Trying to keep one step ahead

Trade bankers in North America are optimistic about the business of trade finance, reporting robust activity, good prospects in the medium term, and new opportunities for value-added product offerings to their clients. At the same time, trade specialists are challenged by dynamic markets, high liquidity among corporates, and margin compression, as well as increasing compliance requirements. Alexander Malaket examines the market.

Trade is a core driver of the economies of North America, accounting for up to 20% of global trade flows by some measures. Under the framework of the Nafta, Mexico, the United States and Canada (once referred to by a former Canadian prime minister as the "Three Amigos") continue to develop further trade, largely on an open account basis.

Large corporates are currently flush with cash, looking for bank support in enhancing the efficiency and transparency across their supply chains, while mid-tier commercial clients continue to require working capital and cashflow management solutions. Small businesses are increasingly involved in international trade, with the effect that trade finance providers are looking to provide solutions that are effective to the particular needs of the SME sector.

Howard Bascom at Bank of New York

Exchange rates have had significant impact, as for example, the Canadian dollar has soared relative to the American dollar, affecting trade flows and financing options accordingly. Bankers are seeing compression in margins, and a general decrease in demand for trade credit in some regions. Mexico continues to be a strong market for trade and trade finance, though it also exhibits some degree of spread compression.

In general the North American market focuses on payment facilitation and financing, with risk mitigation arguably perceived as a lower priority among importers and exporters. The conduct of trade on open account terms covers approximately 80% of trade flows between the three countries, and US-based companies make limited use of export credit agency ECA cover – about 3%, versus European usage at 6%-7%.

Traditional trade products and risk mitigation techniques remain important to North America, though a clear trend is being acknowledged, as observed by John Emens, SVP, Small Business, US Ex-Im Bank: "US exporters, particularly in the SME and mid-market served by US Ex-Im Bank, are experiencing considerable pushback from their customers against the use of traditional trade finance products. The trend is firmly toward trade on open account, and this will continue as US companies move downstream to smaller trading partners in international markets. Our dollar support of SME exporters has grown 60% over four years, to $2.7 billion, and we continue to see tremendous potential for greater market penetration, as well as greater➤

➤collaboration with trade banks. Credit enhancement through US Ex-Im programmes mitigates risk for our customers, and facilitates the support of greater trade by allowing banks to extend additional financing, earning net new revenues in the process."

Intra-company trade is a key feature of the North American market, both historically, and in more recent times as organizations invest in developing market presence and capabilities in foreign markets. This type of trade, previously the domain of large multinationals and 'branch-plant' operations, is increasingly evident in the mid-market, as this segment increases its international presence through local facilities.

Consolidation of trade services

The consolidation of providers in the trade banking space continues as outsourcing arrangements become, not only more acceptable and feasible in the market, but increasingly attractive for a growing number of small and mid-tier banks. Several of the world's credible insourcers of trade finance operations are headquartered in the United States, and one of the pioneering relationships in sourcing trade operations was consummated in North America.

Technology has evolved to better facilitate effective sourcing arrangements, even on a private label basis, and the market has enough 'institutional knowledge' in terms of lessons learnt and best practices, to allow for win/win arrangements and effective trade service delivery to the ultimate corporate client.

For many mid-tier banks, the possibility of exiting the trade business is not an option, despite their sub-scale operations, since such banks frequently service a large number of mid-market customers (who maintain one primary banking relationship) and must provide a comprehensive set of banking solutions to maintain their customer base.

Howard Bascom, managing director, trade finance at The Bank of New York observes: "We are optimistic about opportunities in North America, both within our corporate client base and among our financial institution clients. Even as the market shifts to open account trade, LC-related opportunities are still growing, and the need for banks to invest heavily in technology to deliver a wider range of solutions makes outsourcing increasingly compelling. Our world-class infrastructure coupled with an incomparable training capability allows us to process transactions for new financial institution clients in very short order, often with enhanced service to their trade customers."

