Reality or simply a fad?

Is there really a meaningful convergence of trade finance and cash management in financial services, or is the suggestion itself much ado about nothing? There are a range of visions among bank executives, about the optimal relationship between cash management, payments and trade finance, and the drivers underlying the discussion are as interesting as the disparate conclusions on the subject. Alexander Malaket investigates.

Certain leading global banks have taken steps to integrate their trade banking business with their cash management offerings, to varying degrees. From organizational restructuring to ensure shared executive sponsorship (and a common reporting line) to close integration from product development on through to client-facing delivery, the 'convergence models' for cash and trade are varied indeed.

Trade, cash and open account – with a dash of SCM

What are the dynamics at work in shaping the future of the trade finance and cash management relationship, and their connection to open account trade and supply chain management (SCM)?

There has been, for several years, a gradual, but widespread and inexorable shift from trade conducted through traditional instruments such as documentary credits, to trade on open account terms. This shift has threatened to erode the role and value of trade finance banks in import/export transactions, diluting the value-add to a utility payment processing role, and reducing revenue streams accordingly.

Leading trade banks have observed this trend and responded by looking for ways to provide value – including additional financing options – in open account transactions. As the concept of a 'financial supply chain' acquired traction in the market, financial institutions and other providers of trade finance have positioned offerings targeted at open account trade, but linked to or triggered by supply chain-related events and processes.

Cash management has been facing a similar change in market demands and expectations, though its role as a service to corporate clients became increasingly complex as corporates sought global cross-border solutions, and services to address more than the 'plain vanilla' cash management tasks and activities.

Shafiq Rahman, head of North America trade product and supply chain management, at ABN AMRO, points out: "The focus of both areas [trade finance and cash management] provides natural synergies for the client and is the basis for supporting a client's overall financial supply chain. Trade tends to focus on order management, documentation, payments, data administration and financing while cash focuses on efficiency of making payments on approved orders and providing critical working capital data points along the way."

Several banks have integrated trade, cash and related activities such as foreign exchange under a 'transaction banking' structure, with varying degrees of synergy achieved under these umbrella organizational structures.

Having established some linkages between traditional trade finance, open account and supply chain management, together with cash management, the question of trade/cash convergence can perhaps be explored in context.

The trade/cash convergence

Trade finance and cash management have been managed, historically, as two distinct products in silo-mode, given that most banks were organized on a product basis, from development, through to delivery and right to a product-level P&L.

Trade specialists vary in their perspective on the question of converging or integrated trade/cash products and organizations. Some have expressed a➤

➤neutral view on the subject, and others view these offerings as separate and distinct.

Timothy House, director, supply chain strategy at Wachovia, indicates: "Wachovia's offerings in trade finance and cash management remain separate and distinct, reflecting the way our clients manage their domestic and international operations. We see increasing focus on supply chain-related processes, and can envision an eventual merging of domestic/international 'silos', at which point we may reassess the relationship between our trade finance and cash management businesses."

Some senior trade bankers wonder how the trade/cash convergence model can possibly work especially if it extends to a supply chain optimization offering, given that client organizations are highly fragmented, rarely report to the same executive, and therefore prove to be very challenging to call upon with a cohesive trade/cash/SCM solution offering.

Further, they note, trade and cash are quite distinct at the transaction level, when differences such as documentary requirements, customs issues, the complexity of LC processing and the implications of cross-border business on compliance and transaction support are well considered. Transaction processes and sales cycles vary significantly, further arguing in favour of the traditional 'silo' approach.

Michael Gallagher, senior EVP and head of global transaction banking Nafta at HSBC, expresses a contrasting view, observing: "The evidence is overwhelming: there is clearly a convergence in the trade finance and cash management/payments processes. Many buyers and suppliers have accelerated the move to an open account trading relationship across electronic platforms. The speed as evidenced by the statistics we see on open account transactions is driving banks to develop more cohesive solutions, however, there are numerous visions in the market about what that means. Our larger corporate clients see that convergence, and value our ability to deliver integrated solutions, sometimes in spite of their own organizational challenges in terms of end to end integration. Trade banks will develop different strategies and service delivery models to address this new reality, and HSBC is preparing to lead the market with compelling value propositions for our clients."

John Ahearn at Citigroup in New York

The side of the market that perceives a convergence in trade and cash exhibits a variety of definitions with respect to the idea of a 'supply chain', and by extension, with respect to the scope and nature of activities and business solutions which ought to be offered under the umbrella of financial supply chain optimization.

Credit is increasingly one element of a broader offering in trade finance, with supply chain-related activities involving increasing levels of advisory service, shifting from a process view to a commercial view of customers' activities. The options are so varied at this early stage of development that banks will design, market and deliver a varied range of solutions and offerings, all the while referencing 'open account' and 'supply chain' products, services or business solutions.

The technology factor

Technology is a presence throughout this consideration of the trade/cash convergence, both as a critical enabler and as a key limitation.

Corporates and banks alike are saddled by antiquated, ineffective and non-integrated technology, which hinders the integration of trade finance and cash management, and places limits on broader supply chain solutions – whether through limitations in functionality, or as a result of prohibitive costs..

