# Towards a Solution: A Focused Approach to Supply Chain Finance

- Trade and supply chain finance has been largely integrated into transaction banking lines of business.
- Within that context, the nature and relative contribution of trade finance is being refined across the globe.
- A back-to-basics view arising from the global financial crisis is necessary and timely but ought not to preclude innovation and evolution in trade and supply chain finance.
- The value around trade and supply chain finance will be at the solution level and it will require a holistic, solution-based approach, with trade and supply chain finance leading when appropriate.

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Trade finance has emerged from the global financial crisis as an area of interest at all levels of government, business, banking and international institutions. While a focus on trade finance has long been common practice for a few global financial services organisations, it is atypical in most other contexts and this new level of interest is seen either as a welcome shift or an unwanted spotlight, depending on the organisation.

Whatever the case in individual organisations or, indeed, among individual executives in leading trade finance businesses, this heightened focus must, at industry level, be seized as an opportunity to better articulate, and to further develop, the value proposition that is represented in the provision of trade finance.

The industry responded to pre-crisis risks of a reduction in intermediaries (resulting from a near-global shift away from traditional instruments to open account trade) by focusing on supply chain finance as a "next generation" model for trade finance within the context of integrated transaction banking businesses. For some, this has been perceived and presented as a significant evolution, while others have argued, convincingly, that supply chain finance is little more than a repackaging of a set of existing and familiar transaction banking products, primarily for marketing purposes.

## An Opportunity Exists

Whether trade financiers as a group genuinely intended to innovate and to provide net new value to their clients, or whether supply chain finance was little more than a marketing tactic, is all but irrelevant at this stage.

The value of trade finance has been undeniably demonstrated over the course of the global financial crisis; the evaporation of pre-export finance, and the resulting 40% drop in trade flows from Asia to Europe and the Americas as reported by various international institutions in mid-2009, together with the effective disintegration of the shipping industry, with rates dropping by over 90%, were directly linked to the large gap in trade finance. The global crisis focused attention on such figures, regularly updated through the World Trade Organization, the World Bank, the International Monetary Fund and others –

even shining light on obscure, market-specific data such as the Baltic Dry Index[1] as a proxy to reflect the impact of the crisis through the flow of commodity goods and the related cost of shipping.

At the same time, clients and bankers were reminded that a key element of the value of traditional trade finance – the proven capability to mitigate international risk – had been wrongly neglected in efforts to respond to requirements around open account trade. This "lesson" continues to command attention, alongside the ongoing demand for timely, fairly priced and dependable financing.

The combination of increased positive focus on trade finance, together with some lessons learnt by trade financiers as an outcome of the global financial crisis, present an opportunity for trade finance to evolve in the context of nascent programmes and solutions developed under the umbrella of global transaction banking – and, more specifically, under supply chain finance.

## Back to Basics in a New Reality

The greater focus on the value of trade finance – coupled with increased appreciation among bankers about the relatively low risk profile of trade finance at a portfolio level – presents an opportunity for innovation to trade finance executives with the required leadership skills. Neither, however, eliminates the need for trade financiers to take a back-to-basics approach, at least to some degree.

Trade finance, from the simplest transactions to the most structurally complex, is fundamentally about four things:

- facilitating cross-border payment, securely and in a timely fashion;
- providing financing options and solutions to one or more parties in a trade deal;
- mitigating a variety of risks related to the conduct of business across borders; and
- providing information related to the financial and physical flows linked to a transaction.

A renewed focus on these four fundamentals, with the intention of using them as complementary building blocks in the development of next-generation trade finance, may be a useful and effective way to maintain a link to proven elements of the trade finance business, while exploring ways in which trade finance can evolve in the context of supply chain and transaction banking.

There is significant expertise and market value in trade finance as an element of financial services – value that ought to be used for advantage and actively developed, as opposed to being allowed to fade from view by inaction.

Certain leaders in the industry are deconstructing lines of business into solutions – eliminating product ownership and product-based organisational silos, with varying degrees of support and success. Such initiatives, meant to encourage a solution focus as opposed to a product focus, may well prove effective and viable. Even under such models, however, it remains critical to ensure that the core value proposition – and capabilities – of trade finance are preserved and expanded.

In this sense, trade finance, too, can benefit from a focus on the basics but only as a means of evolving – not as a justification to revert to passive status quo.

1 *A daily index of global shipping prices of various dry bulk cargoes, published by the Baltic Exchange.*

# So, Where's the Opportunity?

The opportunity is in exploring and understanding the business in which trade financiers are truly engaged. Is this a business about payments, paper and political risk?

On a certain level, it certainly is. On another level, it is a business that facilitates, through effective instruments and processes, and through expertise, the movement of goods and services from one corner of the globe to another. Just as leading brands across the globe work to communicate that they are more than the sum of their products and services, so, too, the business of trade finance is about far more than facilitating payments across borders or verifying documents against letters of credit.

