



Despite the crisis of the past two years, the industry has continued to innovate in financial supply chain management to enhance value for trading counterparties and improve efficiency. Banks recognise that the tightening of credit globally represents both a short-term challenge and a medium-term business opportunity. Although the majority of cross-border open account trade is conducted corporate-to-corporate, evidence suggests that a significant percentage will migrate to a bank-assisted model over the coming years. Corporates and in some countries regulators have voiced their demand for banks to provide greater innovation through bank-intermediated supply chain solutions.

According to various studies, there is at least USD 400 billion trapped in the working capital cycle of corporates. Historically, cash management and trade have been housed in separate departments within banks. Indeed, there has been limited attempt to align the centralised management of cash with the often decentralised management of

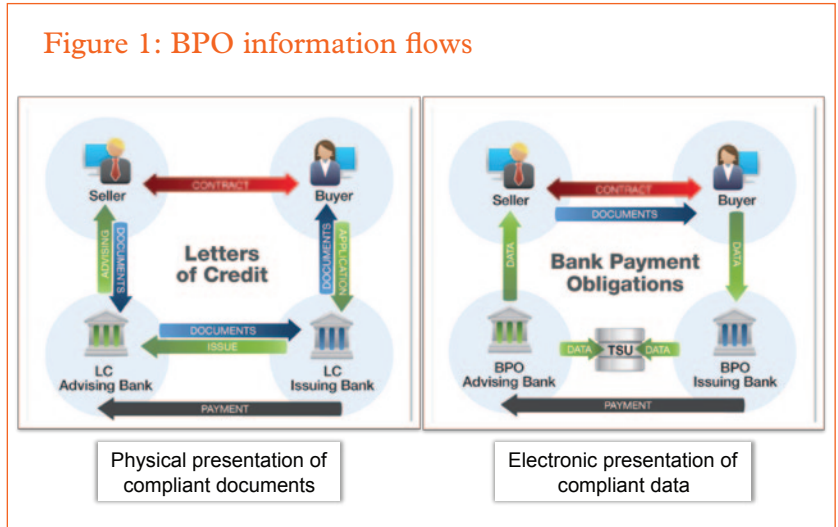
Collaborative supply chain finance

A few more steps to go

In recent decades, banks have successfully developed industry-wide collaborative solutions in traditional trade finance. André Casterman, head of trade and supply chain, SWIFT, argues that the challenge now is to extend those best practices to supply chain finance and deliver improved services to buyers and suppliers.

A set of ICC rules governing collaborative supply chain finance will be a key milestone for the trade banks as such rules will offer a legally binding, valid and enforceable risk mitigation instrument for financing open account transactions.

André Casterman, SWIFT



trade. However, from a working capital perspective, cash and trade clearly converge in their impact on the cash conversion cycle (Days Sales Outstanding + Days Inventory Outstanding – Days Payables Outstanding). It is estimated that companies that optimise their cash conversion cycle can reduce their working capital requirements by as much as 40%.

There is no doubt that supply chain finance represents a major opportunity for banks to generate revenue and increase liquidity in the market. It represents the most prominent example of open account services directly linked to the merger between cash and trade.

With close to 90% of global trade being transacted on open account, banks have had an increased focus on how to intermediate and finance those transactions. In order to deploy such services globally though, banks need a cost-effective network and legally binding collaborative model, such as those existing for documentary trade, in order to engage with dozens, if not hundreds, of correspondent banks at acceptable cost.

The voice of the customers

Declining to accept paper and invoices in PDF format is already a reality in some countries. Large corporations such as UPM and Kone are Nordic examples of buyers that have publicly announced that they will no longer accept paper from their suppliers. Electronic invoicing has proven its value but only represents a first step to link up the financial supply chain with the physical supply chain, as transaction data is automatically reconciled with inventories. When intermediated via banks, electronic invoices enable financing opportunities on both sides of the supply chain – the buyer and its suppliers.

