Cover Story

Banks assert their role in trade and supply chain

Market turmoil is the force behind innovation in trade services. This makes 2007 an interesting time to be at the helm of a global bank developing the mechanisms that drive the global economy. Oliver O'Connell talks to some of the market leaders in the development of trade services and supply chain solutions about how banks remain a vital cog in international trade and how they respond to client demand.

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This is an exciting time to be involved in trade finance. If you look at the market volatility that is out there today, that is what is driving the innovation in trade. Three months ago, most major corporations had access, through a variety of channels, to the working capital that they needed. What capital market volatility means is that with several hundred billion dollars of commercial paper coming due in the next few weeks, many companies are looking for ways of freeing working capital within their own balance sheets. That is where effective management of trade and supply chain finance comes into its own.

"What this has resulted in is a case of necessity being the mother of invention. Companies need liquidity and they are wringing it out of every place that they can – banks can do a lot to help in the supply chain space. Volatility in the capital markets is forcing companies to be very creative, which makes this a very exciting time to be in this area of banking," observes Claudia Slacik, global head of trade services and finance, Citi Markets and Banking in New York.

All this is very different to the conditions trade finance banks have had to endure in recent years. Slacik's colleague John Ahearn, global head of trade services/financial institutions, Citi Markets and Banking, notes: "Our business, and certainly the trade business globally, has been under a lot of pressure over the last two or three years, because what we do very well is mitigate risk, but the herd mentality was this unbelievable perception that there was no risk anywhere in the world. This was coupled with seemingly endless liquidity in the markets. A couple of months ago the herd mentality changed and people came back to realising that there was risk in some of the markets they operate in, and are now they are also realising that beyond that there is risk in countries and risk with suppliers. These are great drivers for our business."

In this kind of environment supply chain finance takes on an even more important meaning for trade as it retains its flexibility and speed to meet changing market conditions. Adnan Ghani, global head of trade services at ABN AMRO, concurs: "There is a lot of focus on trade now as a marker of how the global economy is reacting as trade is its lifeblood. Trade is also a valve to allow liquidity into the market to the supply-side. For the banks trade and transaction banking is a very stable product and the volatility is very low. This is why it is such an important area for banks to consider at this time."

What banks have also had to contend with over the past few years is the increasing drive to innovate in the trade and supply chain space coming from the corporate side. But banks counter that instead of pushing them out of the frame this has only served – through partnerships with clients – to make them stronger and push the development of the trade services market.

Kah Chye Tan, global head of trade services at Standard Chartered Bank in Singapore explains the development of the market in recent years: "Corporates' improvements in their management of working capital and financial supply chain are never a zero sum game. It is little like the introduction of digital cameras. Instead of pushing out the traditional camera makers, there are now a lot more camera makers and more people taking pictures than ever. The market has simply grown exponentially. The same goes for financial supply chain as banks will continue to innovate and meet clients increasingly sophisticated needs."

Claudia Slacik at Citi in New York

He continues: "One of the most obvious innovations is in the area of information integration. We all know that every supply chain transaction begins its life as a trade transaction and ends it as a cash transaction in a current account with a bank. But in between the trade and the cash there are multiple handovers ranging from the warehouse operators to the shipping companies. Banks being the alpha, i.e. trade, and omega, i.e. cash, of these transactions are in an enviable position to integrate the flow of the information through a product life cycle. Furthermore, while it is true that the asset conversion cycle in any supply chain transaction is getting shorter, the working capital being freed up is now being used to finance a lot more trades. Global trade volume grew by 12% in the last three years and banks that are able to capitalize on this growth have seen assets grow by more than three times that growth rate. In short, the market has simply grown exponentially."

This optimism about the growth of trade and the drive for more innovation to further unleash the market's potential is reflected across the board in the run up to Sibos 2007 in Boston. While there is innovation at all levels of trade services, the supply chain, and the role of both the banks and the corporates, is drawing the most interest.

At Citi, Slacik explains: "Our clients have found that you cannot just be a domestic entity – you have to buy internationally to lower your costs, and sell internationally to increase you sales. So as our clients are becoming more and more global, their demand for solution sets that facilitate international trade, mitigate risk and provide liquidity to their suppliers and distributors is growing. That to us is the supply chain – companies have been talking for a decade now about making their➤

➤supply chains more efficient – well their supply chains are now international and you can't talk about supply chain management without talking about innovative products, services and solutions that facilitate trade, mitigate risk and give visibility into the flows."

Ghani at ABN AMRO adds: "The supply-side needs access to cheap financing. The buyer-side wants to ensure a steady and reliable source of supply and they want to make sure they can support their supplier to make sure there is no disruption. ABN AMRO is providing a solution to meet both sides of this. What we are doing is supplying cheaper sources of financing based on the commercial relationship the supplier has with the buyer. What that ultimately means is that the buyer can hopefully source goods cheaper and sell them cheaper to the ultimate client."