The value and impact of trade – and therefore of trade finance – has been undeniably demonstrated to link directly to international development, economic prosperity and standards and quality of life across the globe. With such a view, leaders in trade finance can perhaps take the opportunity to apply ambitious vision to the future of this vital business.

But, to be effective in business, vision must inevitably connect to action and to operational and market realities.

Can trade finance – as an area of expertise or an organisational entity – serve as a "hub" to respond to the requirements of clients engaged in international commerce? All relationship bankers understand credit and lending – relatively few understand these disciplines in the context of international markets. In a product-agnostic environment, where the focus is entirely on client requirements and solutions, the argument is perhaps amplified, in that expertise and advisory capabilities become even more important than in a product-based environment.

When trade finance (as a product or organisation, or as a solution) is viewed in the context of increasingly complex and increasingly global supply chains, the argument in favour of an expert hub represented by a trade financier, becomes even more compelling, particularly when we note that 80% to 90% of global trade flows are supported by some form of trade finance. In addition, lack of adequate financing is identified almost universally by small and medium-sized businesses (SMEs), as being the single greatest obstacle to growth and sustainable success. This appears to hold true across continents and in commercial environments ranging from the most advanced to the most rudimentary.

The important role of SMEs as suppliers to the largest multinationals is gaining greater appreciation and, accordingly, solutions that support SMEs will tend to enhance the efficiency and success of global supply chains.

Moreover, the likelihood of pursuing opportunities in international markets is far higher today, and at an earlier stage in the lifecycle of a business, than might have been the case even five years ago. Textbook advice on expanding internationally suggests that businesses select a market that is similar to their home market and proceed gradually, one market at a time. However, commercial and competitive realities often demand a more aggressive and far-reaching approach to market development. In that new reality, the role of a skilled adviser in international business is critical and will only become more important in the coming years.

# Next-Generation Trade and Supply Chain Finance

As more businesses of all sizes and across all industry sectors engage internationally – Asia providing an excellent illustration of the trends likely to shape global commerce – the importance of effective advisory and solution support will only increase.

Chinese businesses, for example, are increasingly in search of resources and opportunities across the globe, and it is widely acknowledged that the sheer scope and breadth of commercial activities will require a range of solutions and support that cannot, today, be provided entirely by domestic financial institutions. India, similarly, is in growth mode and is internationally focused after a period of domestically powered recovery. Likewise, Indian businesses are in need of a portfolio of solutions related to international commerce and would benefit from the services of an internationally oriented trade financier acting as a hub in managing their relationships and accessing resources and solutions from across the spectrum of transaction banking capabilities.

In complementary fashion, a trade finance and international business specialist knowledgeable in the needs and challenges of supply chain finance would be an extremely valuable asset to the client organisation, particularly in the early stages of international expansion or initial stages in a new market.

Looking at this approach from the top down, the notion is that a trade financier can serve in an advisory capacity as a hub resource to corporates engaged in international business and can do so with an eye to both the supply chain domain and the broader context of transaction banking, from which complementary solutions can be drawn, to respond to the requirements of commercial clients of all sizes.

Solution orientation is based on two primary considerations:

- An intimate knowledge and understanding of a client's business, including its competitive environment; and
- Expertise in the domain and subject matter related to international trade and trade finance.

Just as trade operations staff have been challenged to expand their outlook to better appreciate the importance of client relationships and to take a more commercial view of operations activities, so must trade financiers in the middle and front offices be challenged to better understand the broader commercial context within which trade finance provides its value. The ability to do so will ensure success in the increasingly important advisory role and will enable trade financiers to conceive and craft better financing solutions across global supply chains, drawing upon resources in the broader financial institution.

In the context of international trade and cross-border commerce, the opportunity in trade and supply chain finance need not be in wholesale redesign of the business but may be discovered in turning the conventional model on its head, while remaining focused on the fundamental "pillars" of trade finance (payments, financing, risk mitigation and information). A modular approach to assembling solutions related to trade and trade finance – based on expertise and an advisory focus – will serve commercial clients well in all markets, and will cement a relationship while allowing for evolution in the organisational models adopted by financial institutions over time, from silo- and product-based to product agnostic and client-solution-centric.

# Conclusion

The foregoing is not intended to position or advocate an internal battle for territory among executives leading various businesses in transaction banking or, indeed, in international banking.

Trade finance clearly has an opportunity to benefit from its positive profile, to better articulate its value to commercial clients, the financial institution within which it operates as a business and to other stakeholders (including governments and regulatory authorities) interested in international commerce.

This opportunity must be fully exploited, to ensure a robust, dynamic and evolving trade finance capability across the globe – and such a process must begin with the largest players in the business of trade finance – financial institutions on the supply side and supply chain anchors (large retail and manufacturing clients) on the demand side.

Once the model is inverted to drive from expertise and an understanding of client needs, the modules or components of eventual solutions can be drawn from a variety of sources (internal and external to a financial institution), and tailored to meet the specific circumstances around a client or transaction.