Cross-border trade and global networks

Derek Lunt of HSBC describes the challenges for firms which buy or sell cross-border and explains how service providers can greatly assist the treasurer.

Despite recent regional downturns, World Trade Organisation (WTO) figures[1] show international trade continues to represent a higher share of world economic activity. In 1999, global GDP and merchandise production both increased by 2.5%, but merchandise trade expanded at 5%. Last year, economic activity picked up more strongly, with global GDP growth of 4.5% forecast for the full year. This increase in activity was easily outstripped by the 14% growth in global merchandise trade.

At the macro-economic level, growth in trade can be related to capital flows and elimination of trade barriers but, at the micro level, there has been a huge increase in the numbers of companies buying and selling cross-border. The influences no doubt vary enormously from basic competitive pressure through the growth in supply chain management to the advent of the internet – a marketing tool that knows no international boundaries.

The result for the treasurer is the same – the particular challenges of international trade take more prominence in setting treasury policy and practice.

Risks and trade settlement

The main risks in cross-border trade are:

- country risk (political/economic stability, transfer, regulatory, war);
- transportation risk (mode of transport and storage);
- industry risk (fashionable or seasonal goods, national preferences);
- foreign exchange risk (whether invoiced in local or foreign currency);
- tax risk (adequate customs documents, inefficient corporate structure);
- buyer risk (non/delayed payment of invoices, buyer insolvency); and
- supplier risk (incorrect documentation, failure to supply per sales contract).

Effectively, the last two risks are no different from those in domestic business. But the physical and, perhaps, legal distance between buyer and supplier in international trade raises the stakes considerably.

FIGURE 1

Exporter		**Importer**
Least secure	Open account	Most secure
	Documentary collections	
	Documentary credits	
Most secure	Advance payment	Least secure

For the treasurer, the key risks are settlement and currency. Underlying currency risks are exacerbated by the uncertainty inherent in settlement in importing and exporting, given logistics and regulatory variables. Settlement mechanisms for international trade and the relative levels of risk to the importer and the exporter are shown in the box above. The arrival of browser-based (rather than EDI) e-commerce has had no discernible impact on settlement to date, with the majority of the few live business to business (B2B) trading exchanges which have settlement capabilities continuing to rely on traditional mechanisms.

The method of payment to select with your trading partner depends on a number of factors such as their relationship/track record, creditworthiness, relative bargaining power and import/export regulations. A combination of these factors is behind the predominance of documentary credit (DC) business between Asia and Europe/US and the reliance on open account business between or within Europe and the US.

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Overall, roughly 80% of world trade is conducted on an open account basis with the bulk of the remainder on documentary terms. Open account business can be credit enhanced through factoring or credit insurance. But in looking at settlement terms and risk mitigants, first it is worth bearing in mind that the more secure the transaction, the costlier it will be and that settlement terms imposed on smaller or weaker suppliers and buyers may cause difficulties at a later stage.

Issues for importers

While the traditional approach to sourcing overseas was to leave control of supply in the hands of import agents and/or the ultimate supplier, the competitive advantages to be derived from effective supply chain management as pioneered by big importers in the US and Europe are becoming increasingly apparent. Supply chain management is about taking ownership of all aspects of sourcing and tailoring that activity to facilitate customised distribution. It covers both domestic and cross-border activity, but the latter undoubtedly brings the greater challenge and requires the importer to co-ordinate its approach across all areas, including

buying, logistics and finance.

A holistic approach to supply chain management will undoubtedly mean trade-offs between different functions and a move, for instance, to purchasing free on board (FOB)[2], rather than to delivered duty paid (DDP)[2], would result in new currency exposures for treasurers to hedge, increased financing requirements and therefore new bank lines to negotiate. And while the treasurer might be hard to convince, all this will be most certainly beneficial where a big European or US importer is purchasing from a medium-sized Asian exporter.

Supply chain management is also about an increased focus on relationships with overseas suppliers. This arises from the elimination of middle-men to enhance efficiency and through the necessity to develop a partnership approach for supply chain benefits to be fully realised.

