Thought Leadership Series

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Integrating treasury solutions in Asia and Europe: A roadmap for success

Executive Summary

- A significant trend over the past decade has been the integration of treasury services, particularly cash management and trade financing, by major corporations.
- This white paper sets out to establish the level of treasury services integration at corporate level across six very different exporting economies in both Organisation for Economic Co-Operation and Development (OECD) and non-OECD economies, namely: Spain, Italy, Germany, the People's Republic of China, India and the Republic of Korea.
- The paper aims to determine (irrespective of sector) whether a corporate's geographic location is the key factor in establishing the level of integration with respect to its treasury services provision. Also, where it is established that the level of integration is limited, the paper has sought to establish both the degree and cause of such lack of integration: with the keenest focus placed on local banks as the providers of both cash management and trade finance services for their indigenous exporting companies.
- In all cases, the paper finds that local banks are the central dynamic towards fully integrated treasury services.
- From the companies surveyed for this paper, not one Chinese company utilises an automated cash management or trade finance platform provided by a bank or other provider.
- 80% of companies interviewed in Germany utilise an automated platform or work closely with their bank to manage their cash management needs.
- Where the local banks have invested in the technology required, or are working in partnership with key providers, integration has advanced; helped by exporting companies that have embraced open account trading and IT based supply chain innovations.
- The survey also found that local banks will lose ground to international banks unless they look at offering their own fully integrated treasury services.
- The real choice facing local banks seeking a fully integrated treasury services offering is between outsourcing to a global commercial bank that may be a competitor or collaborating with a non-competing treasury services bank.

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Introduction: What is meant by integrated treasury solutions?

Treasury solutions are the range of products and services offered by banks to aid the smooth and efficient operation of a company's physical and financial supply chains. They involve the provision of adequate and timely liquidity, the minimising or mitigation of credit and operational risk and the optimisation of cash flow management.

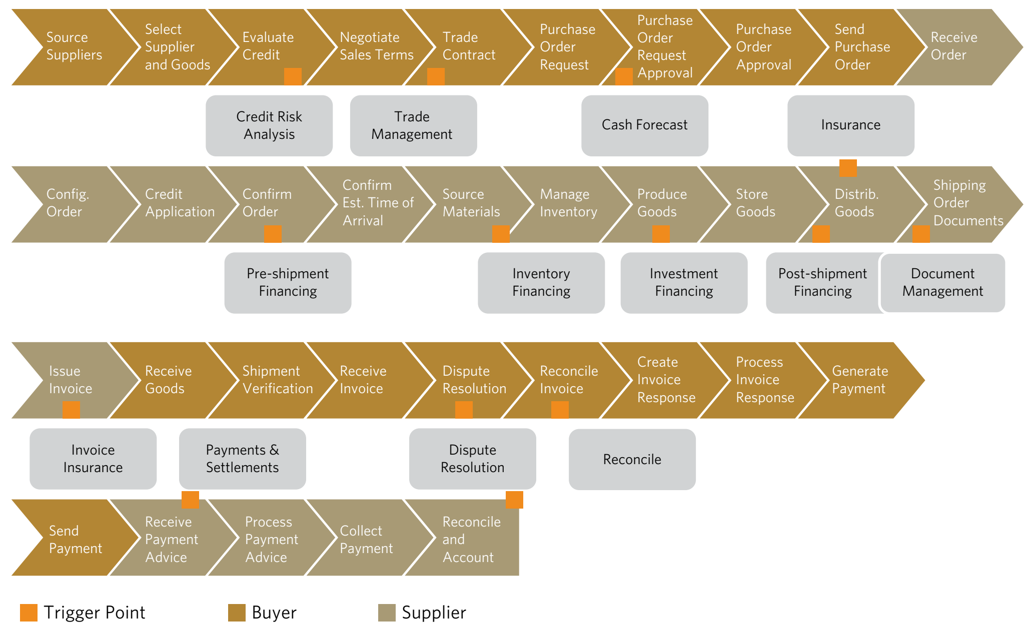
Such products and services are usually supplied via a company's house bank, although some specialist providers offer niche products and services at various points along the supply chain; for instance, while some banks are involved in invoice discounting, it has traditionally also been a strong area for either independent or aligned-but-separate forfaiting or factoring houses. The two key treasury solutions areas (trade finance or trade services, dealing with cross-border risk mitigation; and cash management, dealing with cash flow and liquidity optimisation) have, however, traditionally been offered via two quite separate banking areas, although both have a major bearing on the efficiency or otherwise of a company's supply chain. This is often both reflected by, and a reflection of, the separate treatment of these areas by the companies themselves.

Developments in information technology (IT), and especially the advent of the Internet, have the potential to revolutionise this situation, allowing for the provision of integrated treasury solutions. This is the case in both trade services, where the migration towards electronic documentary processing has driven up confidence in the reliability and efficiency of transactional services; and cash management, where electronic payments systems have helped optimise company cash flows. The combination of these two processes (electronic documentary and payments systems) offered seamlessly to companies, usually via a bank, is what we mean by integrated treasury solutions.

a) The integration of the physical and financial supply chains

In what can be viewed as a two-stage process towards the creation of a seamless treasury services function, the first stage is represented by the integration of the physical supply chain (the movement of goods) with the financial supply chain (the movement of money) running in the opposite direction and including such elements as payments, guarantees, loans and receivables financing. The key to this has been the introduction of electronic payments and documentary processing, often in centralised processing centres. In particular, migrating trade documents onto a transparent and viewable platform can automatically trigger financial supply chain events (such as payments, loans and the opening of letters of credit). By improving efficiencies within the supply chain (for instance by reducing delays in receivables), we can unlock potential improvements in the overall cash management of a corporation (see Figure 1).

