

Plugging the gap

Forget the financial supermarkets –specialist trade financiers, brought about by the financial crisis, are the future says **Kamel Alzarka**, chairman of Falcon Group.

Conservative global banks have traditionally dominated trade finance. Yet this is changing thanks to the recent global crisis. The trade finance environment – including the assumed dominance of these banking supermarkets – is being challenged in ways that will leave a permanent mark on the industry.

The key changes include falling consumer demand in the west; the growth of south-south trade; a lack of available credit from traditional banks due to shrinking balance sheets; the proposed regulatory changes from Basel III; and political pressure to support domestic lending in the major OECD markets – all of which have played a role in reframing the trade finance market, with long-term implications for both the banks and independent financiers.

Since the crisis began, there have been cases of banks retreating from trade finance, although this has rarely been officially announced and is, in fact, mostly a de-facto retreat given their tightening credit availability (I hasten to add that many of the leading trade finance banks stay committed to what they still see as a profitable business). Yet, such a tightening has paved the way for independent providers to step in and increase their market share.

Also, planned regulatory changes to banking practices will – by encouraging banks to reduce their lending books – make it even more difficult for global banks to finance global trade. A survey carried out by the International Chamber of Commerce (ICC) in September 2009 found that there are still serious concerns about the ability of banks to

meet the increasing demand for trade finance credit, despite the G20 summit agreeing measures to support the flow of trade in April 2009.

Some Western banks are now finding that emerging market trade does not fit well with their normal course of business. And faced with other constraints, some banks appear keen to shrink their balance sheets in this area – especially when under political pressure to use any lending capacity to support domestic borrowers. This means their appetite for non-OECD credits has all but dried up. Yet this could not come at a worse time. The restrictions come at the very moment trade between emerging markets – so-called south-south trade – has taken off.

South-south trade finance, however, is not for those with a poor commitment to the emerging markets. It brings with it a need for strong local-market knowledge, something not all banks have – making them reluctant to support what is a sustained trend in trade flows. As a result, even highly-rated emerging market corporates with well-established banking relationships may struggle to gain access to liquidity – forcing them to look for alternative financing solutions.

And banks appear unlikely to regain their appetite any time soon, not least because the world is entering an era of heightened bank regulation. Basel III could be even less kind to trade finance than Basel II – taking a blanket approach to all off-balance sheet exposures that will make trade finance more capital intensive for banks, despite the strong underlying security structure inherent to trade finance.

In this respect, credit is due to The International Chamber of Commerce (ICC) and the World Trade Organisation (WTO), who have been lobbying the Basel Committee to make special allowances for trade finance due to its self-liquidating nature and strong track record. Arguing that trade finance transactions are supported by the sale of goods – and that the transactions are prompted by a request from a client – they state that banks are unlikely to use trade finance as a means of avoiding leverage constraints.

Nevertheless, the overall result of the issues facing traditional trade finance as offered by large banks is a major gap that is being filled by specialist financiers. Such specialists do not operate under the same constraints as banks, and are able to be more tailored in their approach. And this can go way beyond financing one-off deals – perhaps building long-term financial relationships involving a myriad of financing structures, not just immediate supply-chain concerns.

These providers are also able to structure deals more tailored to the client's needs, instead of offering commoditised products sold by the majors. And they can specialise in facilitating emerging market trade – given their often highly-specialist and localised knowledge of specific markets. This means they can maximise the opportunities presented by difficult market conditions – rather than be forced to retreat by fearful credit committees or shareholders. Far from becoming wary of credit risk, it is in crises such as the recent one where trade finance specialists can prosper. ■

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KAMEL ALZARKA

