

TRICKS

of the Trade

Finally, banks are beginning to deliver on the promise of e-commerce and trade finance.
By Tom Leander

Bankers have long predicted that the Internet would make trade financing a movable feast. Now a number of new offerings by the region's major trade finance banks signals that the repast has finally begun. But don't break out the champagne just yet. The economics of this high-overhead, low-margin business have been squeezing the industry for years, and the promised cost-savings and cross-selling advantages of the Internet are still unproven. The region's CFOs may want to keep a few hard-copy bills of lading around just in case the electronic option fails to materialize. >>

ILLUSTRATION BY LAM WAI

Still, there's an unusual amount of action these days in this normally staid business. In November, two regional heavyweights will unveil Internet-based trade finance systems at long last. Standard Chartered will release its B2BeX, an offering that includes features meant to attract the portion of the business that has fled banks in recent years, turning away from traditional letters of credit to open-account transactions, which offer no bank guarantee. Not to be outdone, HSBC, the top regional player, begins pilots on its Internet trading system in the last week of October and plans to unveil it to customers in December.

And then there's Bolero – an open trading system devised by a consortium of banks and logistics companies – which is undergoing a major upgrade. For years, Bolero has tried to build a constituency among Asian corporations, but progress has been as teasingly slow as the development of the melody in the eponymous Ravel tune. Now Bolero will add an online document settlement and compliance platform dubbed SURF that builds on its existing messaging technology, giving users a one-stop trade finance system. This, too, is in pilot but due for release by year-end, though some skeptics note that Bolero's SURF deadlines have been pushed back before.

FEELING THE HEAT

Why all this activity – and why now? One is that banks must offer some type of trade finance service to clients as a complement to other services, but that trade finance itself – with the

characterized as open account. Taiwan semiconductor companies, to use one example, build up long-term relationships with a community of suppliers, who ship goods on a just-in-time basis.

The cumbersome guarantees needed for letters of credit were simply too slow to allow for this model to be effective. “The whole idea was to make trades more maneuverable,” says Wegner. “In this environment, letters of credit just don't cut it.” The trade-off, of course, is that open-account trades provide no middleman to shoulder the risk.

DANCING WITH TRADECARD

But disenchantment with banks in letter-of-credit deals also contributed to the decline. For one, bankers deem smaller transactions – say up to US\$1 million – as ‘nuisance trades’ because of the thin profit margins. An evolving set of commercial rules for trade finance fortified banks' reluctance to service the lower end of the market. The uniform commercial code established by the International Chamber of Commerce, the rule-making body for the trade finance industry, tended to favor banks whenever any discrepancies arose in documents, encouraging delays. Often a letter-of-credit deal with paper inconsistencies would end up in limbo, while the issuing and paying bank passed the hat back and forth. In the meantime, the CFO at the selling company found his cash flow pinched and his insurance plans collapsing.

The market was begging for an alternative. When global

“The whole idea was to make trades more maneuverable. In this environment, letters of credit just don't cut it.” – CARL WEGNER, VP, BUSINESS DEVELOPMENT, TRADECARD

exception of large standalone transactions or ongoing trades with blue-chip clients – is costly. One of the most paper-intensive of all finance transactions, letter-of-credit trade finance deals run on average to 15 days and can involve 12 different types of documents. The Internet would allow banks to service smaller deals and mid-size clients without losing money.

In fact, there's been a general hemorrhaging of trade finance business from banks in recent years. Kurt Cavano, CEO of TradeCard, the first effective non-bank Internet trading system, reckons that over a ten-year period, the total volume of trade finance now stands at 70 percent open-account transactions versus 30 percent letter-of-credit. This is a complete reversal of the ratio only ten years ago.

Carl Wegner, TradeCard's head of business development for the Asia Pacific region, attributes the exodus to a change in the rhythms of global trade that occurred in the 1990s and that banks have only now addressed. The introduction of supply-chain management techniques tended to reduce the dollar size of individual shipments. Managing the supply chain carefully reduces inventory and brings industries closer to just-in-time production techniques. Necessarily, a great many more smaller shipments came to replace big orders. Nowhere did this trend have more impact than in Taiwan, where Wegner reckons that 80 percent of all trade finance transactions can be

banks and logistics companies set up Bolero in 1998, it was in the hope of developing an open system that could bring banks back into that portion of trade finance that had moved to open account transactions. But the inefficiencies were ripe to be exploited by a new player outside the banks. TradeCard set up its system three years ago with seed money provided by private equity firm Warburg Pincus. It has garnered a strong following quickly, with trade volume doubling in the last year. TradeCard offers document settlement and compliance features, plus the ability for two parties to negotiate over a change in terms or clear up discrepancies on the Web while sitting in their respective parts of the world. Other elements combine to make TradeCard a one-stop service. Through an arrangement with Coface, the credit agency based in France, users can have a counterparty rated and obtain insurance on line. Thomas Cook's international payment system is used to complete transactions.

Wegner says that TradeCard has never really had any competition. “Competition in this market would not be bad,” he says. “The biggest barrier has been education.” He adds, “If more players were actually selling it this service, people could judge against one provider against another.”

