

Trading in a tough market

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As far as trade finance is concerned, would it be fair to say that the crisis has hit emerging markets and SMEs hardest?

At a high level the answer is yes and that would indeed be the textbook expectation. But there have been some surprises. There are suggestions that the SMEs in emerging and developing markets did not suffer as badly as might have been expected. At least one development specialist has pointed out that the sources from which many of these companies fund their business are not the traditional ones. It has been suggested, for example, that remittances from workers abroad were able to offset some of the traditional credit crunch issues. Personally, I challenge that view a little bit. My discussions with experts in the field have led to more conventional conclusions. Although there may have been some mitigation of aspects of the credit crisis, fundamentally, the SME sectors in emerging and development markets have probably been affected adversely, and to a greater degree than other client segments.

At a geographical level, there is a suggestion that some economies, and I'm thinking here of Latin America, are quite used to situations of crisis. What others might define as a real crisis, they might well say, "We've seen as bad if not worse than this." Brazil, for example, was able to react extremely quickly to counter the effects of the crisis and injected something in the order of USD15 billion into the economy very quickly to countermand the effects of the crisis. The actions of the Brazilian Central Bank were calculated to reduce the cost of financing, and were successful in doing so, more quickly than other jurisdictions.

In China, for example, the consensus is that government measures were aimed primarily at state-owned enterprises, and that the retreat of some international banks whose core market was SMEs, has adversely affected that sector. Here, the discussion around global banks partnering with local providers in the context of supply chain finance programmes, has been particularly timely.

There seems to be some anecdotal evidence of a return from open account to traditional instruments of trade finance. In emerging markets there was presumably less open account trading anyway?

Interestingly enough, one of the things we noticed pre-crisis was the tendency to move to open account in what were once considered high-risk markets. This was also evident in the BRIC countries. So that open account movement, driven largely by global retailers was quite broad. Now there are admittedly parts of the world where there has been a 'staying of the course' in terms of traditional instruments. The Middle East comes to mind there as well as parts of Africa.

One of the statistics that is frequently quoted in support of the argument of a retreat back to traditional instruments is the SWIFT volumes relating to those instruments: the MT 700s. But when you talk to specialists in the field who analyse those numbers, quite a few argue that it is difficult to find objective metrics to support

the anecdotal suggestion you refer to. We have to look not only at volumes but values. I'd say the jury is still out on that.

Has the crisis slowed down innovation in the evolution in trade finance towards a broader concept of supply chain finance?

Again, some say yes, while others argue quite the opposite: that the crisis has in fact accelerated the dialogue around supply chain finance and its more innovative dimensions. My observation is that the crisis may have slowed down the momentum temporarily, but certainly has not derailed or halted developments in supply chain finance. If anything, those who view SCF as a holistic solution – some refer to an “ecosystem” – will take the lessons of the crisis, including renewed focus on risk mitigation, and incorporate them into SCF programs.

Do you have any sense of whether the market for the provision of trade finance is going to consolidate?

Consolidation in the business of trade finance has been a reality for quite a number of years. The crisis itself has generated some rather significant changes in the landscape. So the answer is an emphatic yes on that. Some of the banks that have merged were big players in this field. Some of the blue chip names have had their business more broadly impacted in terms of their ability to undertake certain levels of risk. There's an unprecedented example form here in Canada where a blue chip American bank will come up to Canada and ask a Canadian bank to add their confirmation to an LC issued by an American bank. Pre-crisis, that would have been unheard of.

You mentioned innovation? Who's driving that? Are the banks being pushed by the corporates?

The use of the term innovation is open to debate. There are some who argue, and I'm probably among them, that historically we haven't seen a lot of innovation in the field of trade finance. The letter of credit has been around for literally hundreds of years. We've been using the same instruments with the same processes since the days of Columbus sailing across the Atlantic.

Some say that supply chain finance is nothing more than a repackaging of traditional bank products and the application of those products to the international sphere. If you think about things like invoice financing, factoring, reverse factoring, and bringing cash management into the equation on a cross-border basis, the most basic forms of supply chain finance don't actually bring anything new to the table. What we've done is repackage things and look at them more on a programme level than an individual transaction level.

There is innovation in the application of technology to the business of financing international trade, including some of the technology based platforms that have been evolving over the past ten years or more to try to replace the letter of credit with more of a technology-based solution or initiatives like the TSU that are attempting to innovate around the business of trade financing with collaborative platforms. Changing sourcing patterns, as well as concerns about the

viability of financial institutions have resulted in greater interest in solutions which allow corporates to manage multiple banking relationships in trade and elsewhere.

So who's driving innovation? From my perspective, this shift to supply chain financing and the resulting outcomes have been a defensive manoeuvre by the banks, the traditional providers of trade finance. The move to open account trading took the banks out of the import/export equation and became a threat to what for some is a significant source of revenue. Their involvement is much less central under open account trading. While the corporates are making it clear to the banks that their requirements are changing, the introduction of supply chain finance solutions reflects an attempt by the banks to re-intermediate themselves in the trade process. The efforts by banks have clearly generated some traction and succeeded in re-intermediating leading providers into trade finance.

Perhaps the most significant nature of the innovation around SCF has been the shift from product or transaction-based service to an approach that is far more holistic, encompassing and solution-oriented and which has extended the value proposition of trade banking beyond its traditional boundaries.

In practical terms, this has meant that trade finance providers have brought a suite of products and advisory services under the umbrella of supply chain finance to respond to the needs of customers, internationally as well as domestically. For some, SCF will extend to a sort of insourcing of payables or receivables processing. In the next wave, which we are already seeing, financial and treasury functions will be more closely integrated with procurement and related operational functions. Thought-leaders in the supply chain space have already begun to consider the implications and opportunities that will arise.

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