TFR's panel of experts explore the risks, challenges and opportunities in supply chain finance and agree this is a rapidly growing area of trade finance – with room for everyone

Bright supply chain future

The panel

Moderator Clarissa Dann, editor *TFR*

Mauro Bonacina, relationship & sales officer, Southern Europe – treasury services EMEA, BNY Mellon
Colin Robertson, managing director – Treasury Services EMEA, BNY Mellon
Mike Gilham, director & head, financial institutions trade sales transaction banking, Lloyds Corporate Banking
Kamel Alzarka, chairman, Falcon Group
Michael Cusumano, head of supply chain finance and working capital, Barclays Corporate
Alistair Newell, head of correspondent banking, instiutional banking, UBI Banca
Charles Berry, chairman, BPL Global

With the eurocrisis placing a squeeze on liquidity and certain European banks shrinking their balance sheets in response to the impending Basel III regulations, the trade finance landscape is undergoing yet another transformation. The ramping up of supply chain finance (SCF) transactions at all levels – from large corporates to SMEs – is making a huge contribution to keeping global trade wheels oiled at a time when the appetite for doing deals has been somewhat subdued.

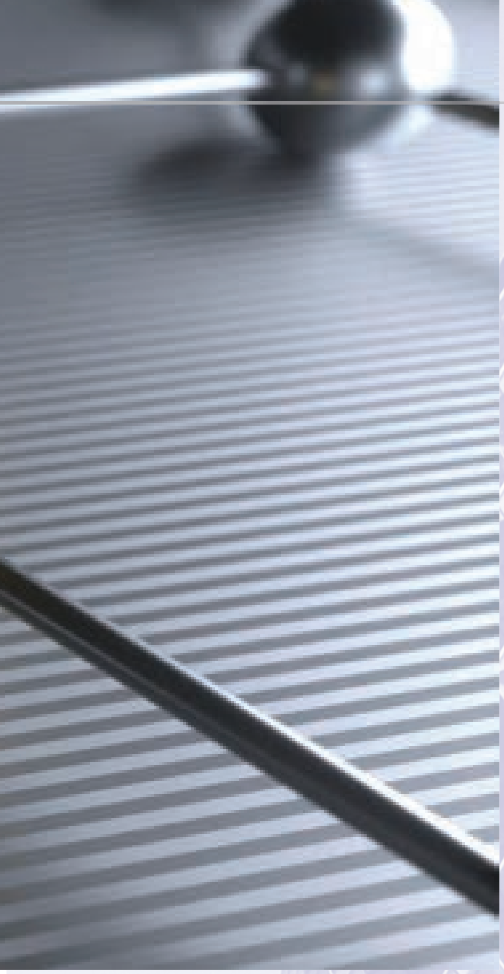
The *TFR* supply chain finance panel session was held on 31 January 2012, hosted by Kamel Alzarka of Falcon Group.

Q1. What effect is the eurocrisis and Basel III, having on supply chain finance appetite and availability?

Alistair Newell As an Italian bank we are in the spotlight and when we do trade finance transactions we're finding there are counterparties who are not risking Italy as they were before. Although trade finance is low risk with guarantees and letters of credit (LCs), there are countries becoming more risk averse. On the funded side, the cost of funding for Italian banks is going up – the dollar is becoming expensive and even in euro-financing we are paying above the interbank rate.

Charles Berry The crisis is making deals more difficult to do. But the amount of insurance business we have done with the banks in this area has increased in the last year.

Kamel Alzarka We've witnessed huge opportunities for us in the last few years as larger players have retreated from emerging markets, and we've seen a lot of new investors and financiers coming into the space left by struggling European banks.



Left to right: Mauro Bonacina, Will Nagle, Alistair Newell, Michael Cusumano, Clarissa Dann, Kamel Alzarka, Charles Berry, Chris Howarth, Colin Robertson, Mike Gilham

Mauro Bonacina From my perspective – until the end of 2011 I was responsible for Italy, Spain, Portugal, Cyprus and Greece – Basel III has been causing major headaches for most large financial institutions so yes, there is scope for other players to get into this market.

