

Financing global trade

Sara Norton* reports on the changes under way in the banking sector where a tardiness over adopting modern technology has resulted in a weak link in the supply chain

Early in October, several thousand members of the global banking and finance community got together in Sydney for the industry's annual expo – SIBOS – a forum that seeks to unite financial services, communications and new technologies to improve standards and interoperability in all areas of payment, securities, treasury and trade.

Why is this of interest?

Increasingly, the banks are waking up to the fact that global trade is accelerating around them and traditional services no longer keep pace with the nature of transactions. In fact, banking is becoming a commodity. The traditional 'intermediary' role (providing trust services or letters of credit) has shifted considerably, to the point that a bank may be involved only in making the final payment.

Maintaining a viable trade services business in this environment requires that banks create a new role for themselves as direct 'participants', focused on bringing efficiency to all the parties in the chain – the corporation, its suppliers (and their suppliers) and customers (and their customers). But here is the rub. As the last link in the import/export process, corporate banking services remain virtually dominated by paper – and the cause of serious supply-chain friction as a result.

As an illustration, when stocks of fruit juice or engine components dip below a certain level, suppliers to retailers and manufacturers are automatically requested to make a delivery according to pre-determined criteria. Such high levels of synchronisation can reduce inventory costs dramatically. However, the process frequently

grinds to a halt due to a discrepancy between purchase order and invoice, or if the supplier cannot meet the extended terms of trade.

Companies have invested millions in automating a range of front and back-end processes to squeeze delay out of the physical supply chain – as well as interfacing their IT systems with those of external suppliers, transport and logistics partners, and customers. But as soon as they approach the financial supply chain – the flow of money and information from order to payment – they hit paper.

This is not a minor inconvenience. According to a recent study by AberdeenGroup, 60% of international settlement processes involve old technologies (phone, fax, email) that do not add to the value chain. Through tradition and a lack of automation, many companies and suppliers still rely on manual procedures for handling receivables, invoices, and letters of credit.

For example, during the 12 months to July 2006, it was estimated that more than US\$1trn in cross-border trade was settled by traditional letters of credit. The consequences for a billion-dollar US company not having a fully integrated financial supply chain are that there could be a perpetual gap of up to \$40m in working capital.

Why is this tolerated?

Historically, banks have built proprietary systems that have locked in their customers, often investing significant amounts over years, or even decades. The banks look on these solutions as a one-too-many. Their message to corporate clients has been "you can come into my world".

Equally, there are still benefits for

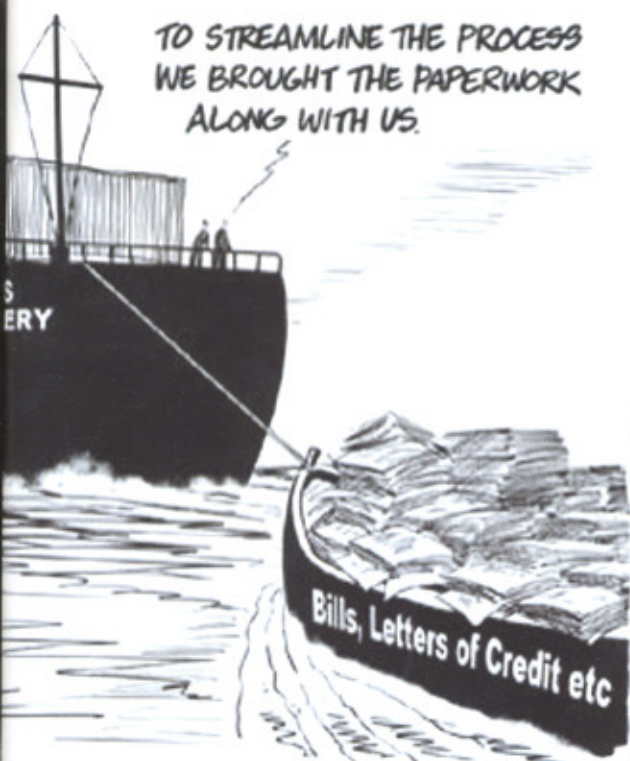
retailers and manufacturers in retaining elements such as letters of credit in the transaction: the buyer enjoys 'final say on payment' as well as assurance on timeliness and quality specifications, as evidenced by other supporting documents. The seller also benefits from cheaper bank financing and the mitigation of credit risk – added to which, many suppliers do not have access to the bank credit they need because they lack the prerequisite financials and a track record.