Figure 1: Trigger points between the physical and financial supply chains



Source: Celent 2008

b) The integration of cash management and trade finance

The integration of the physical and financial supply chain has generated an unprecedented level of confidence in the reliability of trade documentation and associated payments. This, in turn, has fostered a change in perception, allowing a corporate's trading activities to move from being viewed primarily as a risk mitigation function, towards being seen as a potential support for the overall cash management of a corporation. The blending of cash management and trade finance as corporate disciplines is, therefore, a logical and timely second step: a move also supported by the pressure on corporates to improve returns on equity without recourse to additional external funding. Again, improved and integrated technology has been the major driver for such a process: especially since the advent of Internet based platforms.

> Anecdotal evidence from a recent blog survey by Celent (2009) suggests that while the value of integration for cash management and trade finance is obvious, many companies do a poor job of analysing their receivables to tie to cash forecasting and management. However, there is widespread acknowledgement of the benefit of integration, and corporates are looking to banks for both their knowledge and technology to create greater value within their own supply chains.

Such integration does not come cheaply, however. As stated, developments in IT have been largely responsible for fostering this integration, although there has also been some pressure from those leading corporates that have already made the logical connection between supply chain efficiency and cash management optimisation. The development of IT platforms able to cope with the complexity of the needs of such operations, as well as migrating paper based systems to electronic systems in a way that benefits all those involved is, however, a major undertaking, with a prohibitive cost for all but the most committed and global of treasury solutions providers.

Such costs create a potential conundrum. Fully integrated treasury solutions have the potential to revolutionise the provision of trade services and cash management: but is this purely for the benefit of customers of the global banks that have made the required investment in such systems?

If so, does this mean the exclusion of smaller banks, hence, of smaller corporate clients? Is the choice for corporates one between a fully integrated treasury solutions provision, offered by a few global banks to their major corporate clients, largely in OECD countries; or a service, offered by a disparate range of providers, that is inefficient, paper-based, and with little or no integration with a corporate's equally inefficient cash management systems?

c) Impact on OECD and non-OECD trade

Such developments also need to absorb radical changes in the patterns of global trade over the past 20 years. OECD countries, once the major producer/exporter economies for manufactured goods to each other and to non-OECD countries, are moving towards being net importer economies, largely from non-OECD emerging markets. This shift has a profound impact on trading relationships – especially with respect to risk-and most significantly, the terms of trade.

According to SWIFT, over 70% of all trade transactions are now conducted on open account terms; that is, trades that are not protected by a bank-issued letter of credit (LC) guaranteeing payment. This is a reflection of the power of the OECD-based purchasers to squeeze preferential trading terms from their suppliers (who are often stretched to payment terms of up to 180 days) which, in turn, profoundly impacts the working capital needs of these, often smaller, non-OECD suppliers. Fully integrated treasury services would, therefore, help these suppliers mitigate the cash management difficulties that are often an unwelcome consequence of these large contracts. Such companies may, however, have limited access to these services, simply because they are dependent on local banks that are unable to invest in such systems.

This paper, therefore, aims to explore the level of integration in treasury services provision in both OECD and non-OECD markets, and to develop a potential pathway for generating a third choice — namely collaborative treasury solutions along the entire supply chain, which integrate all the existing participants.

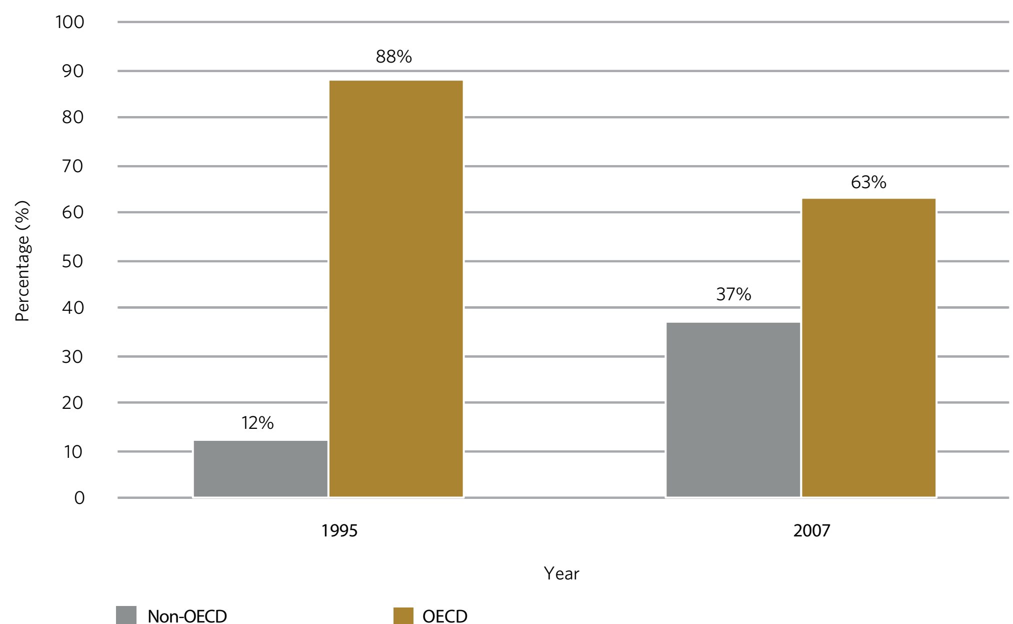
Chapter 1: Factors encouraging the integration of treasury services

In order to determine whether fully integrated treasury services are feasible in both OECD and non-OECD economies, it will be important to further examine the current circumstances and trends in both trade finance and cash management. This should help develop a scenario in which fully integrated treasury services are clearly desirable and theoretically possible. We will then examine progress towards fully integrated treasury services in particular countries (see Chapter 2) – choosing indicative economies in both Europe and Asia, namely: Spain, Italy, Germany (all OECD countries); the People's Republic of China and India (both non-OECD countries) and the Republic of Korea (Asia's only OECD country and a relatively newly "emerged" economy).

a) The changing patterns of trade

In 1995, non-OECD economies contributed 12% of the world's merchandise trade – predominately selling to OECD countries (the so-called south-north trade). By 2007, trade from non-OECD countries had increased to 37% (see Figure 2).