Banks in North America look at outsourcing primarily as a means to ensure access to leading-edge technology capabilities, and as a way to generate net new revenues through Asian re-issuance programmes.

As the market becomes increasingly aware of the range of product and service offerings available, and as prospective outsourcers are increasingly able to articulate their objectives and requirements, consolidation of providers of trade services operations will continue at an accelerating pace.

A leading insourcer of trade operations estimates that 50% of its trade revenues on a global basis are derived from providing trade services to its financial institution clients, noting that an increasing number of trade banks prefer to focus on the customer relationship, as opposed to the processing of transactions.

The next wave will be for sourcing programmes to extend beyond pure trade operations and processing, to cash and payments as well as supply chain solutions (as they evolve) on an integrated basis.

Open account trade and supply chain

Trade banks are increasingly focusing on their customers' supply chains in identifying, developing and delivering solutions related to trade finance. This trend is key in North America, given the nature of the markets and trading relationships involved.

The increasing focus on open account trade illustrates, for some, the ability of large trade customers to 'move the market'; leading trade banks have not only responded to the shift, but several are proactively shaping innovative solutions tailored to the new realities of trade, in North America and elsewhere.

Bruce Proctor, head of global trade services at JPMorgan Chase, notes: "We are seeing a very strong acceptance of and appreciation for the synergies in the JPMorgan Chase/Vastera value proposition. The market trends related to open account trade and supply chain management are such that trade clients value our unique ability to coordinate what were very fragmented processes – from product classifications and import regulations through to working capital management – and to do so on a global basis."

The importance of open account trade, even in its narrowest sense, is universally acknowledged by trade specialists, even those who believe that traditional trade finance products will remain a part of the landscape for the foreseeable future.

Erik Wanberg, managing director and trade head, North America at Citigroup states: "The shift in emphasis to open account is driving banks to offer new business solutions, as we have done with our program-based approach to financing our clients' buyers. Taking a portfolio view allows our customers to enhance sales, and positions Citi as a business partner, effectively embedded in the foundation of our customers' supply chains."

(This trend is reviewed in greater detail in the aligning cash management with trade feature in this issue.)

Differentiation

Several senior executives have articulated a conscious and strategic shift from a product or service-based approach to trade finance, to a customer-centric delivery model, supported by the right combination of expertise, processes and technology. The customer-centric view extends into industry-specific solutions, segment-related offerings and integrated technology capabilities.

Differentiation of product offerings and delivery approach is a critical element of trade banking in North America, across the spectrum of trade banks. From global players to niche providers, every trade bank understands the importance of successful differentiation.

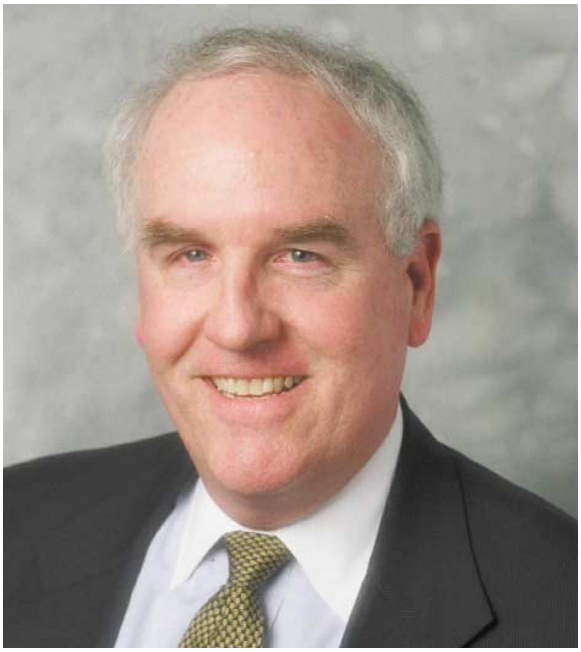
Michael Papadatos, EVP and head of trade services, Nafta, at HSBC, notes, for example: "The importance of a global footprint cannot be overstated. Our ability to deliver value on a differentiated basis in Asia drives success in North America. That same global reach allows us to reduce costs at various stages in our customers' supply chains, as well as to facilitate greater transparency – reducing risk – throughout a transaction. Our approach is increasingly focused on providing advisory services, including in trade compliance, as the historical focus on credit-based products gives way to more integrated, or 'joined up' solutions."