Mike Gilham The reality is that Europe still equates to about 25% of global trade so it is still a massive trading bloc in its own right and the majority of that has been on open account basis for many years. We do see clients looking for risk mitigation on one side and we also see clients looking for trade finance to alleviate working capital constraints on the other.

Our customers obviously have some sensitivities they need to manage if they have been dealing on an open account basis – it's very difficult to suddenly start asking for an LC, so yes there are some changes in that space.

Michael Cusumano There is general recognition that the uncertainty brought by the eurocrisis and Basel III is going to have an impact on credit appetite. The interesting thing we have seen at Barclays, specifically for supply chain finance, is that these factors have not affected our appetite for this particular form of trade finance – or indeed the markets' appetite for the business. Recently, we have seen more interest from the corporates as well as an increase in supply chain finance deal flow.

Clarissa Dann So what size of corporate is this interest coming from?

Michael Cusumano Whereas before mainly the top multinationals were implementing, today more of the large nationally-focused corporates have become interested and receptive to the benefits of supply chain finance. Interestingly, some of these corporates are suppliers in some multinational corporate (MNC) programmes.

Q2 Is there a change in dramatis personae as a result of these developments?

Mauro Bonacina I see more of a change in the way trade relations and supply chain-related methods financing are approached. Not only have we got Basel, but there is enhanced scrutiny. And let's not forget the role the ratings agencies play – they can increase the price of finance significantly.

Kamel Alzarka Banks and corporates are going back to basics – and trade finance and supply chain are the basics. Although the big name banks are quite comfortable in this space, it's more difficult for second and third-tier banks to develop the tools and techniques to offer these services. The result is that some good corporates are finding it hard to get this form of finance from their house banks.

Clarissa Dann What are the operational issues?

Michael Cusumano Corporates expect supply chain finance providers to understand client back-office flows and systems to ensure seamless integration. They want comfort that implementation is short and resource light from an experienced partner.

Q3. What are the challenges in financing a supply chain?

Mauro Bonacina It's a matter of scale. We need to involve more and more buyers as reverse factoring is reliant on large corporations buying stuff. Unfortunately, in the current economic environment one of the few ways, if not the most pragmatic, is to involve more buyers is is a commercial leverage. Which translates into incentives to be agreed...

"One of the challenges is understanding what corporates really want at the moment. Is it cost savings?"

MIKE GILHAM,
LLOYDS CORPORATE BANKING

Mike Gilham The question for me is what is supply chain? It is a term that is used in a general sense quite frequently. I see it as either an automated supply chain solution or a bespoke one-off agreement; a manual process we have with a client to support their supply chain. One of the challenges is understanding what corporates really want at the moment. Is it cost savings? Efficiency or financing? A number of top-tier corporates are cash rich at the moment and can take advantage of supply chain financing opportunities independently.

Alistair Newell We have a lot of SMEs who need help with the very basics of exporting. So we are having trade missions on countries and markets, we're accompanying our customers to those markets – examples are India, Brazil and China – and helping them meet the local companies and local banks.

Q4. Are the larger banks doing a lot of supply chain in emerging markets and how are they working with the second and third-tier banks?

Colin Robertson That is where we play a part in helping these second and third- tier banks. We provide the tools and technology to assist them delivering solutions to their clients – which is different from competing directly ourselves. We call it the 'manufacturer distributor model'.

Kamel Alzarka It does take time for second and third-tier banks in developing countries to develop the tools and techniques needed for supply chain finance. This is where alternative financiers can bring a lot of value to the table. At Falcon, we also work with some very large corporates in emerging markets, which can still deliver good margins within the right structure.

Alistair Newell One market we have been in is Latin America where we have been financing the provision of imports and exports via the corporate's bank so they can import machinery or export coffee. This has become more difficult for us because of the cost of funding, so some other players are stepping in. On the pricing side we don't take a risk on, for example, the Brazilian corporate, we would lend to a financial institution. But we don't know the arbitrage they do between what we lend to them and what they lend out

Kamel Alzarka They have to make a living!

