Flash of brilliance, or flash in the pan?

Alexander R. Malaket explores some of the preliminary developments in the supply chain finance area in the North American context.

Supply chain finance: while some banks and financial institutions continue to debate its substance and sustainability as a business, others debate, or seek to shape, its nature, and still others seek in it a transformational value proposition to revitalize the finance of international trade. Does all this have any impact on trade finance operations?

The state of supply chain finance in a nutshell

Supply chain finance (which we will refer to as SCF – to be distinguished from the other familiar SCF – structured commodity finance) has earned prominence with numerous trade banks and trade specialists as a way of extending the value proposition of trade finance; for some, in an incremental manner, which relates very closely to core banking activities, and for others, in more transformational ways that extend significantly beyond familiar territory.

Elizabeth Atkins, head of supply chain for Wells Fargo HSBC Trade Bank

Interestingly, certain trade financiers who have achieved success in key areas of the business remain skeptical about the practical implications of supply chain finance on international trade, and therefore on the offerings of their financial institutions.

Another reality which becomes quickly apparent in exploring the state of this emerging flavour of trade finance, is that the basics – such as defining what constitutes supply chain finance – are still very dynamic and 'in flux', as several executives have been quick to point out.

According to James Hogan, group head of supply chain management and head of trade services North America for HSBC, "In many ways similar to the dot-com boom, the industry is still working out how best to develop standardized definitions and applications for supply chain finance and related terminology. Today, many of these concepts mean different things to different people. For HSBC, anything related to the support of international trade is part of our organization's DNA – it is fundamental to what we do. There is currently a lot of jargon in use as well as some propositions that are not necessarily commercially sound. However, for HSBC, supply chain finance is a variation of our core trade competency where we support our customers' working capital and international trade needs."

Opposing viewpoints and definitional nuances notwithstanding, it is clear that something is afoot in the business of international trade, and by extension, in the far-flung offices of trade financiers across the globe.

SCF: a framework

Whatever the ultimate view of SCF held by an individual trade finance organization, it is apparent that in its broadest definition, SCF reaches across all levels of a trade finance business – from the more 'structured' side, to the pure transactional and operational side of the traditional trade dichotomy.

The ability to offer diversification of sources of working capital, combined with integration and leverage of treasury solutions and cash management skillsets, as well as extension of documentary expertise across a transaction lifecycle, provides fertile ground for the development of new value propositions in trade finance.

In some conceptions of the SCF universe, this emerging line of business also includes the long-standing element of in/outsourcing, so familiar to trade financiers.

SCF, for some, includes an element where banks are effectively insourcing certain activities from their corporate clients – from document preparation to global sourcing under master letters of credit (LCs), to the full accounts receivable function.

A second level of the emerging SCF model is primarily transactional, and involves one-off purchase order or invoice financing as required by clients on an ad hoc basis. By some assessments, this is basically similar to financing under an LC or a collection, with an incrementally different risk profile which varies in proportion to the visibility of status across the transaction. In general, this is pre-shipment financing.

A third variation may be referred to as 'payables-based financing'; the differentiator here being that an invoice must be issued, and must be accepted by the payor. This variation does not involve rejection, rebate or dilution of the invoice, and given the acceptance of the invoice for payment, this is by definition, post-shipment financing. For some, this is where there is an opportunity to push transaction volumes through a platform-based technology and related business processes.

Operational impact

Trade finance operations could not, as a whole, be mistaken for the most innovative and dynamic units within banking or indeed within operations as a whole, so that it is not surprising to find a certain resistance to change, verging on anachronism, in a significant number of operations units – and perhaps worse, among senior operations managers who refuse to acknowledge the tide of change, even as they scramble to reach for PFD's (personal floatation devices) for themselves and for their teams.

Trade groups that have recognized the inevitability of the changes reshaping the industry are looking for ways to create synergy – perhaps at a level generally not achieved in the traditional trade finance business.

As described by Valeria Sica, managing director and deputy head global trade services at Citi, "Operationally, we are working closely and in partnership with our major clients, to develop and implement optimal solutions, rather than trying to impose a process on them. This approach, we believe is fundamental to success, and will enhance the effectiveness of any technology we may deploy in support of new offerings."

Among those who perceive that an operations-level response and mobilization are necessary, is a view that the documentary expertise is critical to the development of a viable and comprehensive offering in SCF. For some, the shift to open account trade links directly to the transactional and operational aspects of supply chain finance, and there is a realisation that trade operations teams encompass a great deal of valuable technical expertise, as well as significant amounts of institutional knowledge.

"Supply chain finance, as our clients require it, is a complex product with longer sales cycles than traditional trade products, partly because it involves many more touch-points within a client organization. We offer among the most highly integrated supply chain finance and payables management solutions in the market today, and certainly see this as a natural evolution of trade, treasury and working capital finance," notes Elizabeth Atkins, head of supply chain for Wells Fargo HSBC Trade Bank.

The increasing number of client touchpoints, from operations and logistics to purchasing ad treasury, will motivate some financial institutions to offer integrated solutions – not only at the product level, but at the delivery level, and this requires the engagement of➤

Wells Fargo strikes trade and factoring deal with Scotiabank

Wells Fargo will provide Scotiabank with factoring services through its Wells Fargo Century subsidiary and treasury services through its global correspondent banking division.

