions of ITFA's recent annual conference in Cyprus was: *Barriers to Success – what's stopping us growing the receivables markets faster?* A panel of three industry experts surveyed the market, charted the difficulties in growing it to its full potential and offered tools and suggestions to increase its rate of growth. Four ways forward emerged from their discussion: more innovation in digitalising payment processes, new product launches and portfolio approaches, securing clarity on compliance from the industry regulators and increasing the collaboration between banks and insurance.

The panel consisted of Cruz Gonzalez, Executive Director, WTW Financial Software, Carlos Grassl, Director, Platform Solutions, Demica, and Anthony Wadsworth-Hill, Co-founder, DCEO and COO, Mercure Group.

As the moderator, Sheleena Govind, (Head - Financial Institutions, Trade Corridors and Distribution, Trade & Working Capital, Rand Merchant Bank) pointed out, the global receivables market grew 3.6 per cent in 2023 according to FCI's 2023 Annual Report, the third consecutive year of expansion since the pandemic. She also highlighted the fact that according to Demica's Benchmark Report receivables finance has for the first time overtaken payables as the product with the highest growth potential. This all speaks to the market's resilience at a time of macroeconomic and geopolitical uncertainty, but hurdles remain to its growing much faster.

## Six key obstacles to stronger growth

The obstacles were clearly identifiable and familiar: having the appropriate technology, navigating geopolitical risks, strengthening fraud detection, embracing automation and digitisation, incorporating ESG in receivables financing, and developing suitable risk mitigation tools.

Sheleena Govind, from her perspective at Rand Merchant Bank, a leading African corporate and investment bank, confirmed that all these issues are evident on the African continent. She said: "We still continue to face many stumbling blocks: access to limited credit capacity, access to distribution channels, fraud and compliance and the use of digitisation." She added: "Another very important issue is the legal considerations when transacting across different markets."

## Reduce the cost of compliance

Anthony Wadsworth-Hill, at Mercure Group, pointed to further factors: AML, KYC complexity and bureaucracy, and a critically important factor – the cost of execution. If banks and other financial institutions want to lean more into the SME sector, they need to find ways to reduce the cost of maintaining relationships in the SME space, because the SMEs are not going to bring in large ticket values. Although the banks like to say that they can support the SME community, the reality is that when faced with the problem of onboarding with all its attendant costs they look to those relationships that generate the most internal revenue with the least effort.

To address this important issue Mercure is developing a corporate KYC passport for a customer which will contain all the customer's data. The corporate can then grant access to that KYC passport to a financial institution to meet regulatory compliance. Mercure will house the passport and maintain it within three months of the customer's cycle. Mercure will also be working with the ICC's digital standards to enable corporates to issue their own digital instruments wherever possible. The company is piloting the passport with one lending institution and two more may follow.

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**Clear the misperceptions about receivables finance**

A key barrier to the growth of the receivables market is how the product is perceived. Carlos Grasl, from Demica, outlined a range of misperceptions. There is a myth that receivables finance is for companies with cash flow problems, “but we are in a different environment now”. Rising interest rates have increased the cost of borrowing, prompting the quicker monetisation of receivables from companies both large and successful. Receivables finance is a tool available for CFOs and corporate treasurers that they can use to decrease borrowing, to increase liquidity and to improve working capital metrics.

Another myth is that receivables finance is expensive. However, supply chain finance in general, from a funder’s perspective, is a lower risk option given its direct visible link to commercial activity, so the asset backed nature of receivables finance facilities can often translate into lower pricing versus other potential bank debt facilities in the form of revolving credit. “So, receivables finance in general provides corporates with relatively quick access to low-cost funding, particularly in this environment of higher rates.”

A further misconception among some corporates is that receivables facilities are always disclosed, unaware that in the mid-market or SME sector especially there may be undisclosed facilities where their customers are not notified or contacted at all. Therefore, they may believe that they might lose control of their customer relationships. “They don’t realise that they can collect directly from the customers and maintain their relationships provided that they provide the funder with control of the collection account.”

An additional myth is that structured receivables facilities are too complex for inexperienced sellers. “While it is true that the lack of experience can create challenges this can be overcome through the right support and knowledge from the banking partners.”

**The need for clarity and pragmatism in new regulations**

A more widespread concern for the receivables market is regulatory challenges. Cruz Gonzalez explained how impending regulatory change is impacting the receivables finance industry. There is uncertainty and inconsistency with the regulatory changes that are being proposed. She said: “The market has and will continue to adapt to regulatory change, but we need a consistent and finite message. We need to know what we need to adapt to. The banks are waiting for the regulators to make their final position and to have a level playing field. Then we need to know how long this is going to take us to adapt and get there.” She also referred to new Basel requirements, in particular requirements “around eligibility criteria and issues that are impacting heavily on the wordings that need to be supplied by banks that are covering receivables finance transactions.” The regulators want to see a standardised approach to wordings, but each bank will have its own separate terms and conditions and requirements that they need to meet internally. Maybe the industry could agree on some common clauses in receivables wordings.

