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WHAT CHALLENGES AND OPPORTUNITIES DOES THE RISE OF OPEN ACCOUNT TRADING PRESENT FOR BOTH CORPORATES AND BANKS?

Finding a common denominator

Damian Lanter*

Relatively speaking, documentary credits are falling out of fashion. Meanwhile, banks face unprecedented cost pressures while forced to sustain ever-higher service levels. All this started to happen just as industrial firms were re-thinking processes with a view to revolutionising their efficiency. One favourite tool for this purpose, the internet, has allowed banks and other sectors to create accessible and user-friendly portals for retail clients. When it comes to corporate clients, however, financial institutions have chosen to focus their internet banking efforts mainly on optimising their own processes rather than meeting client needs.

Exporters and freight forwarders have responded by building their own financial services capabilities: one example is UPS Capital, which established a financial services department in 1998. Although solutions such as Bolero and TradeCard had already been devised, in some cases with the backing of the banks, the opportunity to create a uniform basis for exchanging goods, funds and information has remained largely unexploited. Documentary credits are just one link in the import and export supply chain, with many other independent elements both upstream and downstream – elements that, over time, supply chain management has tied together to create optimised processes.

Yet many exporters, seeking an alternative to the huge costs of paper-based documentary credits, have turned instead to delivery on open account terms. Although this has meant taking on part of the risk themselves, it has allowed them to exploit the latest developments in IT to minimise costs and operational risks. Big firms especially can now achieve significant economies of scale thanks to large volumes. Effectively, they have substituted fully integrated processes for the traditional bank instruments used for payment and performance risk protection. Documentary credits – and therefore banks – do not come into use as a tool for protecting against payment risks or for financing until fairly late in the day, and so have not played a central part in supply chain management.

As for the banks, the trend towards open account trading has further reduced the amount of information available to them. This further complicates the task of anticipating client needs. To put it bluntly, it was the shortcomings of banks that resulted in increasing challenges for corporates in the first place, and it was the reaction of the latter that caused today's challenges for banks. Instead of re-inventing what corporates have already done, banks should therefore search for opportunities by focusing on the main challenges that still make foreign trade a complicated and incompletely integrated part of the supply chain. Against this background, banks need to decide just how big a role trade finance is going to play in their product and service portfolio.

NEW SERVICES

For most banks, trade finance represents either a core product or a supplementary service offering; it invariably forms part of the portfolio for corporate clients and is closely bound up with cash management and foreign exchange. It is also the basic element of correspondent banking relationships in emerging markets. As well as resolving the central issue of how to regain access to their corporate clients' supply chains, banks therefore need to decide what to do about those labour-intensive documentary credits, for, although volumes are stagnating, documentary credits still matter.

So far, the still existing volume of traditional letters of credit and guarantees as well as payments has kept banks involved to a certain extent and corporate clients are constantly requesting banks to make trade finance more efficient. After all, in many cases, open account is a trade-off rather than a solution for corporate challenges like paperwork, risks or the lack of integration and transparency in payables and receivables. Since all information in an L/C, and certainly in the case of open account, is ultimately channelled through banks and transported by SWIFT, extending this connectivity at both ends towards the seller and the buyer seems obvious.

With the recent developments in the area of SWIFT for corporates, real multi-banking capabilities and actual transparency for cash, treasury and trade are within reach and could pave the way for new services that are based on core competencies of banks and the technical functionality of the SWIFTNet Trade Services Utility (TSU) for example. When banks seek to identify their core competencies, the answers are not always clear-cut, though. As a result, the future is likely to be more complicated than a 'two-tier society' made up of banks that outsource and ones that insource.

Usually, the point of outsourcing is not to save money but to boost quality. The huge variety of sectors in different countries, each with their own global trading partners, means the range of options is virtually limitless, and covering them all is an impossible task. In addition, trade finance is morphing from a transaction banking product into a financing and structuring-oriented offering where the advisory aspect plays a major role. The challenge facing the entire financial sector is to find a common denominator. Doing so will require banks to not only involve their end-clients directly but to work together even more closely than they have been prepared to do up until now, and quite possibly embrace the idea of amplifying the collaborative space defined within the TSU.

Certain functionalities or services which are normally requested from banks should be covered and standardised within the collaborative space, like the confirmation of an L/C, which is commonly defined but where there is competition in terms of whether the service is offered at all, the pricing and value-added services offered. As an example, the proposed inter-bank obligation in TSU might ultimately lead to the long-requested 'light' L/C. Only a combination of connectivity and service will result in the critical mass that is essential to success. The characteristics and diversity of foreign trade as well as the increasing demand for higher service quality will continue to ensure enough room for competition.

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