Lead story

Opening the floodgates

The financial crisis may have seen a renewed focus on Letters of Credit, but open account is still the predominant form of trade. However, some banks are struggling to find a place for themselves in the confusing morass that is open account, which means different things to different providers. The question now is can banks innovate and provide customers in the open account space with more client-centric solutions? *Financial-i* investigates.

"We consider ourselves to be ... a visionary and innovative company" reads the home page of Falcon Trade Corporation, an emerging markets trade finance specialist. With equity of USD 50 million, which it is looking to increase to USD 100 million, Falcon Trade is by no means a direct competitor to the major global trade finance banks. But if you are looking for innovation in trade finance then Falcon's chairman Kamel Alzarka believes that they have it in spades – they have to, he says, because they do not have the balance sheet to compete directly with the banks. "Where we can make a difference," Alzarka says, "is in the structuring of deals that are complex. Banks ask us to structure deals they are not prepared to do themselves."

Alzarka is tight lipped about how Falcon actually structures its deals. However, he says instead of selling its clients "ready-made" products, which is what the trade finance banks tend to do, Falcon Trade develops a specific understanding of what firms need and does it in a manner that is more bespoke for clients. That may sound like a no-brainer, but historically trade finance has been a largely bank-centric business dominated by large, typically conservative global banks. "I am happy for trade finance to remain an old-fashioned business as this is why we are successful," says Alzarka, highlighting his firm's agility and nimbleness. "We can adapt quickly. "You are likely to see a lot more independent players like Falcon, which have an important role to play."

The financial crisis threw up some "opportunistic" transactions for Falcon and many other boutique trade specialists like China Export Finance, which continued to finance Chinese exporters, particularly small-to-medium-sized firms that found it difficult to access bank financing. "Essentially it is about risk appetite and the major banks are not doing anywhere near as much in the small-to-mid cap sector," says Karl Alomar, CEO of China Export Finance.

While the major banks have well-developed trade finance machines, Alomar says they are more comfortable working with large creditworthy buyers than middle-market companies. "Ultimately, they may not have the appropriate systems and processes to support [the middle market], and in order for banks to get their head round the risk of financing the middle market they would need to implement processes which may be more expensive to maintain." Although Falcon Trade and China Export Finance often work in conjunction with banks in structuring trade

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finance deals, arguably if these smaller, nimble and less risk-averse boutiques did not exist, some trade finance deals may not get done at all as they would be to far outside the banks' comfort zone.

While traditional instruments such as letters of credit (LC) have long been a staple of banks' trade finance portfolios, the rise in open account trading, which does not require a bank guarantee of payment to the supplier, presents numerous challenges for banks looking to offer solutions in this space. Jean-Paul Riolacci, head of global trade solutions at BNP Paribas, says in order for banks to remain competitive in the trade finance space, they need to shift their focus away from LCs, which is a declining business and invest in open account offerings or business models that are less sensitive to what happens with LC volumes. "In terms of product mix, we are developing a number of financing products, particularly supply chain financing," says Riolacci.

A research paper Aite Group published back in April 2009 based on a survey of senior trade finance and supply chain management representatives, identified a number of services banks with leading positions in trade finance believe they could potentially offer in the open account space including the electronic capture/receipt of purchase orders and invoices, electronic matching of purchase orders and invoices and subsequent payment. However, only a small percentage of global trade banks offered these services.

But do customers really want these services? Between April 2008 and May 2008, Aite also surveyed US and Canadian middle market companies, 94% of whom used open-account transactions. However, 51% said they did not know whether they would use services for electronic capturing, submitting or receiving purchase orders and almost 60% said they did not know if they would use similar services for invoices. Nancy Atkinson, a senior analyst at Aite Group, says solutions banks are offering in the open account space are more likely to appeal to large corporates that are worried about their suppliers. However, she adds that banks are trying to find a niche for themselves in open account rather than companies demanding that they provide solutions.

Customer-centric

Open account has come to embody a rather confusing morass of services including purchase order and invoice matching, accounts payable financing and receivables discounting. Dominic Broom*, head, business development, EMEA, Bank of New York (BNY) Mellon, says customers are not getting a consistent story. "Is it [open account] a technology offering or a business management offering?" Increasingly in the context of open account, banks talk about supply chain financing where approved payables or invoices from the buyer are used to extend financing to its suppliers. However, Markus Wohlgeschaffen, head of global trade finance and services, UniCredit Group, says supply chain financing is hyped. "The terminology is misleading," he says, adding that open account does not have to be complex. "We should focus on what the customer needs in terms of optimising liquidity and working capital."

There is a growing chorus within the banking community that would like to see more uniform definitions and guidelines around open account, similar to what the International Chamber of Commerce (ICC) has achieved with its Uniform Customs and Practice (UCP 600) governing the use of documentary credits in international trade (see Trade & Supply Chain Focus *page 39*). Given the lack of standard definitions, Patrik Zekkar, head of trade finance, Sweden, SEB, says open account is a more confusing landscape for banks than LCs. "Sometimes it is more efficient handling an LC than an open account trade," he explains. "With an LC you know the processes and the documents, whereas in the open account space there is infrastructure required that the banks need to invest in."

SWIFT's Trade Services Utility (TSU) provides a data matching engine which seeks to standardise data extracted from existing paper or electronic trade documentation (invoices, transport or insurance data). By capturing purchase order and invoice data and matching it in a standardised way, banks plan to use the TSU to identify trigger points for the provision of open account solutions such as supply chain financing. Standard Bank in South Africa sees the TSU as an opportunity to differentiate itself in the trade space. It is one of the 18 banks within the TSU that is piloting the Bank Payment Obligation (BPO), which is also referred to as 'LC Lite'. Once the purchase order and invoice are matched within the TSU, a BPO is issued.

Karin Mathebula, head, product management, Transactional Products and Services, Standard Bank, says the BPO is useful for buyers in the open account space, particularly in South Africa where they have little bargaining power and often have to pay upfront for goods using their overdraft facility. "The BPO enables them to pay using credit as opposed to the working capital of the buyer," she explains. "We hope to use the BPO as part of an end-to-end supply chain financing solution." David Hennah, senior product manager, supply chain business solutions, SWIFT, says the BPO enhances the risk profile of an open account transaction by placing an obligation on the bank to pay another bank upon presentment of compliant data within the TSU. "It is the open account equivalent of what the LC has given us for the past 90 years," he stated at a Celent event in London recently.

The bank-centric model doesn't work anymore. We shouldn't be afraid of opening up our concepts and products.

Markus Wohlgeschaffen, UniCredit

Collaborate or go it alone

But not everyone is convinced of the benefits of the BPO, let alone the TSU. "I am not saying LC Lite or the BPO is not a useful concept but given