Differentiation can derive from fundamental variations in mandate, market focus or vision, as well as from more subtle nuances in approach, or simply, differing conclusions about the source of the greatest value among a series of viable choices.

The Trade Bank, (a joint venture between Wells Fargo and the HSBC Group) is a chartered bank focused on international trade, serving primarily the US mid-market (including Wells Fargo customers) with trade finance and risk-mitigation solutions. Sanjiv Sanghvi, EVP Wells Fargo and Trade Bank CEO notes: "Intra-company trade is significant in North America and increasingly so among mid-market companies, which are opting more and more to set up operations in foreign markets. The challenge now becomes about international borrowing rather than transaction-based product solutions. We are initiating a pilot program which allows us to provide financing without regard for the geographic location of the underlying asset, and will be looking at several initiatives – including identifying opportunities to work through the capital markets – to respond to the evolving needs of our client base."

Differentiation is such a critical element of business for leading trade bankers, that it extends into areas that relate to transaction clarity and information quality, as well as pure payment or financing aspects of trade services.

Trade banks will, for example, tout unique or customized reporting solutions, technology and data capture that facilitate compliance – both within domestic borders and reaching into foreign markets – as the demands of various regulatory authorities intensify across the globe.



Bruce Proctor at JPMorgan Chase

While the objectives of trade finance are fundamentally identical, the variations in approach, focus, and solution-offering are extensive. Even as trade financiers work to differentiate their offerings in the context of emerging client needs, several specifically indicated that it remains important to retain core skills in traditional trade finance and trade operations.

The long-anticipated demise of the letter of credit has not yet arrived; however, the ability to effectively process LC transactions will become a differentiator in the medium term, if banks fail to maintain some level of operational skill.

Looking ahead: innovations and emerging trends

Online and internet-based client interfaces with extensive functionality are becoming increasingly common, shifting from leading-edge to a 'price of entry' requirement for trade financiers. Leading banks are investing significant monies on the development and deployment of integrated technologies, while ECA's are similarly enhancing online capabilities.

Some have hinted at 'surprising' levels of inquiries and interactions online, from across the globe, while others acknowledge that the Internet has fundamentally shifted and accelerated the dynamics of financing international trade.

Several organizations have described initiatives, such as process redesigns, to simplify interactions with customers, while others actively work to broaden the sectors they serve. One organization described its efforts to extend business solutions and financing products beyond the primary importers and exporters to freight forwarders through working capital programmes, while another indicated that its focus is shifting beyond traditional export finance, to include support of investments in foreign markets.

Just as large corporates are sourcing financing through capital markets, mid-corporates are increasing their use of working capital programs and optimization solutions. At least one financial institution has linked working capital solutions to a company's ability to secure second-round venture capital funding, in industry sectors that are both very internationally oriented, and often taken to IPO based on venture capital financing.

Innovations are also arising at the transactional level, with financing options now available across a larger portion of a trade transaction than was previously the case. The need to provide buyer financing to overseas companies while ensuring the availability of adequate working capital for domestic clients is an increasingly common expectation in the market.

Trade banking executives share a common perspective: trade finance is at a crossroads, and continued success will require a combination of traditional skills and innovative business solutions for importers and exporters.

Trade finance from a North American perspective reflects the market it serves: largely secure, technologically enabled and endowed with financial resources – partly resting on its past successes and partly driving forward to innovate. There is indeed, reason for optimism for the future of trade finance on the North American continent. ■