Figure 2: Change in trade patterns : non-OECD countries triple trade activity

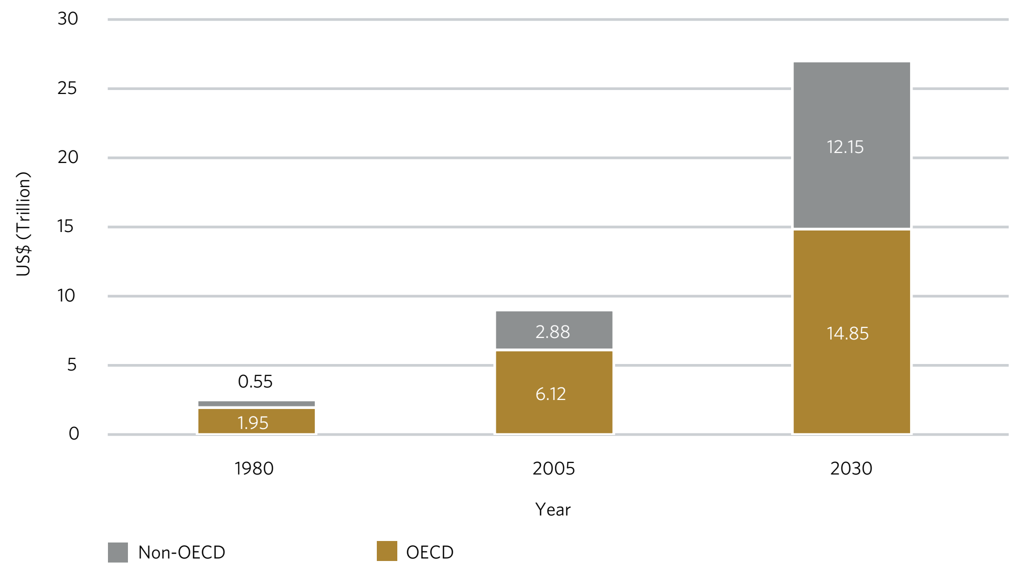


Source: UNCTAD data 2008

Furthermore, south-south trade – the trade between non-OECD countries – has begun to play an increasingly important role in international trade. Its share in overall trade has increased dramatically, particularly in the past decade. In the 1980s, the developing countries had a 22% share of international trade, but, by 2005, it had grown to 32%. While the high income countries more than doubled their trade, developing countries recorded a more than fourfold increase. By 2030, it is estimated that 45% of international trade will originate in non-OECD countries, while OECD countries will see a 13% drop, to a 55% share (see Figure 3).[1]

1 Pierron, A., Sankar, S., 2008. International Trade & Trade Finance. Celent.

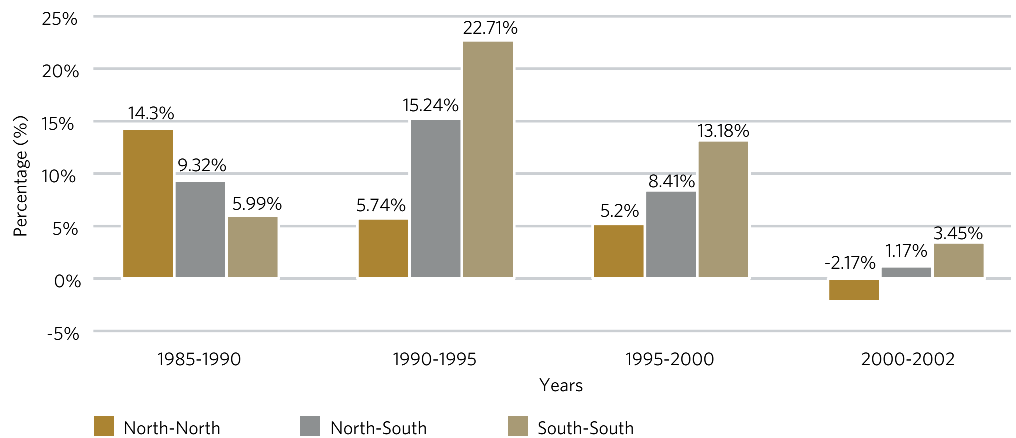
Figure 3: World trade market share for OECD countries



Source: IMF 2006

Also, south-south trade is growing much faster than the growth of world trade (see Figure 4). In 2006, total exports from the south reached $4.5 Trillion, accounting for 37% of world trade. Also by 2007, Asia had developed into the world's most important trade hub between developing countries, accounting for about 90% of total south-south trade.[2]

Figure 4: Historic growth rates: south-south trade volume



Source: OECD 2008

Analysing the trade patterns of individual countries and particular regions (Figures 5-10 below) further indicates wholesale change in the way countries trade with each other.

2 Pierron, A., Sankar, S., 2008. International Trade & Trade Finance. Celent.

Figure 5 reveals a dramatic increase in China's share of global exports since the early 1990s, while Italy's share of exports has trended down. This shift has, however, occurred during a half century that witnessed an unprecedented increase in trade, especially since the 1970s: meaning that even Italy's relative decline still represents a major increase in exports in dollar terms. Figure 6 indicates a smaller but still significant increase in Chinese imports, with a more dramatic growth in imports for Germany (although showing signs of peaking in the 1990s).