And then there is the issue of mistrust. The biggest obstacle to closing the gap between physical and financial supply chains is the 'us and them' syndrome. Corporates still do not think that the banks are ready and willing to share data in a timely and convenient way between multiple parties involved in a transaction; the banks do not think that corporates are interested in standards. Consider this – how many banks employ managers with a strong corporate background, or vice versa? In reality, people tend to spend their careers in one camp or the other, with insufficient cross-fertilisation to truly understand the challenges the other side faces.

Globalisation and complexity are also contributory factors. Most global organisations use multiple banks, which results in headaches that stem



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Source: International Banking Systems Journal, June 2006

from dealing with individual bank portals, Word documents, faxes and emails. The same applies to export letters of credit and guarantees, where there are also multiple lines of communication and where production can be held up waiting for advice. Frequent examples can be found of organisations with 50 people in the accounts payable department who do nothing apart from match up invoices and orders on foreign supplies.

With the drive to low-cost country sourcing and longer, more complex supply networks across the world, importers and exporters have to look for new ways to maintain margins and grow market share. Limiting balance sheet liabilities typically incurred in trading is now an area of considerable interest, both by the use of non-traditional financing techniques to support trading counterparties and through improved and faster reconciliation of purchase orders and invoices.

Put simply, corporate patience is running out. Evidence suggests that if banks do not provide meaningful services to support the reality of today's globalised supply chain, they will be left behind, while other more flexible finance providers take a greater share of the market.

Clearly then, there is a huge opportunity for banks to automate interna-

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tional settlement pieces, as well as develop more value-added trade services for the supply chain. This is backed up by research studies that highlight "improving the global trade process" as one of the top corporate priorities for companies in 2006-7.

Individually and/or collectively, the leading trade services banks are starting to respond, with a spending estimate of \$3bn in software and systems for expanded and automated trade-related services next year. For example, SWIFT (the industry body that represents global financial and banking institutions) is currently piloting a Trade Services Utility platform – an e-commerce tool that enables multiple parties to match purchase order and invoice data online to reduce payment delays. Added to which, the Single Euro Payments Area (SEPA) EU Directive – due to be introduced in 2008 – will require standard bank payment and collection instruments to be applied throughout the eurozone with the aim of enhancing the speed and efficiency of payment flows between customers and suppliers.

And it is worth the investment. According to Aberdeen's study, companies that used their bank's trading services found savings of tens of millions of dollars annually through pre-shipment financing for multiple countries and accelerated payment and receivables cycles.

Delivering that kind of a return is also a sure-fire way to retain and build customer loyalty, as well as minimising exposure to risk. Most large companies are not interested in taking a piecemeal approach to global trade management, and as the percentage of business operations labelled 'international' grows from perhaps 5% five years ago to 40% now, chief financial officers and treasury departments are increasingly influential in many areas of procurement, meaning that the priority is to consolidate the end-to-end circle of physical and financial supply chain, gain visibility to cash-related events and enforce better financial reporting and controls.

Here, as in other spheres of international trade, technology can be an enabler. Systems exist that offer banks the ability to act as a global trade hub, connecting the prospective importer or exporter, Customs broker, transport and logistics intermediary through a

secure online portal and providing a central point of integration for key physical and financial supply-chain triggers, such as purchase order generation, advance shipment notification and warehouse goods receipt. This in turn enables companies to improve forecast planning, manage inventory levels and automate other business processes for transportation and regulatory compliance.

It is not a difficult argument to present. Banks that have these systems onboard can say to their clients: "You take a \$1bn line of credit for financing and I will manage your Customs clearance for you." For SMEs and global corporates alike, a single-source trade management proposition is both operationally and commercially attractive. As experts in supporting trade transactions since the Babylonians devised a crude form of a bill of exchange, banks are now in a position to marry age-old expertise with 21st century technology to deliver solutions that mirror the speed and accuracy already evident in the logistics world.

So, what is the hold-up?

Fundamentally, there is no dissent on either the corporate or banking side about the mutual benefit of bringing together the two halves of the supply chain, but the lack of understanding between banks and corporates, the siloed nature of each, and the perceived danger of trying to do too many things at once, are still significant barriers to progress.

There was a time when 'he who brings the gold' ruled. That time, arguably, is no more. Banks need to recognise that global trade is growing at least three times as fast as GDP, and this demands a new approach to trade services – based on a collaborative mindset and the application of new technologies.

Equally, retail and manufacturing importers and exporters looking to convert hard-won operational savings from low-cost sourcing and demand-driven production strategies into balance sheet profits need to work more proactively with their banking partners to gain better visibility, accuracy and financial rigour across their global supply chain. ■

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