

Coming of age?

Alexander Malaket examines the state of supply chain finance as transaction bankers, trade financiers and other market stakeholders continue to define the business of financing supply chains and search for a balanced set of products.





Mark Evans at ANZ
in Sydney

Supply chain finance (SCF) is poised to become 'the next big thing' in trade-related financing. And for some, it presents an opportunity to blur the lines between domestic and international banking, by linking the financing practices applied in the context of cross-border business, with finance related to primarily domestic supply chains, and vice versa.

SCF is positioned as a model which provides value and solutions for large multinationals, concurrently supporting the international aspirations of small suppliers in remote parts of developing and emerging economies. For large global banks, SCF may even offer an opportunity to build bridges between operating units or lines of business, such as transaction banking groups and investment banking units – recent crisis-motivated rhetoric on the differences between these areas notwithstanding. Finding the perfect balance, however, remains a challenge.

Thought leaders are developing several flavours of the SCF value proposition – some with limited impact on organisation, business model and required investment, and others with broad-ranging implications, from the need to develop custom technology platforms, to the requirement to ensure adequate operational and transaction-processing support for what amounts to a new offering.

In short, supply chain finance, broadly viewed, is an area brimming with potential.

The challenge of definition

It remains true however, that SCF remains very much in preliminary stages of development as a coherent value proposition, even considering that senior bankers have argued that there is nothing fundamentally new in the products and services which comprise supply chain finance. More importantly, bankers, corporates and others continue to use the expression supply chain finance to refer to a wide range of things – from discrete products to full-blown programmes with global reach and supporting platforms. Similarly, the product and solution sets included under the heading of SCF can vary significantly between providers, just as they can vary in the minds of technology providers, end-clients and other interested parties.

There have been efforts to create a common understanding and a common vocabulary around SCF, notably by the Bankers' Association for Finance and Trade and the International Financial Services Association (BAFT-IFSA); the reality remains however that a conversation around SCF today will often benefit from an initial exchange around definitions of what constitutes supply chain finance.

Mark Evans, global head of trade and supply chain at ANZ, notes: "The banking industry has not done itself any favours in the way we have allowed the market's understanding of supply chain finance to evolve. We must work harder to provide clarity on this fundamental aspect of a promising and important part of the overall transaction banking value proposition. At ANZ, we are taking a very clear path – following trade and investment flows, making financing available, engaging in selected markets in Asia and aiming to tap into an attractive deposit base in the region, and choosing not

to compete on price or reductions in security related to financing solutions."

The present state of the dialogue is somewhat reminiscent of the ultimately ineffective approach taken by trade financiers in defining the value of trade-related advisory services, or the deliberately inconsistent use of the term structured trade finance which for many, served only to allow an additional flavour of marketing around trade finance. The more recent reactive approach to anticipated and unavoidable regulatory demands, likewise, reflects the risks and consequences inherent in the absence of clarity, though we are finally seeing signs of engagement by senior leaders in the industry in clarifying the regulatory discussion.

The imperative – and the genuine desire – to differentiate is completely understandable and legitimate, but should be based on a clear and relatively common understanding of what is being differentiated to begin with. Differentiation by definition (ie. lack thereof) will serve neither providers, nor end-clients.

Recent lessons illustrate that opacity has its consequences when regulators determine how to define and apply regulatory requirements in financial services. In addition to marketing challenges, the prevailing lack of clarity around supply chain finance could result in significant unwanted consequences as SCF matures beyond a group of disjointed products, as it is doing already with some providers.

This risk is already on the radar with senior transaction bankers, as anchor client based supply chain finance offers an opportunity to engage in risk transfer between (for example) an SME supplier and an anchor buyer. It is already a question, whether regulators will allow this type of risk transfer, which is, in practical terms, risk enhancement, to be recognised and granted favourable capital treatment.

SCF today

Senior bankers from institutions fully engaged in developing SCF businesses describe a ramp-up in demand for supply chain-related financing solutions. As the question of credit availability and liquidity recedes gradually, the need for producers to respond to increases in demand is driving a commensurate demand for supply chain finance, particularly from larger or global financial institutions.