Scotiabank's clients – exporters and distributors – will benefit from being able to accelerate their cash flow through accounts receivable financing, reducing the time distributors wait for payments.

Scotiabank will also begin to offer pre- and post-export financing immediately through its commercial banking centre in the Dominican Republic and plans to expand factoring to other countries soon. In turn, Wells Fargo gains new international business opportunities, particularly in Latin America, where exports have increased due to the Dominican Republic-Central America Free Trade Agreement.

"Adding factoring to our supply chain financing capabilities will allow us to provide our clients in the Americas and around the world with more financing options to accelerate their accounts receivables so they can concentrate on managing and growing their business," says Alberta Cefis, executive vice-president and group head, global transaction banking, Scotiabank.

"We are pleased to be working with Wells Fargo Century, a respected and experienced factoring company," says Rob Pitfield, executive vice-president, international banking, Scotiabank. "As Canada's most international bank, we are pleased to offer this new service to clients and looking forward to expanding the service to more countries."

"This is truly an international success story, bringing together not only a US and Canadian bank, but also multiple teams within Wells Fargo to provide financing to companies outside of North America," says Stuart Brister, president and CEO of Wells Fargo Century. "We are excited to work with Scotiabank and leverage its expertise to provide flexible financing solutions to customers beyond our borders."

Sanjiv Sanghvi, president and CEO Wells Fargo HSBC Trade Bank

➤operations specialists.

Where certain banks have opted to create 'proof of concept' teams within their operations groups – perhaps positioned as the leading-edge 'pioneers' within the broader operations function, others prefer to facilitate the evolution of a hybrid operational capability which crosses former boundaries such as trade and cash management operations.

In any event, the need for more frequent and far more effective client interaction skills is recognized, to the extent that even cross-cultural effectiveness training is gaining some profile in operations. One specific instance of new levels of client interaction pre-occupying some banks relates to the need to 'get closer' to the vendors in-market – and to do so at the operational and transactional level.

The view which supports a notion of a reshaping of the trade business is expressed by Sanjiv Sanghvi, president and CEO Wells Fargo HSBC Trade Bank: "Trade bankers have been operating for years with a view equivalent to 'the earth is the centre of the universe'; recent developments are fundamentally reshaping traditional views and expectations about the business, essentially breathing new life into trade finance at all levels, and resulting in several compelling value propositions for our clients."

Clearly, the foregoing statement could describe nearly any 'level' of the trade finance business as it is evolving today. Perhaps most telling of the evolution is that it holds equally well in reference to operational aspects of trade finance, and the sense of rejuvenation is, we are told, strikingly apparent among members of the operations units charged with delivering services related to supply chain finance and open account.

Technology

Trade technology typically resides in an operational environment, and several major vendors – as well as financial institutions with the increasingly rare preference for in-house development – are investing significantly in the development and implementation of viable technology solutions in support of SCF. These solutions may be modules added to existing processing systems, or they may be fully integrated platforms meant to address SCF at its broadest.

In any event, trade, cash, 'working capital' (or any numbers of variations thereof) operations are, and will continue to be directly implicated in and impacted by these developments.

An oft-repeated characteristic of SCF – especially for those advocating the delivery of 'end-to-end', or even 'self-financing' supply chains (some prefer 'self-liquidating finance) – is the absolute, critical need for transparency at each stage of a transaction, and across the supply chain.

The most effective technology may assure a certain level of transparency through platform-level transaction initiation and near real-time reporting, however, it will be important to engage front-line transaction specialists in assisting with the ongoing validation and management of that transparency, given their proximity at the transaction level.

Conclusion

As we have argued in the past, undervalued and underleveraged operations units are too common in the business of trade finance. The evolution of this business into the supply chain space will only enhance the value of a well-leveraged operations capability, and compound the loss of potential in an operational capability (even an outsourced one) that is relegated to pure transaction processing.

According to one senior executive, trade finance is shifting from a primary focus on transaction processing, to a greater emphasis on risk management, particularly given the prevailing business climate and economic conditions. If that premise is accepted, one can argue that a fully mobilised trade business will derive competitive advantages against a disjointed, silo-constrained or even 'reactionary' competitor that remains oblivious to the reshaping of global commerce – and with it, the repackaging and redefinition of trade finance.

Supply chain finance and operations tomorrow

One well-placed executive with a broad market view noted that the shift to supply chain finance and open account is driven largely from the sales and product side for the banks, and that its implications – and potential – are largely lost on operations teams. This is a luxury that our industry can ill-afford.

To quote, once again, a senior trade operations executive whose comments in 1992 proved prescient, "…we must change our way of doing business, or we will be outsourced within five years…".

To the trade operations executives of 2008, the same message applies: if you intend to maintain a capability in trade/cash/working capital operations, it is necessary to adapt your business processes and value proposition. Failing that, one of your competitors, already preparing capabilities to deliver in the redefined landscape of trade finance, will thank you in two years, when your business volumes, insourced, will help shorten the payback period for the technology they are developing today. ■