A recent study initiated by the Bank of England and published by the Association of Corporate Treasurers (ACT) concluded that supply chain finance, in particular buyer-driven receivables programmes, offers opportunities to expand lending to smaller and mid-tier companies, while the larger companies – the ‘buyers’ – can play a significant role to the benefit of their supply chains. In this case, the funding is based on the credit standing of the

buyer and not the supplier. As a result a buyer-driven receivable programme is less complex than other structures and funding is likely to be less expensive for suppliers where the buyer’s credit is stronger than that of its suppliers. The benefit to suppliers also feeds back as a benefit to buyers in terms of better relationships with suppliers and a reduction in possible financial weakness/instability of suppliers. The study also concluded that supply chain finance structures have developed to suit a variety of needs and that no one structure should be singled out as the preferred option.

In order to offer such open account financing services in support of international supply chains, the buyer’s bank is dependent on industry-wide best practices, similar to today’s UCP600, to work cost effectively with the suppliers’ banks and indirectly reach the suppliers.

Integrating innovation into today’s best practices

For decades, banks have built efficient networks of partner banks to carry out a variety of financial transactions. Even

global banks with a presence in dozens of countries around the world recognise the need for such partner networks. As an example, Citibank recently referred on gtnews.com to its network of 3,000 banks covering 100 countries for trade services. In order to leverage those networks for supply chain finance, banks now need collaborative market practices and operational rules similar to those developed over the recent decades to conduct traditional trade business.

In the traditional world of the letter of credit (L/C), an obligation is placed on the issuing bank to pay the beneficiary, subject to the presentation of compliant documentation. Until now, there has been no such equivalent instrument to enable an exporter to trade on open account with the same degree of confidence that payment will be executed in accordance with the terms of the contract.

Banks have attempted to plug the gap through the issuance of conditional payment guarantees or standby letters of credit and have also developed a new instrument: the Bank Payment Obligation (BPO). The BPO is an inter-bank instrument as it places an obligation on the issuing bank to pay the receiving bank, subject to the presentation of compliant data (See figure 1).

In placing reliance on this guarantee of payment, banks are better able to develop alternative forms of supply chain financing solutions, mapped against the matching of data which is consistent with the movement of goods along the physical supply chain.

A role for the ICC Banking Commission

As part of its mandate to be a leading forum for the banking industry and its goal of determining the ways banking will be conducted in the future, the Banking Commission of the International Chamber of Commerce (ICC) aims to develop new projects to account for new practices, such as supply chain finance, e-trade and open account trading.

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André Casterman, SWIFT

The ICC Banking Commission has traditionally been the leading, global rule-making body for the banking industry, producing universally accepted rules and guidelines for international banking practice, notably letters of credit, demand guarantees and bank-to-bank reimbursement. It is widely recognised that ICC's voluntary market-based approaches have led to best practices in trade finance.

At the ICC Banking Commission meetings of November 2009 and September 2010, major trade banks presented their progress in deploying supply chain finance services to corporate customers in a global and collaborative way using the BPO. The time has come for the ICC Banking Commission to embrace the BPO rules, and help the industry establish best practices in supply chain finance. A set of ICC rules governing collaborative supply chain finance will be a key milestone for the trade banks as such rules will offer a legally binding, valid and enforceable risk mitigation instrument for financing open account transactions and will remove the need for individual bilateral agreements between correspondent banks.

A role for SWIFT

SWIFT also has a major role to play. As part of its mandate to bring the financial community together to work collaboratively to shape market practice, define standards and consider solutions to issues of mutual interest, SWIFT is ideally placed to help banks extend services from traditional trade finance to supply chain finance. SWIFT's FIN messaging service today facilitates the exchange of L/Cs, demand guarantee and documentary collection

transactions amongst trade banks who exchange close to 200,000 trade finance messages on a daily basis. Re-using SWIFT to implement a new instrument such as the BPO represents a global and cost-effective technical solution for trade banks. This is the intended role of the Trade Services Utility (TSU), which provides an inter-bank communications platform in support of collaborative supply chain services.

Combining the use of the SWIFT with extended ICC rules will offer banks the ideal technical, operational and legal framework to roll out innovative services to their corporate customers. This is now seriously progressing through SWIFT's BPO Commercialisation Group which gathers 18 trade banks. Banks just have a few more steps to go in order to move from the proven concepts and available BPO rules to enabling the majority of trade banks to offer innovative financing services to the benefit of their customers' supply chains. Major global and regional banks have anticipated the opportunity and will demonstrate their new supply chain finance services in Amsterdam as part of the Sibos Trade and Supply Chain stream. ¹

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