Reference to supply chain finance today can translate to a one or two-product offering centered on factoring, more evolved programmes of buyer or supplier-centric financing programmes, anchor client, onboarding and all, or full-scale, multi-country, multi-currency programmes aiming to address the needs of buyer, supplier and global supply chains overall. Likewise, an SCF programme today could be primarily a platform-driven technology proposition, or a solution based on financing and liquidity.

One senior banker notes that end-clients in manufacturing are expressing a growing need for effective supply chain solutions – a reality consistent with the crisis-motivated focus on the 'real economy'. Some providers are consciously keeping away from what they perceive as complementary activities such as document preparation, logistics and similar aspects of trade and ▶

Supply chain finance: state of the market



Olivier Berthier at Misys in London



Matthieu Delorme at Cotecna in Geneva

► supply chain finance, while others take precisely the opposite view, aiming for a more comprehensive approach.

Innovations such as SWIFT's Trade Services Utility (TSU) and the related Bank Payment Obligation are attracting attention among bankers, some engaging with enthusiasm and others directed to consider such developments in the context of a 'watching brief' around market development.

Numerous commentators have argued, tactfully, that trade finance is a rare winner as we work our way through the global economic crisis.

"Trade finance", says Markus Wohlgeschaffen, head of global trade finance and services at UniCredit, "will continue to enjoy greater appreciation in the market for the breadth and importance of its contributions, now that people across the globe have greater awareness of this reality. This is not a matter of short-term fashion, but rather an irreversible trend, which also encompasses developments in supply chain finance."

Aside the question of definition and clarity, there appears to be a sense that SCF in its broadest form, represents significant opportunity for financiers and associated service providers and stakeholders.

Matthieu Delorme, COO of Geneva-based Cotecna Trade Services, notes: "Supply chain finance is in its early stages of development, yet we perceive a very significant opportunity in this space, including in pre-shipment financing. We are very optimistic, even relative to the most energetic champions of SCF. The evolution of SCF may benefit from some of the practices which have evolved in the much more mature space of commodity finance. Our role at Cotecna, for example, is to be present in the physical world of trade as inspectors and specialists, to serve as a link to the financing world, informing financial decisions."

It is axiomatic at this moment to note that Asia and the Asia-Pacific region are playing a critical and growing role in international trade, increasingly as importers and consumers in addition to the familiar manufacturer/exporter role, and, as with other regions, the evolution of supply chain finance is taking place at varying rates.

Evans at ANZ observes: "Our approach is to focus on financing as the core of our SCF offering, and to reinforce with clients and partners the advantages of our regional footprint and intimate knowledge of key markets in the area brings to the table. While factoring is generally at the lower end of commercial client segments in terms of maturity of the businesses financed, our brand of SCF is more bilateral in nature, centered around an anchor client on a transactional basis.

"We make it a point to understand the business of our clients, which allows us to extend and broaden our financing solutions – even increasing the level of financing offered as a percentage of the value of a deal, as the transaction matures and our visibility increases."

It is equally true that supply chain finance figures prominently as an evolving value proposition in markets as varied as Europe, North America and Asia with increasing interest and focus on this solution in the Middle East and Africa.

For some providers, supply chain finance is primarily

a bilateral relationship with the anchor client whereas for other providers, SCF provides an opportunity to engage more broadly across a global supply chain and to pursue relationships actively with the anchor client's counterparties for example.

SCF moving forward

Some senior trade banking and supply chain executives take the view that there is too much focus on information technology and technology platforms in the development of the supply chain finance value proposition, noting that many suppliers in developing and emerging markets still use paper-based documentation and facsimile machines. At the same time however there is recognition of the importance of adequate technology and platforms given the fact corporate clients are in search of single portal solutions which enable interaction with multiple banking providers in a multi-currency environment.

Today, supply chain finance can be found organizationally within financial institutions as an element of the payments and cash management business, as an element of the trade finance business, or as a collection of activities and products under which traditional trade finance is positioned. Similarly, SCF can be found as either a technology-driven offering or an asset-based financing offering, commonly under some form of global transaction banking business.