Evolving technology is, however, fundamental to the progress made to date; the Internet in particular is acknowledged as the main enabler which will allow the development of effective open account solutions and (financial) supply chain management.

Axel-Peter Ohse, head of trade & risk sales, Germany, Deutsche Bank, observes: "Banks by and large still operate on separate legacy systems for trade, cash management, payments and lending, resulting in a component-based approach to various service offerings.

In a world of increasingly commoditized flow-products, banks are forced to develop new integrated supply chain service and finance systems which in turn offer cost efficient solutions."

He adds: "Many of our clients, large-caps and mid-caps alike, are deploying state of the art supply chain systems and processes, looking for effective solutions at each stage of their transactions. Deutsche Bank has taken a platform approach to technology, providing increasingly integrated, collaborative systems which also facilitate the important flow of data from corporate ERP systems.

Deutsche Bank also takes the opportunity represented by the ongoing convergence of cash and trade to offer innovative transaction based finance solutions which can be combined with established supplementary services that include risk mitigation, creation of documents, handling purchase orders, invoices and many more."

Technology solutions are gradually converging, as some banks seek to leverage, for example, experience with electronic invoicing utilized in domestic cash management, as a basis to solution an e-invoicing process for trade finance. Similarly, the success of payments groups in effecting payments on a 'straight-through processing or STP basis is motivating leading banks to identify further opportunities for lower-cost STP through the integrated trade/cash world. The question posed is how one type of payment for $100 million can be processed on an STP basis, while another type of payment for $12,000 can require multiple verifications because it happens to involve a letter of credit.

The critical importance of interfacing (securely) to customer ERP systems cannot be overstated, especially as compliance-related data requirements increase, and Basel II-related opportunities (to reduce capital usage) become accessible through the collection of customer data.

Integration 2.0 – the next stage?

John Ahearn, managing director and global head of trade services at Citigroup, notes: "Historically, clients have appreciated a trade bank with vision, but remained most interested in core, current delivery capabilities; over the past 18 months, the vision – and an ability to implement it quickly, using a clear migration path – have become key as corporates shift to open account business. That trend will become characteristic of mid-market and SME clients as well in due course, and Citi is well-positioned as a visionary trade bank with superior execution capabilities across market segments."

The trade/cash integration, and the optimization of financial supply chains, which is so closely linked, would be greatly facilitated, and its value enhanced, based on a few key developments. Some are within reach, others are longer-term objectives; each would contribute to the success of trade banks operating in the trade/cash/SCM space.

Access to sufficiently senior, even C-level executives in the client organization, coupled access to the right execution-level resources to implement financial supply chain management (F-SCM) solutions. This access is critical given the broad consensus that corporates generally lag trade banks in having integrated their trade and cash management or treasury functions.

Within the bank, a customer-level P&L, ideally coupled with a well-integrated organizational structure across the trade/cash world would prove highly advantageous to the successful evolution of a holistic offering. A product-independent, customer-centered P&L will assist in ensuring that the right solutions are offered to clients. The organizational integration ought to facilitate the development of cross-functional teams, which can nonetheless combine generalists with product specialists.

Finally, active searches for alternate revenue streams are critical, as shifts to 'pure' open account will significantly reduce revenues – an open account payment coupled with the related processing generates one tenth the fees earned through re-issuance of a letter of credit; when a bank can add vendor financing to the open account transaction, the fees become comparable. As one executive characterized it, staying focused on pure cash management and pure trade leaves one in 'commoditization hell' – a situation to be avoided!

Is there a true trend at convergence in the trade/cash management businesses of banks?

Angela Potter at Barclays International in London

Angela Potter, head of Barclays International Trade and Cash Solutions comments: "Corporates are managing both cash management and trade through the central treasury operations and demand that their bankers provide solutions that meet their needs. Banks acknowledge that their customers need a holistic, fully integrated approach to maximize the efficiency and effectiveness of their operations, and this is why Barclays merged the two disciplines of cash and trade when we restructured the business during 2005."

Clearly, for a number of leading trade banks, the convergence of trade and cash, linked ultimately to the delivery of open account solutions and financial supply chain optimization, is a real and significant development.

Whether there is room for two extreme delivery models (silos versus fully integrated and/or their multiple variations in the marketplace remains an open question. Do trade banks lead the way, or simply adapt to the requirements of their clients, and keep pace as these clients either find a comfortable approach, or slowly evolve to a new model.

Regardless of the flavours of cash/trade integration that might evolve or be present today, the reality remains that the broader issue of financial supply chain management is still in its early stages of development, and that decisions made today about how to address cash/trade integration could become the foundation of future differentiation – for better or worse.

The impact of the trade/cash integration decision could extend from corporate clients to financial institution clients, if/as these FI's seek to source some or all of their trade and cash business on an integrated basis.

Jim Liddell, VP trade finance at Scotiabank in Toronto provides an effective closing comment: "Scotiabank has fully embraced the convergence of trade finance and cash management; our new global mandate coupled with significant investments in staffing and technology will allow us to respond effectively to this convergence, providing holistic, leading-edge business solutions to our clients and business partners." ■