He may be getting his wish if the Bolero rollout of its SURF product gains fans quickly. If SURF's performance is as billed,

then it would provide a direct challenge for TradeCard. While the latter has had first-mover advantage, it has limited capital, and, according to Cavano, will only become profitable in mid-2003. Bolero's bank owners have deeper pockets and a commitment to stay in this market for the long haul.

"I would say that once SURF is active, Bolero will offer very serious competition for TradeCard," says Alan Wilkinson, head of trade services for HSBC in Hong Kong.

HSBC has built proprietary link-ups for trade finance through a system called Hexagon for 15 years. It is now rolling out some of the features of Hexagon into the new Internet system, targeting the middle- and low-end of the trade finance market. Wilkinson says that there are about 2,500 HSBC clients using the Hexagon system. By introducing the Internet-based system, HSBC intends to provide services to upwards of 4,000 more clients.

HSBC's new product will not be an open system. It is not designed, like TradeCard, for a seller to deal with a buyer without bank intervention. Standard Chartered's experiment with its B2BeX represents a departure from traditional bank Internet offerings. The bank polled almost 800 clients before designing the system, according to Ken Stratton, Standard Chartered's head of trade sales. "What they wanted most," he recalls, "was a way to overcome the fragmentation in the trade finance process." One such fragmented area was the incompatibility of company back-end systems, making it difficult to automate transactions between companies and sometimes even within the same company. B2BeX will feature a document and data management capability, Stratton says, that allows CFOs or treasurers to use their existing systems or a web browser to send and receive all trade-related documents. The result is that users should be able to summon the electronic record of each transaction in the course of a deal. The advantage to Standard Chartered of the open system is that it will provide a window to potential clients that are currently trading on open account, but could be won over to services related to trade finance, such as cash management and foreign-exchange hedging.

LET'S BE FRIENDS

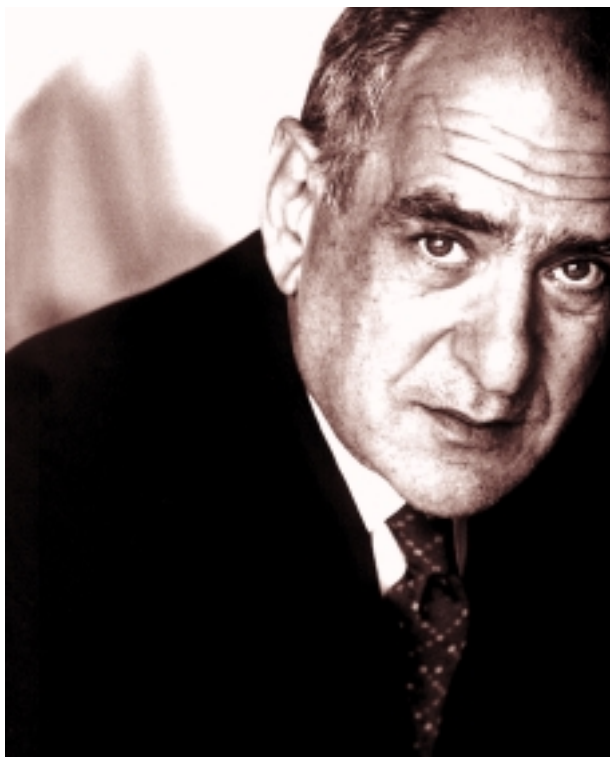
JPMorgan introduced its own electronic trading system, TradeDoc, almost three years ago. TradeDoc is used for electronic outsourcing of export documents. More recently, the bank developed a linked electronic trade information service called Trade Information Exchange (TIE), which allows CFOs to look at outstanding trade activity and actual export document images in real time. Bruce Alter, JPMorgan's head of trade finance for Asia Pacific, says that these e-trade offerings help users flag trouble spots. "A CFO can go in and look at transaction activity, such as payments outstanding," Alter explains. "From TIE reporting, the CFO can now see which countries and buyers within those countries are slowest to pay. He or she can then get on to the sales people in that country and make the terms much more aggressive."

Like HSBC's system, TradeDoc and TIE are proprietary

offerings. But the bank has recently included a 'white label' TradeCard service in its product mix (it also linked up with Bolero this year). The rationale here is to portray these services as one suite available to a bank client, rather than competing services. If a JPMorgan client wants to use the open-system capability of TradeCard, the bank sees it as another way to satisfy a customer, who may then buy into its other services.

Working together in this way would not have happened two years ago, when the more powerful banks saw TradeCard as a kind of uninvited guest at a fraternity dinner. Now it seems that mutual interest is carrying the day.

And not before time. The banks face enormous skepticism about the effectiveness of their technology and their ability



"Banks will have to remain the ultimate window ... because in the end, we all want to get paid." — Richard Elman, CEO, Noble Group

to overcome these difficulties. "The adoption is very slow on these things," says Richard Elman, chief executive of the Hong Kong trading company Noble Group, referring to the commodity market. "I've not seen anything that's successful, because most transactions have a complex set of documents involved." That said, he adds, "Banks will have to remain the ultimate window," in a trade finance deal. Why? "Because in the end, we all want to get paid."

Let the banquet begin. S