Figure 5: World merchandise exports by selected economy (%)

	1948	1953	1963	1973	1983	1993	2003	2007
Germany	1.4	5.3	9.3	11.6	9.2	10.3	10.2	9.7
Italy	11.3	9.0	7.8	5.1	4.0	4.6	4.1	3.6
People's Republic of China	0.9	1.2	1.3	1.0	1.2	2.5	5.9	8.9
India	2.2	1.3	1.0	0.5	0.5	0.6	0.8	1.1
Total trade (Billion dollars US)	59	84	157	579	1,838	3,675	7,375	13,619

Source: WTO 2008

Figure 6: World merchandise imports by selected economy (%)

	1948	1953	1963	1973	1983	1993	2003	2007
Germany	2.2	4.5	8.0	9.2	8.1	9.0	7.9	7.6
Italy	2.5	2.8	4.6	4.7	4.2	3.9	3.9	3.6
People's Republic of China	0.6	1.6	0.9	0.9	1.1	2.7	5.4	6.8
India	2.3	1.4	1.5	0.5	0.7	0.6	0.9	1.6
Total trade (Billion dollars US)	62	85	164	595	1,882	3,787	7,691	13,968

Source: WTO 2008

Trade, therefore, is playing a far more significant role in the life of many major OECD corporates, as well as increasingly involving non-OECD countries, whether as importers or exporters. This impression is reinforced by Figure 7, which shows Asia-Asia trade accounts for 57.4% of all Asian trade, while Europe accounts for 47.7% of Commonwealth of Independent States (CIS) trade and 31.7% of Middle Eastern trade; while Figure 8 demonstrates an almost three-fold increase in trade from Korea to other Asian countries since 2000. Interestingly, the significant shift towards 'southern' countries driving the traffic of world trade is also highlighted by the fact that trade from Korea to within Asia accounts for more than half of Korea's total merchandise trade. Similarly, Figure 9 shows the considerable proportion of global trade now exported from China (US$1,217.8 Billion) a third of which is within the Asian continent.

Figure 7: Shares of regional trade flows in world merchandise exports, 2007 (%)

	World	North America	South & Cental America	Europe	CIS	Africa	Middle East	Asia
Europe	42.4	18.2	17.8	71.2	47.7	41.6	31.7	13.2
Asia	27.9	30.1	20.5	12.0	20.1	25.7	31.2	57.4

Source: WTO 2008

Figure 8: Merchandise trade of the Republic of Korea by region 2000-2007 (exports)

Value (Billion dollars US)	2000	2001	2002	2003	2004	2005	2006	2007
World	172	150	162	194	254	284	325	371
North America	42	35	38	40	50	49	54	58
South & Central America	7	7	6	6	8	10	13	17
Europe	27	23	26	30	41	48	54	61
CIS	1	2	2	3	4	5	7	11
Africa	3	4	4	4	7	8	10	11
Middle East	7	6	6	8	9	10	12	17
Asia	84	73	80	104	134	152	174	195

Source: WTO 2008

Figure 9: Merchandise trade of China by region 2000-2007 (exports)

Value (Billion dollars US)	2000	2001	2002	2003	2004	2005	2006	2007
World	249.2	266.1	325.6	438.2	593.3	762	968.9	1,217.8
North America	73.9	77.5	100.4	130.4	176.2	226	284.2	326.2
South & Central America	5.7	6.3	6.5	8.4	13	17.7	26.6	39.3
Europe	51.6	55.4	67.2	100.8	140.5	186.8	244	317.3
CIS	3.2	3.5	5.1	9.3	13.8	21.4	28	48
Africa	4.9	5.9	6.9	10.1	13.6	18.5	26.2	36.5
Middle East	6.2	7.1	9.5	13.3	16.9	22.2	29.6	44
Asia	103.5	110.3	130	165.9	219.1	269.2	329.4	405.3

Source: WTO 2008

Conversely, Figure 10 shows that while trade from Spain to other European countries has grown in proportion to Spain's overall amount of trade, trade from Spain to Asia still occupies a relatively small proportion of overall world output.

Figure 10: Merchandise trade of Spain by region 2000-2007 (exports)[3]

Value (Billion dollars US)	2000	2001	2002	2003	2004	2005	2006	2007
World	115	117	126	156	183	193	214	253
North America	7	7	8	10	11	12	15	15
South & Central America	6	5	4	5	6	7	8	9
Europe	88	89	97	122	142	147	159	188
CIS	1	1	1	1	1	2	2	4
Africa	4	4	5	6	7	8	9	11
Middle East	3	3	3	3	4	3	4	5
Asia	5	5	5	6	7	8	9	11

Source: WTO 2008

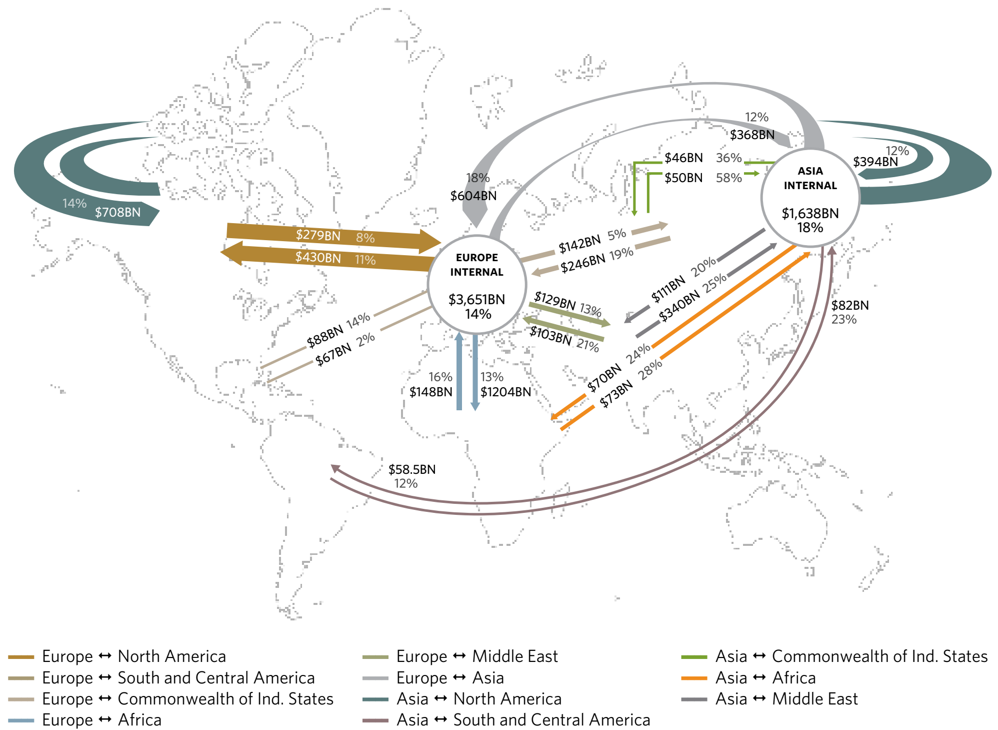
All these statistics point to the trend of increased south-south, south-north and north-south trade and these trends are likely to intensify in coming years. In 2000, non-OECD countries accounted for a little over one third of world output (at purchasing power parities). By 2008, this share had risen to 45%, with the share of the BRIC countries (Brazil, Russia, India and China) leaping from 16% to 22%, a sharp rise in such a short period. Indeed, almost 60% of all the increase in world output that occurred in 2000-08 was in developing countries, with half of it taking place in the BRIC countries alone.[4]

