

Turning promises into cash

Contractual promises to pay are valuable assets, but cash is even better. Michael Rowe reports on the growing popularity of procedures that allow exporters to discount their receivables.



Slacik at Citigroup in New York

Exporters keen to lay their hands on immediate cash have always been able to use a variety of methods to obtain discounted payment of sums due to them at a later date from their buyers. Techniques such as invoice financing, factoring, and the purchase of bills of exchange (drafts), promissory notes and rights under letters of credit (LCs) have a long history. Now though the demand for these services is increasing sharply, and the ways in which this is happening are posing new challenges for banks and other providers of trade-linked financial services.

Michael Quinn, head of product management for trade services at JPMorgan Chase in New York, says that the above trend "particularly affects mid-market companies who are concerned about the financing of their receivables in general". He believes that a major factor in this respect is the movement towards open account conditions, which has been especially strong over the last two or three years. "The vastly increased availability of information resulting from the communications and IT revolutions is an important supporting element in making this move possible," Quinn adds.

Also, according to Domenico Del Sorbo, independent export credit risk manager in the Naples region of Italy: "Buyers have more power than they used to in international transactions and they want deferred provisions in order to pay with the cash flow of the goods imported. But sellers want to be paid at sight and they want to avoid risks." Discounting trade receivables provides one solution.

At the same time, Claudia Slacik, global head of trade services and finance, Citigroup Corporate and Investment Banking, Citigroup, New York, believes that much of the above trend is tied to three specific business issues. "First, many of the larger corporate customers are requesting greater clarity in the cost of financing in the supply chain. They have recognized

that the cost of financing in the supply chain is a fairly large component of their cost of goods sold," Slacik says. "Only by first improving transparency and getting visibility into this cost can they begin to control it."

Second, Slacik points out that many of the vendors "are beginning to see concentrations in their portfolios to specific buyers that they want to mitigate their risk with. By selling down some of these receivables, they are reducing their exposure even though they may not need the financing". Finally, as the evolution of the supply chain continues, many of the weaker players in the chain are ending up carrying most of the financing cost. "Trade finance has become a core requirement in providing working capital to these firms," Slacik concludes.

Integrating supply chains

The increased demand from major corporates for integrated supply chain financing is playing a particularly important role in the above developments. For instance, Gilles Deschanel, head of financing products, ECEP GTS (trade finance department) at BNP Paribas in Paris, says that large companies want more and more to finance operations from end to end, and that replying to this demand extends the bank's role beyond the financing of its own client in the chain.

John Rice, president of Capstone Trade Partners (a member of the Capstone Group, a New York-based enterprise that specializes in trade finance and related services), highlights another instance. "Major US retailers such as Walmart import much of their stock from China and other low cost countries in Asia. At the same time they insist on operating rigorous purchasing programmes that enable them to apply just-in-time purchasing procedures," Rice explains.

"Our group can help by setting up end-to-end financing procedures that cover the operation from ►

Discounting trade receivables

► pre-shipment stage to final payment," Rice explains. For instance, different members of the Capstone Group can initially undertake to buy the goods from the exporter and issue a letter of credit in its favour.

"The manufacturer/exporter may be able to raise pre-shipment finance on favourable terms in its own country against the security of this LC," indicates Rice. Capstone can also arrange warehousing in the US, and provide a factoring or invoice discounting facility once the goods have been ordered and dispatched to the retailer.

At the same time, major banks are developing proprietary communications platforms that help to reach electronically across the different trading relationships involved in the supply chain. RBS TradeFlow launched in August last year provides one instance. In addition, SWIFT is working on an open solution called SWIFTNet Trade Services Utility.

Talking with treasurers

When companies ask for global financing solutions of the above type, there will normally be a single person within the client company who will formulate the demand and present it to the banks. This will tend to be the corporate treasurer or CFO (chief financial officer) and not the export manager. The financial executive concerned is likely to have a number of preoccupations including management of country risks and credit risks, trade financing, cash requirements and balance sheet financing.

"Banks can offer all the individual elements that make up packages of this type, but corporates, especially large corporates, often want a unified global offer bringing all these features – and not just the marketing aspect – together," says Deschanel. A globalized approach of this type requires strong coordination since the different techniques involved are highly specialised, and they are carried out in different departments or units involving personnel with different specialist skills.

"A commercial manager can front the overall offer to the customer in relationship terms. The next step would be the integration of services of this type within banks, and banks are already working on this subject in order to adapt themselves to the evolution of the market," adds Deschanel.

Converging techniques

Since corporates are looking increasingly for overall solutions to their receivables discounting requirements, there is also a trend towards convergence in the different specialized financing techniques that may be employed to address this need. One prominent example is the use of international factoring and invoice discounting procedures alongside traditional trade finance techniques. David Millett, head of international trade product management at Royal Bank of Scotland (RBS), in London, says that this trend has been particularly noticeable over the last couple of years.

In addition, Jeroen Kohnstamm secretary general of Factors Chain International (FCI) in the Netherlands, says that factoring has become a strong alternative to LCs as a means of providing credit protection for exports from Asia, since many major importers in the west are no longer prepared to issue LCs. Moreover,

factoring techniques may be used in a wide range of international transactions.

For instance, John Beaney, head of the international department of HSBC Invoice Finance UK in London, says that many UK exports around the world are of sophisticated services such as engineering, computers, telecoms and oil sector deals. "The exporters involved typically need to maintain teams of expert personnel in the importing countries, and we can finance invoices as work proceeds to facilitate payment of their salaries," he indicates.

Also, according to Kohnstamm, banks that were not previously interested in factoring are now considering setting up factoring divisions, partly as a way of providing work for staff formerly engaged in LC activities, which are now in decline. He adds that this is not always easy to put into effect successfully, since banks' trade finance staff are used to looking at documents and not at the underlying transactions.

Since corporates are looking increasingly for overall solutions to their receivables discounting requirements, there is also a trend towards convergence in the different specialized financing techniques that may be employed to address this need. Deutsche Bank in Frankfurt provides one specific example of this trend. DB's structured trade and export finance department includes units for trade receivables, forfaiting and mid-cap asset-backed structures (ABS), and it also offers customers a factoring service.

Albert Traunthaler, Deutsche's director of structured trade & export finance, says that "In order to provide clients with the most suitable and cost-effective solutions Deutsche Bank is nowadays not shy to act as an intermediary to provide a customer with a tailor-made factoring programme. The investor for such transactions might then be a subsidiary of credit insurers or large corporates."

Moreover, as a further indicator of convergence, the department's scope has recently been extended to cover domestic as well as international finance, and it also handles deals that mix domestic and international elements. "There is no real distinction between international and domestic activities in these areas. There are some legal distinctions, but the procedures are similar," Traunthaler comments.

In addition, some credit insurers are now offering invoice discounting services alongside their traditional products. For instance, French credit insurer Coface provides invoice discounting in several countries including the UK, France and Germany. "One of our advantages is the fact that we can deliver a full range of services including insurance, discounting and credit information," says Coface chairman François David.

The developments outlined above reflect a more general movement in business and finance that has taken place over the last couple of decades or so. Under the impetus of market liberalization and globalization, very specialized financial organizations and other businesses have either had to widen their areas of activity or find a market niche in which they can excel. Against this background, it remains to be seen whether trade services may merge further into more general lines of finance. ■