Clarissa Dann So how banks they get in on this small-cap to small-cap action?

Alistair Newell Although we don't have the resources in house to develop

Alistair Newell and Michael Cusamano

certain products a big player can help us squeeze more value out of the chain – with open account trading there's quite a lot to be made on the foreign exchange conversions.

Q5. How are you getting new supply chain finance business?

Kamel Alzarka 80% of our team is made up of ex-bankers so it's very easy for us to go and talk about alternative solutions to clients. We work a lot on referrals as well, and sometimes we simply go and knock on doors. If we see an opportunity where we can structure and fund a transaction, we believe that we offer a good value proposition to clients.

Michael Cusumano Barclays focuses on our strong existing relationships in core markets to generate new SCF business. We are in it for the long term and take a partnership approach with our clients. SCF is a strategic decision that the client undertakes and an important one not taken lightly. Some companies we have been successful with

"In supplier finance, clients are placing high value on local capabilities to serve major supplier regions like Africa and Asia"

MICHAEL CUSUMANO, BARCLAYS CORPORATE

started as exploratory conversations back in 2009. The win-win approach comes from working closely with the client's procurement teams to understand supplier management. Defining the on-boarding strategy and targeting the right suppliers can be the difference in the success of a programme

Mike Gilham It is through the close and deep relationship you have with the client – who trusts you to deliver their requirements in the first place. If they want an automated solution you can take that route.

Colin Robertson to Mike Gilham How have you seen supply chain solutions evolve in the last couple of years with the economic changes? How do client needs change during the course of the relationship?

Mike Gilham There have been some changes. During the financial crisis treasurers were internally focused but now they are keen to protect and secure their supply chains and look hard a the cost aspects and efficiencies.

Q6.What are the main risks in supply chain finance these days?

Charles Berry Clearly the main risk we are involved with in this whole area is counterparty default; straight default by whoever your borrower is. Our clients in this area are you, the lending banks. There is a great deal of scope these days for banks to insure their counterparty risk in supply chain finance, whether you are lending to the buyer or supplier of the transaction. The comprehensive credit insurance we offer banks is a very simple, clean, powerful product. Appreciation of this is gradually seeping into the banking industry's consciousness.

Clarissa Dann How do you assess the risk of a possible broken chain?

Charles Berry We are covering the bank against default by an identified counterparty. The due diligence on the counterparty is a combination of both the insurer's own sources and underwriting the banks own due diligence process.

Alistair Newell As well as the traditional use of a big global bank with a master risk agreement we also use other resources like the trade programmes of the IFC and EBRD and we are joining the intra-American development bank programme. We don't always need to use their guarantees but the fact they have been to a counterparty and done two weeks due diligence gives you quite a bit of comfort on that counterparty.

Kamel Alzarka Risks are rife, and everyone is looking to hedge. Like many, we use credit insurance to a large extent. Certainly, we need to hedge our risk as much as a bank does. I am less optimistic than Charles, however, about banks adopting an insurance product as we have found them rather too cautious. So we structure most of our transactions and business to be Basel III efficient, and we have built a big balance sheet to give confidence to our bank and financiers that, if something goes wrong, we can absorb it.

Charles Berry I think you are saying what I am saying!

Kamel Alzarka I agree with you on risk but am less optimistic about bank appetite for insurance. Most policies we see today are risk mitigants and are not collateral for banks. However, we are starting to see more policies that are Basel III compliant and so do provide some capital relief. This is going to be a game changer for the industry.

Clarissa Dann moderating the TFR SCF round table

Charles Berry When you take the basic comprehensive-non payment policy, as long as it is written correctly and as long as the bank has the right systems in place, many banks successfully treat the insurance as Basel II/III compliant. These policies have conditions, but those conditions are within the direct control of the bank, which is the key for capital relief..

Mauro Bonacina I completely agree. Counterparty risk is something shared

Kamel Alzarka considers the latest exchange on SCF

"Banks and corporates are going back to basics – and trade finance and supply chain are the basics"
KAMEL ALZARKA, FALCON GROUP

by other lines of business – I personally believe in credit insurance.