Figure 11 (overleaf) provides a visual representation of global trade flows in 2008.

3 Global Trade Atlas of Global Trade Information Services, Inc.

4 2009. The Economist

Figure 11: Overview of global trade flows (2008 US$ values & five year CAGR)



Source: WTO (Oliver Wyman elaboration) 2008

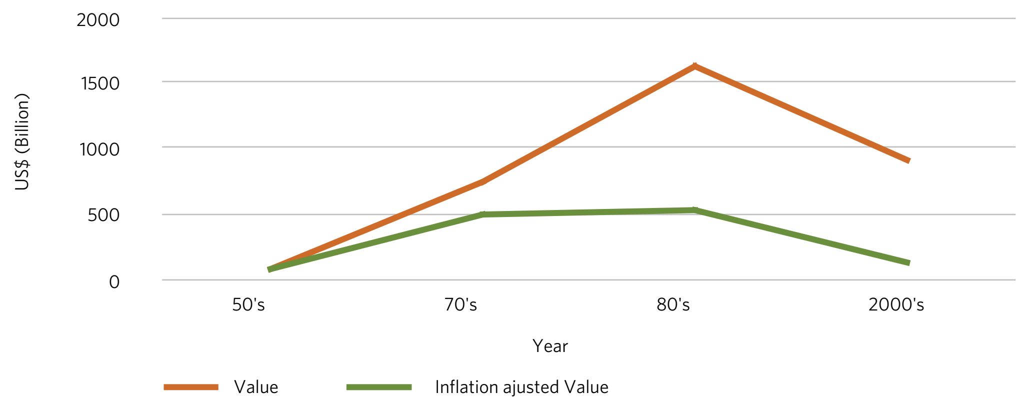
b) The impact of trade finance – the growth of open account transactions

The impact of these changes on the provision of trade finance has been marked. Despite the tremendous growth in the volume of international trade, the use of risk-mitigating trade finance tools has remained relatively flat, at least in percentage terms (see Figure 12). This suggests that the growth in trade has been largely on open account, often involving no form of risk mitigation. This situation may reflect the fact that the payment risk on most of this additional trade lies with large OECD buyers and is borne by non-OECD exporters, and may have much to do with an increase in the power of purchasers who are forcing suppliers to cut costs. As trade finance costs can represent around 8% of the value of each trade, this increased use of open account can also represent a real impediment for south-north exporters.[5]

5 Pierron, A., 2006. Trade finance at regional banks: What are the options? Celent.

Figure 12: Value of trade guaranteed with Letters of Credit

(Total LCs Issued in 2005 = US$ 17.5 million)



Source: Celent 2008

Certainly, the high cost of trade risk mitigation tools has encouraged corporates to look for cheaper solutions to conduct international trade, even if that means undertaking trade on an open account basis. Open account now represents around 70% of global international trade, compared with 15% for letters of credit, and 7% for documentary collections.[6] The use of trade finance instruments by trading companies is therefore shrinking, at least in relative terms, as many no longer see the need to continue paying high fees only to lose time covering a risk that has decreased, at least in terms of perception. In short, considerations of cost and inconvenience have in most cases superseded aversion to risk.

Yet, LCs are far from dead: indeed, they are the still the most widely used trade finance tool globally. Some 83% of companies engaged in import-export activities use LCs, and while 70% of trade activity is through open account, it is a method utilised by just 50% of trading corporates (suggesting that comfort with open account may be a luxury of larger trading companies). While the issuance of LCs in north-north and south-north trade is in relative decline, and will probably continue this relative decline over the long term, despite some revival of the LC as an outcome of the credit crisis (see Chapter 3), the use of LCs in south-south trade remains buoyant, with 20% of trade (by value) conducted using this tool in 2008.[7]

c) The growth of supply chain finance

These trends have a profound impact on the provision of trade services by banks and those wishing to stay competitive in trade finance will need to fundamentally rethink their approach. While the relative decline in LC usage for trade involving OECD countries suggests that a traditional area of trade finance revenue for banks is, at best, stagnant; other trends are painting a more optimistic scenario; not least the growth in supply chain finance, supported by the development of global communications and particularly Internet technology since the mid 1990s.