The way technology can enhance this is that a buyer can have hundreds of suppliers across all continents – look at the average supermarket chain and think of the complexities involved. Supply chain solutions are able to smooth this through the ability to match purchase orders to invoices, and once they are matched they can be financed and on the maturity date they can be repaid. This simplifies the process and gets rid of a lot of things that were done on paper. Trade has moved from a timeframe of days to an almost instant process. This speed has also meant that the disputes that you used to have regarding discrepancies, that caused delays and cost time and money and damaged the relationship between buyer and seller, have now been largely consigned to the past.

In making this happen it is important for a bank to work closely with its customers to find out exactly what they want. David Manson, director – international sales at Royal Bank of Scotland, explains how cooperation is needed to push development forward: "Supply chain finance has to be driven by both customers and banks. It recognises a massive move to open account. Documents are drying up to a degree and there is a lot more of a move towards electronic payments, so we are blurring what we traditionally saw as trade and what we traditionally saw as cash management. What this means is that cash management is really now the mechanism for settling trade, and supply chain finance recognizes that."

The traditional three unit model of trade, cash management and foreign exchange is blurring. A typical mid-market client will have one team and one decision maker who wants a solution for all three elements. For a bank, issuing an LC is a trade transaction, but for a client at the same time they may need to make a payment in another currency. For a bank that is an FX transaction but for a client they see it all as trade finance.

Says Ghani at ABN AMRO: "Customers probably do not distinguish the differences between the three areas in their minds. What is cash flow advisory? What is trade flow advisory? What is FX advisory? They want a solution that mixes all three."

So for a bank the boundaries have blurred. The challenge for the banks is making sure they can put the right person in front of the client who can service all the client's needs across the three topics. They must

Adnan Ghani at ABN AMRO in London

have strong product knowledge across all three sets. Relationship management is crucial. From a technology perspective, banks have developed products that from a single sign on the customer can now access all three modules in one system. This makes it one transaction but with three different things that can be done end-to-end – what has been described as an animal with three tails and one head. This allows for the flexibility clients demand and broadens the scope for use by more clients.

Martin Allison, head of international banking services at RBS, adds: "The end game of this is building what I can describe as channel choices to ensure the customers' needs. This is a reversal of the old-fashioned Ford mentality of here is a black car, buy it. We are actually tailoring the right access to our payments and trade services capabilities to each customer. Flexibility is crucial."

Managing trade relationships

Supply chain finance is a major project for banks to take on, but it is always customer driven in how banks are moving with their clients to help them trade on an open account basis. Banks keep certain customers very close to them in the development and building of new solutions, and in many cases this justifies the bank's investment in development with the finished product being not only what that particular customer wants, but also what other customers will find they need. The dialogue between bank and corporate is very much a partnership in how that product is designed and rolled out.

Manson at RBS, adds: "We ask three questions – what do customers need for operational effectiveness; what are their levels of financial sophistication; and what is their credit dependency? These are at the forefront of the customers' mind. Working with them as a relationship bank is so key."

Long-term, intensive relationships with customers enable banks to understand the internal workflows, production and trade cycle. A constant monitoring of market trends via client group interviews as well as independent research material is important for deeper understanding.

Axel-Peter Ohse, head of Deutsche Bank's trade and risk sales team in Germany says: "My personal view is that this is very much a 'give and take' situation. Of course clients have and do formulate requirements and consequently drive banks to become ever better in addressing and fulfilling those requirements. But also the banking industry does come up with new technology applications, product ideas and services which – once operational and often jointly tested with pilot clients – are well taken up in the market. A high profile example is the TSU facility, driven by SWIFT and a handful of leading bank players, which currently is being tested with corporates and will offer a basis for data matching of purchase order and invoice data, linked to payments and potentially financings."

Development strategy for banks today is a push and pull model. On one side banks are looking at what their clients need from which they then develop solutions. It then becomes a push strategy from the bank side as they ideas developed for one company and go through their client base to see where the solution can be replicated. On the pull side clients are very innovative and they bring ideas to the banks that they may not have thought of, which can then be co-developed with them. This can happen at different scales too, as a solution may be required, or has been developed, for a specific problem in one subsidiary of the customer, or it can be on a global scale across the client's operations.

One main goal on the banks' side is to develop a solution that has as wide a variety of functionality and scale so to be of use to as many clients as possible. "We will always strive to develop a solution that can cater to our varied customers' requirements. That is easier said than done. Take reports as an example. No two corporates will have the same reporting requirements. Even within the same corporate, no two departments will have the same reporting requirements. Within the same department, no two individuals will have the same reporting requirements. Having said that, we are quite effective in creating solutions that will meet customers' requirements at the lowest common denominator. Let's use Microsoft Excel spreadsheet as an example. I think that is a wonderful product that meets the needs of people from a diverse industry and specialization. It does not matter if you belong to a transportation company or a hospital. It does not matter if you are from finance department of human resource department. You will still be a user of Microsoft Excel," says Tan at Standard Chartered.

Kah Chye Tan at Standard Chartered Bank in Singapore

Wish list

So what else is on a client's wish list? "One is the speed at which they want to be able to process their trade transactions. They want speed and they want simplicity. What banks are trying to do therefore is introduce technological solutions to meet the need for speed and simplicity," says ABN's Ghani. If banks can provide this to clients at an affordable cost then they can work on increasing the scale and scope of a solution.