**Insurance costs**

Insurance costs is another issue according to Cruz Gonzalez. She said: “If insurance is going to be one way by which to further the growth of the receivables finance market, then the market has to factor in the fact that the insurer will have a cost of the capacity that is being reserved for the transaction”. The question remains: who is going to bear the extra cost that needs to be included in the deal? She added: “Another challenge right now within the banking sector and among lenders in general is finding better utilisation of the lines they have with insurers. The number of insurers within the receivables finance space is limited. So making a good use of insurers and partners that we have is the challenge at a time where capacity is scarce and we need to find more ways to continue to grow.”

**Technology can play a part in furthering market growth**

Carlos Grassl argued that technology can remove some of the obstacles in receivables finance. It can solve time-consuming and complex manual tasks in the form of data extraction, data mapping, data formatting and data scrubbing. Trade finance data often resides in different systems, across different seller entities and in different formats, and therefore often lacks standardized structures. This is where technology can add a lot of value. Today, many banks continue to struggle with outdated technology. Improving tools in this respect can ultimately help them in increasing funding frequencies. By being able to capture data inputs and process them more efficiently, they can increase the purchasing and settlement frequency to better serve their client needs.

He added a list of other benefits: "They can add and manage more debtors to transactions. They can monitor exposure, both at individual transaction level and at the portfolio of transactions that they offer to clients. Technology can help by triggering different dynamic reserves, pulling fees directly from credit insurers, prioritising the purchase of assets by a combination of attributes such as currencies, jurisdictions, credit ratings and multiple other factors. Technology can also help later as well with the distribution of these assets and orchestrating payments and loan bookings further downstream in the system."

**Creating a digital business exchange**

Turning to some of the tools that can enhance the faster growth of the market, Anthony Wadsworth-Hill explained that a significant way to assess a performance risk is to create a digital business exchange that links to the relevant legal requirements. Mercure's digital business exchange, through its technology company, is geared up to be a regional document issuer, as it has been for example, in enabling a UK sugar trader to make purchases from Central America. Once the payment instrument is digitised with other parts of the financing, then the whole process is speeded up. What is important, he said, is not to overburden the customer with too much technology at the same time.

**Current drivers of growth**

Carlos Grassl pointed to a number of developments that are boosting the market. Rising interest rates are prompting the quicker monetisation of receivables. There is an increased use of trade credit insurance which is growing the market. The enhanced capabilities of participants to distribute is also boosting the product. In addition, there is much greater interest in the portfolio approach to receivables finance which is facilitating its growth. There are also new users of the product, for example fintechs or marketplaces with embedded finance capabilities that are relying now on trade receivables securitisation as a low-cost option. There is an increased focus on launching new products as a growth driver. Finally, he highlighted that receivables discounting is now perceived by the industry globally to be the most popular product for growth.

**The need for collaboration**

Looking to the future, Cruz Gonzalez said that further growth requires more collaboration and understanding between financiers and insurers. Retention is important, so indemnity levels play a good part in that. She pointed to the need for indemnity levels and first loss tranches to increase capacity and manage risk. There has already been a shift in this direction. She explained: "We are seeing a lot of structures with the first loss based on historic losses with a few deviations. And then above that, just to top it off, they have insurance up to 100 per cent cover at indemnity level which is equal to the facility size. We are also seeing single risk transactions turning into a portfolio approach, which solves a lot of the issues we have come across in terms of barriers to market growth." She added that if you have a portfolio approach then you can leverage on that relationship and volumes to get better pricing as well. It also helps you with the operational risk and concentration of the volume and the management, because if you have everything together in one place it is easier to have control over what your insurance is, and this is where technology can play an important part as well.

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She added that WTW is seeing platforms supporting not just the streamlined process for documentation share, but also once a deal is insured, and once the bank has several insurance partners, they want to still be able to see how much of their exposure is covered at a specific time, but not individually per insurer. "Having cross insurers information available so they can see exposure levels, utilisation volumes, and how much of that capacity is free for them to utilise at any one point in time, is also a request we have seen."

As the discussion closed Sheleena Govind concluded by saying that synergies between banks and insurers and the market as a whole is not just beneficial. It is essential for the resilience and expansion of international trade.