Clarissa Dann Is supply chain finance one of the less risky types of trade finance?

Mike Gilham The better you understand the transaction and transaction flow the better secured you are and the more due diligence you do will mean a better performance. As an industry we have struggled in terms of providing clear metrics and data and we need to improve on this and engage more with regulators.

Charles Berry Global supply chains are stretched and tight and very risky inherently and contingent business interruption is one of the risks that businesses in the supply chain should have covered in their general insurance programmes.. This area of risk is under the microscope at the moment due to losses like the Japan earthquake and the Thai floods. I never quite know how much due diligence a bank will do on the general insurance programmes, but you should be checking your borrowers' contingent business interruption cover to make sure they are covered against events happening to a remote supplier.

Alistair Newell Not so remote in Italy! Last week the Italian lorry drivers went on strike and that interrupted Fiat's supply chain. The factories had to go on short time and that possibly affected their cashflow.

Clarissa Dann But not their capacity to repay their loans?

Mike Gilham You are financing the company anyway. If you are giving them a general financing line you have the same risks, such as business interruption, but you have no sight of what the supply chain is. If you are financing a particular transaction or specific flow you understand what it is you are dealing with. Although you are not going to prevent a business interruption from happening, but if it does happen you are far better informed and far more able to mitigate any issues that come up for you as a lender and your customer. For me that is one of the benefits of supply chain financing in all of its forms.

Q7. What adjustments have banks been making to their supply chain offerings in response to client requirements?

Michael Cusumano We have seen an increase in the corporates' service level expectations for SCF programmes. Clients and suppliers are demanding local capabilities in regions where some of the major suppliers are coming from - for example, China. Asia in general is becoming much more predominant in supply chain finance.

Clarissa Dann Can you tell us a bit more about your supply chain activity in China?

Mike Gilham For automated supply chain solutions you need to have a local onboarding capability when speaking to the local companies' suppliers. This is not the sort of thing we are looking to develop ourselves, Lloyds is a UK-centric bank and not looking to create a big footprint in China. You will see different strategies in different banks depending on their footprints and wider group strategy. Automated supply chain finance solutions need people on the ground in the country where the bank is looking to on-board, or it needs to work with a partner to deliver that service.

Colin Robertson China is one of our major markets where we have an Asian processing hub located in Shanghai.

We look to follow-up with local companies by calling and working with them to get our customers' business routed through us where possible. This brings the service and benefits back to our partner banks where they don't have the Asian service capability or those located in the region. We have made the investments required be a major transactional player in Asia.

Q8. What about the supply chain model itself? How are you optimising it?

Alistair Newell For a medium-sized bank like ours we want to make sure we are part of as many chains as possible and work with partners to get income from them. Unsurprisingly, the biggest country for our import house is China. A lot of those LCs get discounted. The Chinese banks usually don't want to discount with us, they tend to go to the big players in China, the US and Canada.

Mauro Bonacina We are doing that in several countries. In addition to China, we have top names in Seoul doing discounting. With supply chain, a key driver is to be more comfortable lending money. This means the underlying big buyers committing themselves to the programme and only that way will the banks really be comfortable putting money on the table and increasing the working capital of the various suppliers and enhancing the efficiency of the whole chain.

Q9. How worried are you about competition – or larger corporates becoming self sufficient?

Mauro Bonacina There is room for everybody. If you look at SWIFT statistics, 2011 is substantially in line with the 2010 despite the crisis.

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>
> ALISTAIR NEWELL, UBI BANCA

Mike Gilham I see continued opportunity in the supply chain space and a good opportunity to work with clients, big and small, and support them in their activity.

Kamel Alzarka In Falcon's 18 years of business, we have realised that people always learn and copy what has been done previously. The only way to be successful in this business is to keep evolving by being inventive and creative – as Mike says – the needs of people keep evolving and you therefore must keep coming up with new ideas and solutions. People will learn sooner or later and will offer similar services. How innovative these are will be the key to how successful they are.