Going deeper into client need, Deutsche Bank's Ohse observes: "Clients want state-of-the-art technology based on open architecture. There are many systems being employed by our clients and a lot of re-engineering has happened on the supply chain management side – clients will not repeat that just to be able to interface with their pool of bankers but demand that bankers can interface with them. Besides that, supply chain management is not doing away with the classical functions of risk and payment management, it will just be done differently, i.e. a lot more based on open account payment basis."

Customers want more than the ability to log onto the internet to retrieve their supply chain information. They want the information to be 'pushed' to them based on their predefined frequency and requirements such as email, fax, SMS, customized spreadsheets and text files for upload into their latest SAP.

Says Tan at Standard Chartered: "Apart from technology, customers today want a bank that can function as their panel of core service providers, in a way that is no different from any OEM partners or their logistic partners. For example, when the customer goes to Indonesia, sets up sales offices and appoints distributors (and accepts inherent risk working with these distributors), the customer expects us to share this distributor risk and provide financing to these distributors. Essentially, we are no longer just a banker to our customer. Today, we are increasingly their full commercial partner."

Deutsche Bank's Ohse adds: "In general, I would say that not only corporates but also banks are faced with tremendous pressures to streamline the trade business. The margins in trade finance are pretty much fixed if not declining, the paper based process requires a lot of manual interaction and staff salaries are ever rising – a formula which cries for process reengineering and usage of integrated and straight-through work processes. In that respect the big banking players do➤

➤look carefully into opportunities, which can and do offer a better connection of the physical with the financial supply chain. Technology and in particular technology integration capabilities play a vital role for both partners – clients and bankers – but I do see that as a natural evolution from a paper-based to an electronic-based trade finance business which will simply utilise a different combination of the same base products: country risk management, counterparty risk management, funding and payment."

There can be surprises along the way to developing new systems through client feedback. Citi's Ahearn explains: What we're seeing is that as the enterprise resource planning (ERP) systems are rolled out to large corporates, the feedback we got was that their desire for web-based technology was less than it had been. Clients are actually running most of their enterprise off of the ERP system. As they bring more and more of their own processes onto the ERP system, they don't want to have a disjointed information flow by having a separate web-based system."

An example of this is in Citi's supplier finance or reverse factoring business. The way the model used to run is that companies give the bank information to be processed. Now what they want is to give the bank the information, have it processed and then have it returned to them so they can drive their downstream ERP systems, their inventory systems, their cash forecasting, a whole variety of things. This is really a fundamental change, however, when you start talking about a large company's vendor and supplier base, that element of trade is still very much web-based technology for now.

Ahearn adds: The feedback on web-based systems is really quite different to what we anticipated. I think what's going to be interesting is there is now newer slimmed-down ERP systems that are being sold to SMEs in middle markets. So they may not have the full SAP or Oracle system, but you have Microsoft and others developing thinner ERP systems for the small business. One of the things we are looking at is whether we can embed ourselves into those systems as we do our development – and that's where our clients are driving us."

David Manson at The Royal Bank of Scotland in London

Web-based or not you have to be able to take all this information and be able to present it in a clean and concise manner that makes sense for the client, so that they can take that information and react off it. The bank can then provide the financing or whatever service is needed.

Client wish lists for what banks can provide them with will certainly be at the forefront of people's minds at Sibos this year. Marilyn Spearing, global head of trade finance and cash management corporates at Deutsche Bank points out: "This will be the first Sibos to have a corporate 'conference within a conference'. I expect that will drive a higher than usual discussion of services designed to meet their needs, which is a perfect platform for discussions of ramping up volumes on the trade services utility, and partnering with our bank relationships to do this effectively."

Standard Chartered's Tan adds: "Contrary to the usual perception, I do not think corporates are looking for the lowest cost provider. I think corporates are looking for value. Frankly speaking, if corporates are looking for lowest cost providers, a lot of banks and my peers would be out of business."

So what can we expect going forward in the trade and supply chain arena? At Deutsche Bank Ohse observes: "One particular area will be new for clients as well as banks: electronic integrated processing offers a wealth of data and information which was not readily available in the past – that alone could create a whole sequence of corporate wishes for value added services which banks can provide in the future, such as, for example, automated data matching, reconciliation and dispute management services."

The data generated by trade offers up exciting possibilities not just in the corporate-bank relationship but also inter-bank with the potential for banks to collaborate and share information with partners in markets where they have a limited presence. The possibilities for new services and products, white-labelling and outsourcing will then grow from there.

Banks are even looking for inspiration in the phenomenon of social networking sites such as Facebook. There are exciting pilots being beta-tested which are opening a new channel for interaction within the various trade communities. The exchange of information and advice and access to information on trade facts, regulations and laws is seen as having potential as a value-added service to build off traditional trade solutions and roll out to a wider client base. As these products are tested and customer feedback comes in and development takes place it will be seen as to what clients and partners value in this area.

Slacik at Citi sums up the trade bank mood looking ahead: "The innovation that is coming out and the integrated solutions we are working on is mind-blowing when you look at where the business was four or five years ago. There are some real leaps being made that will transform the industry." ■