6 Pierron, A., 2006. *Trade finance at regional banks: What are the options?* Celent.

7 Pierron, A., Sankar, S., 2008. *International Trade & Trade Finance.* Celent.

Supply chain finance, the function of aligning the execution of trade finance instruments with the movement of goods and payments along the supply chain, now accounts for a third of trade finance revenues for banks (along with structured trade finance): up from only 20% in 2000.[8] The expectation is that this area of trade finance will continue to grow rapidly as supply chain finance not only aligns itself well with the growth of open account trading, but also maximises the efficiency gains made possible from the introduction of improved IT driven supply chain management monitoring. For instance, managing the supply chain more efficiently (most obviously through the use of online data management platforms) has reduced corporate inventories and brought industries closer to just-in-time production. This has meant smaller, more frequent, shipments replacing single larger orders. In 2001, the average value of an international shipment was 42% of what it was in the 1970s.[9] These smaller shipments have decreased the perception of risk, while increasing the potential for supply chain finance techniques such as invoice discounting and supplier finance. Yet, importers and exporters require access to the latest Internet driven supply chain technologies to benefit from these improvements: technology usually supplied in partnership with their banking partners.

As stated, open account trading in conjunction with IT driven improvements in the supply chain has also led to the potential for receivables or invoice discounting style financings: traditionally an area reserved for specialist forfaiting houses, but now very much the preserve of large import-export banks. Indeed, forfaiting (these days more often referred to as "receivables finance" or "invoice discounting") now accounts for 17% of international trade and is set to grow: helped, for instance, by IT driven improvements in payments processing.[10]

Other factors are, however, also having an impact on the growth of supply chain financing, including:

- Increasing intra-company trade flows – further reducing risk perception, as well as aiding the growth of open account transactions and supply chain financings.
- Rising commodity prices in the period prior to the fourth quarter of 2008, increased risk perception, as the dollar-at-risk from each shipment has gone up. This has encouraged the use of invoice discounting or receivables finance as a form of payment risk mitigation.[11]
- Rising import-export activity from small and medium enterprises (SMEs) in both OECD and non-OECD markets. This trend, in particular, has encouraged the growth of integration of cash management and trade finance (see below), although it could potentially arrest the growth of IT driven integration.[12]
- Extending the limits of the supply chain. Due to the scale and complexity of the physical supply chain, companies are increasingly sourcing unique and specialised products from new markets.

As we shall see in Chapter 2, the theory of a perfect scenario in which companies trade together on open account, monitored by an Internet based platform hosted by a major export-import bank with timely financing products such as invoice discounting or supplier finance being offered and executed seamlessly, is some way from becoming reality in the key growth markets of the world.

8 Pierron, A., Sankar, S., 2008. International Trade & Trade Finance. Celent.

9 Pierron, A., 2006. Trade finance at regional banks: What are the options? Celent.

10 Pierron, A., Sankar, S., 2008. International Trade & Trade Finance. Celent.

11 Pierron, A., Sankar, S., 2008. International Trade & Trade Finance. Celent.

12 Pierron, A., Sankar, S., 2008. International Trade & Trade Finance. Celent.

d) The growth of working capital efficiency in OECD countries

Simply examining the trends in global trade finance is not enough if we are to fully understand the potential for fully integrated treasury services. Just as significant, at least in OECD markets, has been the growth in automation of treasury processes, particularly in cash management. Moreover, the roots of treasury automation lie not simply within IT developments, although these are important. Within major corporations the treasury department has been asked to play a greater strategic role. Along with their traditional responsibilities, treasury professionals are increasingly expected to improve the bottom line. They are also expected to identify solutions to daily cash management challenges in an increasingly complex and global environment, while improving internal data controls and meeting increased compliance expectations, all within an environment of increased regulatory requirements and accountability, as well as intensified investor scrutiny. On top of this, they are expected to undertake these increased responsibilities with less staff and minimised expenses.

Such drivers place a greater focus on process documentation, controls and risk management, and on the accuracy of financial information. As a result, treasurers have a renewed focus on cash forecasting and global cash management, interest rate and foreign currency risk management practices and overall working capital management processes. But with limited treasury resources, treasurers are frequently left to "do more with less", hence the move to automation – i.e. the movement of cash management services onto a globally integrated IT driven platform.

Certainly, companies that conduct business worldwide are becoming increasingly aware of the benefits of timely and accurate tracking of their global cash position throughout the day. Not only does this enable them to manage their funds more effectively – maximising investment returns and decreasing interest on borrowed funds – but automation also reduces exposure to fraud by freeing up time to review cash flow and banking activity in more detail. The optimisation of cash flow, improved visibility of bank account balances, efficiently expedited data collection and analysis, improved internal and external controls and compliance and the enhanced mitigation of risks (such as price risk, currency risk or interest rate risk) are further benefits of the automation of cash management.

Once on stream, such automation will inevitably colonise further areas of a corporate's operations – most obviously both the domestic and international supply chain, such that the automation of both the cash management and trade finance systems onto one global IT platform. This is, as discussed, the common definition of fully integrated treasury services.

Treasury automation, therefore, offers unprecedented competitive advantages for companies to turn the treasury function from a cost centre into a profit centre. The creation of such infrastructure comes at a high cost, as a corporate could incur costs of between US$1-2 Million to implement and US$30,000 per month to maintain a global treasury platform. Meanwhile, banks can be faced with start up costs that can rise to the tune of US$200 Million, with monthly development and maintenance costs potentially reaching US$300,000, for proprietary global cash management and trade finance systems. Costs will also increase should the system need adapting or updating - a likely scenario in light of today's rapid technological developments and the increasingly global and regulated nature of commerce.

Fortunately, technology advances and the increase in the number of providers of such automated services in the past decade offer improved choices for corporates. When looking for a reliable and efficient treasury services platform, companies now have several choices, all of which can reduce the cost of a self developed proprietary system.

Firstly, online solutions are providing an affordable alternative to first generation workstations that habitually required operation from specialist terminals. Internet based offerings reduce accessibility concerns and eliminate upgrade costs.