For Olivier Berthier, solutions director at Misys, the business of SCF has not evidenced massive changes of direction in the past 12 months. Berthier notes: "We do not yet have a significant adoption of a 'four-corner' model in the financing of global supply chains, as is familiar in the context of letter of credit transactions. Rather, the majority of models we see today are single-bank models, with only limited evidence of true collaboration and revenue-sharing between equal partners in the delivery of SCF solutions."

Berthier adds: "On the corporate side however, we





Andrew Betts at
JP Morgan in London

are seeing clear indications of demand for solutions which provide an integrated view of cash, trade and treasury. Interestingly, we have observed some appetite among corporates for integrated solutions and for assistance from bankers and solution providers in migrating from traditional trade products to open account and supply chain-based solutions.”

Trade bankers operating at the more advanced end of the SCF evolution spectrum also note a degree of interest in multi-bank solutions further observing that multi-country and multi-currency solutions are increasingly important to larger corporates.

Andrew Betts, managing director, global head of supply chain at JP Morgan Treasury Services notes: “For us, supply chain finance is a credit product, core to the international expansion of the corporate bank and one of the fastest growing and most profitable of our funded lines of business. Our decision to put credit at the centre of the SCF business will, we hope, be interpreted by the market as a sign of commitment to our clients; we are working in close partnership with the investment banking group and actively pursuing over thirty international markets. We view the successful onboarding of local suppliers as core to our approach, and resolve this where necessary, through partnerships with local financial institutions.”

Some commentators contain that the oft-referenced onboarding challenge remains a core challenge of SCF, especially in cases where suppliers are remotely located and difficult to reach, for know-your-client (KYC) purposes as well as continuing transactions in the context of a supply chain finance programme. For others, the selection of suppliers to participate in an SCF programme is at the discretion and direction of the anchor (buyer) client, and their counter-argument is that buyers tend to focus on the larger, more strategic supplier relationships, which has the effect of mitigating the complexities of onboarding.

Certain global providers will suggest that the tech-

nology around SCF is, broadly, similar and does not provide sufficient basis for differentiation. They will therefore tend to focus on credit solutions, meeting the working capital requirements of customers, and looking to maximise their ability to engage in SCF through participation in the syndicated loan market.

Thought leadership in the SCF space is looking at this relatively new business in a holistic and integrated manner, optionally selecting some subset of activity to focus on as the fundamental element of a bank's value proposition. Buyer-focused programmes are described as having long sales cycles, perhaps suggesting that a white-labelled, variable cost model based on outsourcing of the related platforms has merit. Supplier-focused programmes in contrast, can support internal development of a custom platform, and eventually, can extend from trade-related, cross-border programmes, to seamless integration with purely domestic supply chain programmes, deployed and managed at the country level if need be.

The need to manage supplier-focused programmes centrally can arise due to funding issues and the requirement to allow for multi-currency capabilities and cross-border settlement, whereas such a centralisation requirement does not exist in the context of buyer-focused programmes.

The value of solid information technology, likewise, is not lost on those considering SCF in a holistic manner: portfolio-level statistical data assists in predicting the likelihood of repayment of financing at various stages of a transaction, informing the financing decision and influencing the amount of financing made available. Increasing the volume of transactions (the size of the portfolio) results in larger amounts of data to analyse which, it is suggested, increases the funding options and the variety of financing solutions which can be offered as a result of increased knowledge of borrower behaviour at the portfolio level. This greater clarity inevitably places a financial institution in an enhanced position in seeking favourable treatment from regulators in terms of capital allocation and reserve requirements.

Trade bankers will occasionally admit that holistic and highly integrated SCF programmes present another extremely important advantage over a series of discrete and disjointed products: the tighter the bank-client integration, the higher the customer retention rates, and, in all likelihood, the higher the cross-sell rates and the opportunity to attract new customers through comprehensive, integrated SCF programmes.

Leading SCF programmes, likewise, report success with a variety of client segments including SMEs, particularly where the process and administrative burden linked to engaging SMEs in a supply chain programme are appropriately streamlined.

Wohlgeschaffen at UniCredit concludes: “In addition to leveraging our international network, particularly in the CEE, the supply chain finance programme is an excellent competitive differentiator against savings banks which have strong retail and commercial (SME) franchises in key markets in Europe. The potential around SCF, both internationally and domestically, is extremely compelling for us.” ■

