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Financial Supply Chain: Overcoming Challenges to Deliver Innovation

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Recent years have seen a resurgence of interest in trade finance and financial supply chain (FSC) products and services — both in response to the increasingly cross-border nature of modern trade and as a tool for improving the performance of working capital.

FSC solutions have long played a central role in overcoming the challenges inherent in international commerce. However, this area of finance has now moved to the fore, as treasurers realize the greater potential for improving cash cycles and respond to recent seismic shifts in the flow of global trade.

Changing Demands

The far greater role of emerging markets in global trade — intra-emerging market (or "South-South") trade is now worth approximately US$2.82 trillion* — has placed the spotlight on secure trade processing and enhanced supply chain transparency.

Brazil is a case in point. South America's leading export economy — known for its wealth of commodities, and a key driver of South-South trade — recently signed a trade agreement with China to encourage mutual investment and facilitate this bilateral trade flow. For corporates in Brazil, such expansion of trade — dealing with increasingly diverse counterparties in potentially unfamiliar economies — brings new risks.

For this reason, document-based trade settlement tools such as letters of credit (LCs) — and the risk mitigation they offer — remain in demand, despite the dramatic movement toward open account terms seen in more developed markets. Indeed, instruments such as LCs, standby LCs and certain short-term trade finance tools, although less efficient than open account, are vital to corporates in countries like Brazil for minimizing the risks incurred by new trade flows.

Supply chain transparency is also crucial for Brazil and other emerging economies, where growing South-South commerce warrants greater security, and in the West, where buyers seek greater visibility and control over their increasingly dispersed supply chains. A key way to achieve such enhanced transparency and control is through automating the end-to-end supply chain via an innovative electronic platform. Although such capabilities come as standard with global providers operating in emerging markets, some domestic providers may require the assistance of their larger counterparts.

While the demands of growing cross-border trade are at the center of discussion for expanding economies in emerging markets, for Western firms the ongoing constraint of credit — along with sluggish growth in the US and market volatility in Europe — takes precedence.

Again, FSC solutions can play a vital role. As a lack of credit continues to hinder Western markets, economies in developed regions are looking for new and enhanced ways to ease their cash flows and improve their day-to-day working capital. By using advanced FSC programs, treasurers can release previously trapped streams of liquidity to better leverage existing capital.

While some market pressures are popularizing the use of trade finance and FSC tools, others are threatening the banking community's ability to meet the increased demand. Indeed, Basel III is likely to ramp up the cost of trade finance by allocating it to the same capital-adequacy risk category as demonstrably riskier business lines. This will make it difficult for providers to maintain their existing FSC offerings, let alone invest in continued innovation to meet future challenges, and it will require the combined effort of the cash and trade community as a whole to drive the industry forward.

Core Values

The successful development, provision and implementation of global-standard yet locally relevant FSC solutions rely on four key values.

First is an expert understanding of credit — in terms of economic credit cycles, the likely impact of market developments, the movement and optimal flow of liquidity and how best to release, leverage and allocate these pools of cash. Although current market pressures will inevitably move on, new regulatory environments are likely to continue the constriction on the use of balance sheets by many financial institutions, and potentially hamper the growth strategies of corporates of all sizes. Improving credit efficiency will require creativity, and in the quest to unlock trapped working capital we are likely to see an increase in syndicated supply chain programs, an expansion of self-funded programs and greater integration of FSC solutions with capital markets instruments.

The second key value is technological capability. In an era where advancements in technology are occurring at an exponentially faster rate, it is no surprise that the most innovative FSC and treasury solutions are achieved via significant technological strength. Indeed, technology has matured from a solution enhancer to a core enabler, and sophisticated electronic platforms bring invaluable functionality to both developed-economy multinationals and emerging market corporates involved in increasing cross-border trade.

Certainly, for corporates in Brazil, the speed, reliability, security and flexibility that come with automation — both for trade transactions and supply chain management — will prove increasingly valuable as trade connections with Asia and other emerging markets expand and mature. In fact, for corporates in any economy, it is the range of functions enabled and powered by technology (such as extensive and speedy customization regarding discounting rates, currency conversions and management reports), and the integration of such functionality with other banking services, that will herald a new era of transaction banking.

It is this integrated approach that forms the third pillar of modern treasury services. In an increasingly globalized world, working in collaboration has already proved beneficial to the industry, as market-wide debates and bank-corporate partnerships resolve mutual challenges and drive innovation. But this approach must also be used internally, as the integration of treasury products (such as FSC programs with cash pooling options and FX conversions, for example) can create enhanced holistic solutions better able to address the complex demands of today's marketplace.

Finally, there is the need for truly global solutions. As trade flows shift, emerging markets develop and pan-regional regulations come into force, it is international-reaching solutions — able to support complex cross-border supply chains and cater to the needs of clients and their trading partners around the world — that are invaluable now and will prove vital in the future. As globalization continues, it will be the ability to implement far-reaching solutions — that are of international standard yet leverage local expertise — that will set banks apart, boost corporate success and keep FSC and treasury solutions center stage.

* www.pwc.com/th/en/press-room/press-release/2012/new-release-27-06-2012.jhtml