Secondly, specialist technology providers have commoditised such software requirements to something approaching an off-the-shelf product, accessed online via a password protected portal. For a fee (or as part of the package), these companies can monitor, maintain and upgrade their systems as required.

Thirdly, corporates can outsource the entire process to a major provider of such services, most usually a leading transaction services bank. Outsourcing to a bank also allows payments, cash management, risk mitigation (such as foreign exchange risk, price risk and interest rate risk) and trade finance services to be applied by the bank as and when required, even automatically if key triggers are included in the programming of the account.

Despite the apparent need for automation of treasury services, and with the options open to them increasing, many corporate treasurers – even with respect to some multi-national companies within the OECD – have yet to fully adopt the process (as we shall see in Chapter 2). This is partly a logical calculation among corporates analysing the potential returns for such expense: not least because the calculation of daily cash positions and liquidity forecasts has already been simplified by the development of software such as Microsoft Excel®, with the advent of e-mail also improving communications (if not the security of communications) between subsidiaries or between elements within the supply chain. Furthermore, given the fact that outsourcing options may actually save rather than cost a corporate money, it is also partly a reflection of the banking provision on offer to, and in many cases preferred by, the corporates within certain countries. It is these local peculiarities that need further examination and which will be the subject of Chapter 2.

Some final but equally significant elements to consider are advances in the automation of logistics (i.e. the physical movement of goods through the supply chain). This process, which can typically take a number of months, follows a common cycle marked by various value points along the supply chain and the automation of these value points has allowed for better transparency and traceability of goods.

Indeed, according to Stuart Morrison, CEO of London-based financial logistics company EZD, technology and innovation are the drivers of supply chain efficiency. "The subsequent improvements in data flow and knowledge are exponential," he says. "Developments in IT have provided companies with the ability to track down individual products at any point along the supply chain, which in turn has created opportunities for companies if certain shipments are held up. If an importer discovers a product shortage or deficiency, they can expedite other shipments to mitigate the commercial risk. The real financial benefit comes from applying this data flow intelligently to the packaging of supply chain risk for financial service providers in the banking or insurance sectors."

e) Is there a global development path which results in integrated treasury services?

Finally, before examining individual countries in more detail, it is worth asking if there is a clear development path towards fully integrated treasury services. The brief answer to this is "no" as Chapter 2 will explain. Corporates in different countries operate under different circumstances and these – rather than any global developmental progress – are the central cause for any shortfall in the adoption of fully integrated treasury solutions. That being said, the movement towards full integration still seems to follow a trajectory of sorts. First, trade patterns shift, resulting in a move from LC driven trade to open account, although trade risk mitigation is still required by (most non-OECD) suppliers, perhaps through the injection of receivables or supplier finance. Meanwhile, OECD based corporates discover the benefits of automation of the cash management function. This, in time, colonises the entire supply chain, bringing trade finance within the cash management fold as another cash management tool.

Figure 13 offers a high level plotting of this path, with progress towards collaborative treasury services reliant both on the level to which trade has converted to open account and the level of automation with the cash management area. As Chapter 2 will outline, however, this theory is rarely borne out by the reality of local proclivities.

Figure 13: The path towards collaborative treasury services

** Including payment risk*

*** Including factoring, forfaiting, and invoice discounting*

**** Some examples include: confirm order, source materials, produce goods, distribute goods, issuing shipping order documentation*

Source: BNY Mellon and Moorgate Communications 2009

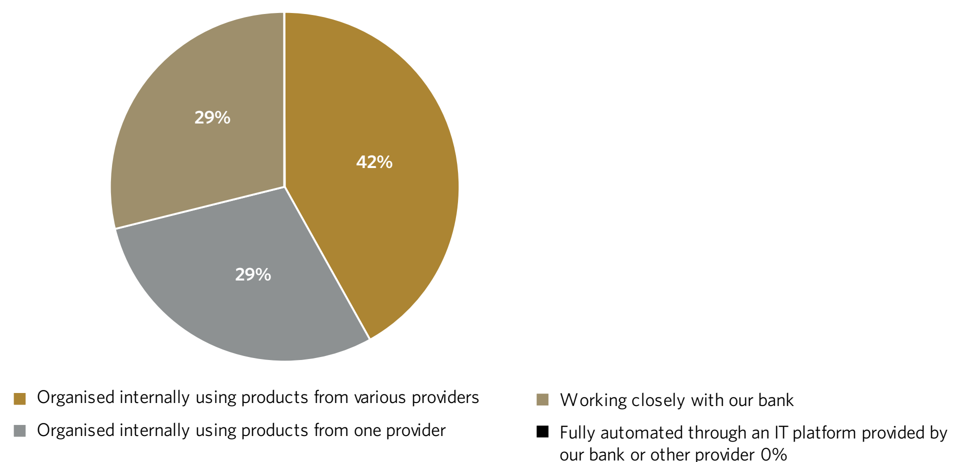
Chapter 2: What is the level of integration in the six surveyed countries?

To establish the position of various OECD and non-OECD economies with respect to treasury services integration, BNY Mellon employed the services of the research group Celent, who surveyed senior treasury managers from a range of trading corporations across various sectors in six countries (the People's Republic of China, India, the Republic of Korea, Spain, Italy and Germany). Their findings are below, although it is worth immediately stating the limits when trying to establish generalities for a particular country. In each country, the survey sought the opinion of major exporting manufacturers, and these inevitably varied in size and level of IT sophistication. The unifying element in each economy, therefore, is simply their location in that jurisdiction as well as their access to local banks' treasury services provision. Access to more sophisticated bank services, perhaps provided by foreign banks, was by no means universal.

a) The People's Republic of China

From the companies surveyed, not one Chinese company utilises an automated cash management or trade finance platform provided by a bank or other provider. Yet, almost a third "worked closely with a banking provider to organise their cash management needs" (see Figure 14). In around two thirds of cases, the respondents stated their "house bank was not an international bank": in fact, in most cases the bank supporting the company was one of China's largest domestic banks. However, 42% said they did use a "variety of products and providers for their cash management needs", so there is clearly some level of sophistication from Chinese corporates even if they are dominated by a single domestic cash management provider.