Q10. How do you see technology driving supply chain finance developments?

Mauro Bonacina In Europe there are more than 400 different providers of proprietary systems. Are they going to converge? No way – its about confidentiality, copyright, compliance and regulatory requirements. Many countries impose Chinese walls. Even if you go back to the late 1990s when Bolero came to the market, look how long it took for Bolero to become an industry standard.

We are investing in SWIFT TSU and we are an early adopter of new technology and new solutions and industry trends, but I am not optimistic of 'simplicity' standards.

Michael Cusumano In short and medium term, I agree that convergence is a long shot. At this stage, the commoditised core technology is a distant second to funding. Market players with the funding and investor networks will be well-positioned to continue delivering SCF programmes

Alistair Newell Your technology only takes you so far, especially if at the other end of the chain the countries your customers are importing and exporting to haven't even got email.

Kamel Alzarka We see technology only as a tool, what is really important is the funding. If you have the funding, it's not really important how you deliver it.

Michael Cusumano Well, although the technology is largely commoditised, we believe that corporates do expect a robust system to deliver supply chain finance in an efficient and secure way, and for high volumes.

Clarissa Dann But what about dealing with the speed of transactions ¬– especially if there are a lot of them?.

Mauro Bonacina Even if you go for e-invoicing: that could quicken the whole process by a couple of days – which is nice. But the point lately is, am I getting paid in the first place? There is also the cultural aspect of e-presentation adoption. Despite technology being there, different counties have different approaches to internet use and online

The panel relaxes after agreeing the future is bright for supply chain finance

banking. In the UK 82% use the internet but only 42% use online banking. In India there is only 5% internet use and almost no online banking. And in Norway it's 90% internet use and 90% online banking adoption.

Q11. How would you describe our outlook for supply chain finance for the next 12 months?

Colin Robertson Understanding the needs of customers and focusing on that is key, rather than trying to bring components or solutions into play that do not achieve their targeted objectives. We talked about technology. There is a lot of noise made about that rather than the funding and financing of the supply chain. I see a greater volume of business particularly when the eurozone scenario is clarified – but for now there will continue to be an aversion to credit risk and risk generally.

Mike Gilham In short we see strong growth for supply chain business in all its forms; from the more bespoke arrangements with clients through to the automated solutions. It comes back, as Colin says, to focusing on client need and delivering on that.

Charles Berry We are operating in a very stressed environment financially. But in a slightly self-serving way I hope you don't mind me pointing out that the insurance industry is not in crisis. The fundamentals are pretty good and it's been functioning perfectly normally throughout the financial crisis. There is plenty of grumbling coming out of the underwriters about too competitive pricing – but that is a function of excess capital in the industry. There may be a lot of uncertainly around but there is a very interesting interaction going on in the supply chain and trade finance area between two industries [banking and insurance] that have traditionally looked at each other with a great deal of scepticism. We think this interaction is soundly based and is set to grow.

Kamel Alzarka Supply chain is definitely part of the growth we are seeing in our markets. There are tremendous opportunities.

Michael Cusumano Supply chain is still a nascent business. We are just scratching the surface. Corporates are starting to understand it more they are buying into it. And in this economic environment suppliers are clamouring for it right now. The future is bright.

Alistair Newell I agree there is real potential for growth here to offset the loss of income in other areas.

Mauro Bonacina To increase this business, cooperation is fundamental for all the good reasons we have discussed – from Basel III up. Banks and FIs have to focus on what is core. Nobody can afford to go out and pretend to have global reach and global capabilities. We all need to cooperate and leverage what we do best. Its co-opetition!

Alistair Newell It's financing the real economy and political weight is behind this.

Kamel Alzarka I think we are very lucky because we are in a part of the financial world where there is clearly political support. If you do trade finance you don't look like the bad guy, and you support the real economy. Supply chain is definitely part of that. I very much agree with Michael that we have only scratched the surface and it is a nascent business. World trade is growing, and is now a US$15trn business. That shows you the size of the opportunity. There is a lot to be done, and there is definitely room for everyone.