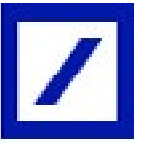
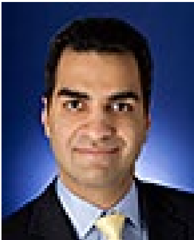
Deutsche Bank
Global Transaction Banking



TreasuryPulse

Supply Chain Financing Complements Traditional Trade Finance in Latin America



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Latin America, particularly Brazil as the largest economy in the region, has experienced a volatile few years. In 2007 and 2008, Brazil's economy was growing rapidly, the country had become a net creditor and its rating was increased. The 2008-9 financial crisis hit the region hard, in large part due to its reliance on commodity-based trade with North America and Europe, which declined sharply. Brazil was one of the first economies to experience recovery in 2010, but something had changed.

While traditional trading partners remain important, and commodities continued to be the backbone of international trade, south-south trade routes that had been narrow and bumpy before the crisis are now becoming the trade superhighways. China, for example, has become Latin America's second largest trading partner after the US. In June 2012, this link was strengthened further by a China–Brazil trade agreement intended to encourage bilateral trade flows and mutual investment.

Over the next five years, we expect Brazil to become one of Asia-Pacific's fastest-growing export and import partners, with rapid growth in trade with India, Indonesia, China and Singapore.

Strongly emerging south-south trade routes are not restricted to Asia, however, as trade between Latin America and Africa is also rapidly on the rise.

Managing Risk, Maximizing Efficiency

Changing trade patterns, industrial diversification and strong growth momentum create new challenges, including the need to manage risk and optimize efficiency when dealing with diverse counterparties in less familiar economies. Companies based in Latin America looking internationally should be focusing on how they manage their counterparty risk, ensure appropriate levels of liquidity, and enhance their operational efficiency as they extend their horizons to new regions. Consequently, they require international banking partners with the geographic footprint that meets their own aspirations, the relevant portfolio of trade finance instruments, and the technology and advisory services to enable them to maximize process efficiency and control.

Flexible Solutions to Support International Growth

Documentary trade instruments such as letters of credit (LCs), standby LCs and short-term trade finance tools are playing an increasingly important role in managing risks associated with new trade flows. In Latin America, not only do trade finance instruments have credit risk mitigation benefits, but there are also benefits under tax and insolvency laws in some countries.

However, as many companies' credit facilities have shrunk, there is less contingency funding available for standby LCs. Consequently, banks are providing bilateral facilities to customers specifically for standby LCs. This frees up working capital, allowing companies to simplify their exposures by working with a single bank, and enhancing efficiency by enabling a single point of entry for standby LC business.

Supply chain transparency is also critical for Brazil and other Latin American economies in order to manage the security implications of more extended and increasingly diverse trade routes. An effective way of achieving improved transparency and control is the use of end-to-end supply chain automation.

A 'Win Win' Through Supply Chain Finance

For Western corporates investing in Latin American economies, the priority is often liquidity rather than automation, as many have already achieved a high level of operational efficiency. Although credit may be more easily obtainable by larger corporates than their smaller peers, these companies are often seeking to reduce their reliance on bank credit and wish to use their bank financing for strategic purposes instead of funding working capital requirements.

Trade finance and financial supply chain tools have a major role to play in optimizing liquidity, by reducing working capital requirements and aligning each of the components that comprise the financial supply chain more closely. For example, supply chain finance (or reverse factoring) is particularly valuable in regions such as Latin America, and provides a "win win" for buyers and suppliers alike. Larger buyers can optimize working capital by standardizing and potentially extending payment terms. At the same time, they increase the resilience of the supply chain by supporting suppliers' liquidity requirements.

Ensuring Success

The successful implementation of financial supply chain solutions that both meet global requirements and comply with local regulatory and cultural requirements relies on three key elements:

- ***Credit expertise.*** Banks providing financial supply chain solutions need detailed credit expertise and in-depth local knowledge to understand economic credit cycles, liquidity optimization opportunities and the impact of market and regulatory developments. Regulations such as Basel III are likely to change the market environment considerably, so companies need to be confident in their bank's ability to navigate through complexities and alleviate constraints.

- ***Technology.*** One reason that trade finance fell out of favor in the past was the amount of documentation and manual processing required. Today's trade finance and financial supply chain solutions rely on a high level of automation, security and integration to support companies' need for scalability, control and efficiency in their cross-border trade requirements.

- ***Integration.*** Not only is technology integration an essential element of efficient financial supply chain solutions, but there also needs to be a cohesive approach to the way that solutions are constructed to meet companies' global requirements while ensuring local compliance and support.

Banking Partnerships to Drive Success

Techniques such as supply chain financing are becoming an important complement to traditional trade finance instruments in Latin America. As we move forward, we expect to see greater sophistication in countries with a strong trade finance background, such as Brazil, Argentina, Venezuela and Colombia.

Regulatory change such as the adoption of Basel III could have a major impact on the trade finance landscape. Companies headquartered in or operating in these countries have increasing opportunities to leverage innovations from global banking partners to enhance working capital management, risk mitigation and processing efficiency.