Against this background, it is important for the importer to recognise that its preferred settlement mechanism, open account, may cause problems for its suppliers, particularly if they are located in markets such as Asia where local banks prefer to fund working capital against export DCs. Equally, the importer must recognise that if it negotiates a very cheap deal for opening DCs then this may be because its banker is loading penalties on to its suppliers. These charges are inevitably factored into a higher FOB price.

For treasurers, the advantages of working with banks with strong global networks are clear in supply chain management projects. Because global banks have relationships with suppliers as well as importers, there is a good fit with the partnership thrust of supply chain management. This has benefits whether the business is conducted on an open account or DC basis.

For DCs, the international bank will need to come up with a sustainable pricing structure that the importer and supplier will find competitive. However, because the international bank will be able to see a banking relationship developing with the suppliers, there will be a readiness to extract less return from the pure trade transaction than would be the case for a more regionally based bank.

Equally, by leveraging off importers' continuing relationships with their overseas suppliers, the global bank may be in a position to put in place an open account-based financing package, even though this is not the market norm.

Outside supply chain management, utilising the same bank at both ends can have more prosaic benefits in terms of transaction costs and settlement completion. For DCs, transaction time can be enhanced by reduced document checking requirements and faster intra-group service standards than would be the case working through correspondent banks.

Issues for exporters

For growing companies, exporting is no longer a luxury but a necessity, with domestic markets vulnerable to import penetration and supplier rationalisation. In addition, the global market has suddenly become accessible via the internet, with many businesses having to handle overseas orders for the first time. Whatever the trend, the issues for treasurers remain how to control the receipt of sales proceeds and, with a wider stance, protect against buyer risk. The same trade-offs also apply to the UK.

For exporters, the benefits of global networks are visible first in collections. Having real networks, rather than a representative office in markets such as China and India enables global banks to develop local links with domestic banks, thereby leading to a faster resolution of discrepant documents or settlement difficulties. For instance, HSBC has ten branches in mainland China and its TradeCollect service speeds receipt of payment by up to roughly ten days.

At the market intelligence level, international banks can also provide considerable intangible benefits in terms of research on new markets, potential buyers, payment terms and regulations and the like.

Impact of e-commerce

One of the pre-requisites of a bank operating on an international scale is to ensure intra-group efficiency regarding systems and procedures. HSBC has a common global processing system which has already proved an effective straight through processing platform for its global e-banking system, Hexagon. This proprietary system is now being supplemented by browser-based capability such as the supplier EDI connection. This will enhance acceptability and ease maintenance.

A significant trade e-commerce initiative currently underway is bolero.net[3],. Created by the world's logistics and banking communities, it is designed to move world trade on to the internet, allowing documents and information to be exchanged online, but at high levels of security between all parties in the trade chain. Many of the world's leading banks are members. Bolero.net will facilitate the elimination of significant amounts of physical documentation over time as it reaches critical mass. This will yield considerable cost benefits for big importers and exporters.

Banks have an important role to play in facilitating overseas suppliers' links into bolero.net. This has been evident in the comprehensive bolero pilot in progress today, which is being led by the German mail order group Otto Versand with Commerzbank, Panalpina, P&O NedLloyd and HSBC as partners.

Improving services

The few banks which have an international presence must look to use this resource to maximise shareholder value through superior customer service propositions wherever possible. Trade is an area where such banks can bring considerable advantages to their clients, including DC issuance in the country of the beneficiary and tailored supplier finance programmes that meet buyers' complex requirements.

At the same time, such advantage requires strong technology support, both through traditional proprietary e-banking systems and increasingly through web-based services and related shared platforms such as bolero.net. Banks with global networks will continue to have something extra to offer the treasurers of importers and exporters for the foreseeable future. ■

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Notes

[1] Source: WTO International Trade Statistics 2000 (see www.wto.org for further information).

[2] FOB/DDP are ICC abbreviations (or Incoterms) for Free on Board and Delivered Duty Paid. For information on key Incoterms, please go to www.tradeservices.hsbc.com/ts/tools/tutorial/index.htm and click on Introduction to International Trade and look under Further Information.

[3] For more information on bolero please visit www.bolero.net.