Figure 14: What is your current level of cash management services?



Source: BNY Mellon and Celent Analysis 2009

Also, while the corporates had not adopted any form of cash management automation, some Internet banking services were offered by a major Chinese bank through its bank-enterprise interlink service, although some 57% of the companies surveyed thought that their banking partners "did not have the necessary technology for their needs". Bankers operating in this region support this claim: Henry Guo is Senior Associate – China for Treasury Services at BNY Mellon.

"Increasingly, there is a trend towards a combined cash management and trade finance solution, but most smaller banks do not have the capability and resources to integrate these two products," he says. "Nowadays, corporates' needs are diversified, so not only do they need banks to manage their accounts, they also require the additional expertise from banks to provide trade finance solutions."

In terms of trade finance provision, while it is impossible to gain any consensus with respect to an LC/open account split (answers ranged from zero use of open account to a 5:1 ratio in favour of open account) it was clear that all those surveyed utilised documentary credits in one form or another, and that – of the countries surveyed – China had the highest usage of LCs. Having stated this, some 35% responded that the only credit risk management undertaken on at least a proportion of their overseas trading purchasers was the "imposition of credit limits" (suggesting these are open account trades), while another third "utilise receivables financing or invoice discounting". In fact, of the open account trades, 14% of the respondents opted for the statement, "we utilise no financing on our open account trades and are reliant on payment by the purchaser on the due date", while almost half agreed with the statement, "we approach our bank on a case-by-case basis for consideration of some form of supplier finance". The remaining 42% agreed with the statement "all our supply chain finance needs are run in partnership with our bank".

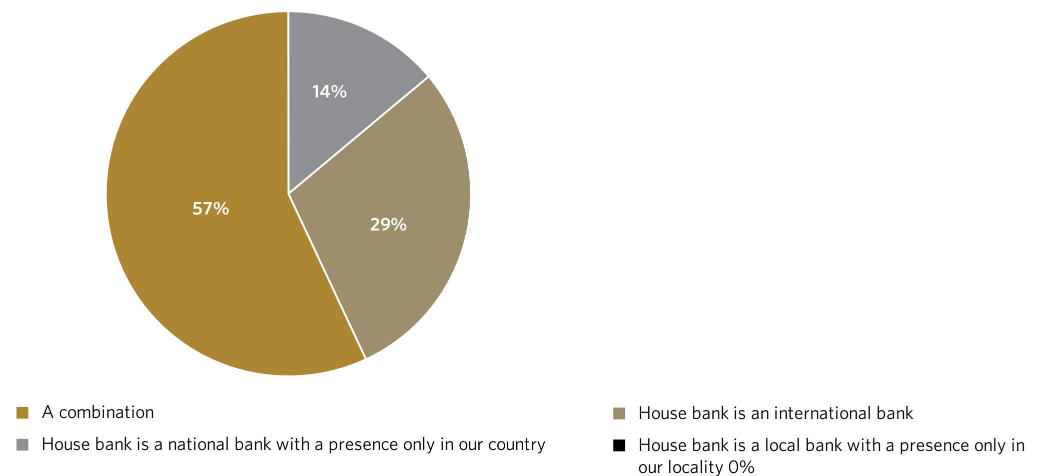
Therefore, China appears to be, increasingly, an open account market, especially with respect to exports to OECD countries (of which the EU and US are the dominant trading partners, holding 20.1% and 19.1% share of China's trade, respectively).

Open account is a trend that the local banks have facilitated, via their supplier finance offerings. It is also clear that international banks have a low penetration rate with Chinese corporates, perhaps due to the fact that China has a large number of small local manufacturers who remain dependent on their local banks, and that cash and trade integration and automation is most likely to be furthered through close association with, rather than avoidance of, the local banks. Having said this, local Chinese banks clearly need support with respect to developing a fully integrated and IT driven treasury services offering.

b) India

Of the companies surveyed in India, only 14% utilised an "automated cash management or trade finance platform provided by a bank or other provider." Currently, 40% work closely with their bank to "organise cash management needs and maximise the cash efficiencies possible," however, 57% stated that they, "organise all cash management services internally using a variety of banking and investment products from various providers". Meanwhile, while 14% said their house bank is a national bank, some 29% indicated their house bank is an international bank, with one company stating that their bank "is highly aggressive, innovative, and fairly sophisticated," The remaining 57% said their house banks were a combination of local, national and global banks (see Figure 15). Interestingly, this figure coincided with the number of responses citing local banks "lacking skills to perform deep evaluations of prospective borrowers".

Figure 15: What statement best describes your current banking provision?



Source: BNY Mellon and Celent Analysis 2009

Surveyed respondents were also evenly split between those who agreed and disagreed with the statement "local banks did not have the necessary technology". One company said "Indian regulation requires paper based signatures and document handling", while another said "we see that [local] banks are struggling to provide strong propositions against a backdrop of expensive operating platforms". Implementing such a solution is probably not a short-term priority for them.

With respect to trade finance, the split of exports sold on open account, against those supported by documentary credits was strongly favoured towards open account with respondents saying 75% to 100% was conducted on open account. This bias is anecdotally supported.

"Open account trade is something that has only emerged in the last decade, although it has taken off well because it is less complex," says Aneish Kumar, Managing Director and Senior Representative at BNY Mellon in India. "Ten years ago the business was mainly backed by bank guarantees/LCs, and was driven by banks. This has now shifted largely to the corporate side, due to the growth in open accounts. Customers are therefore looking at banks that have an open account trade process which engages both ends of the supply chain. They want to deal with financial institutions that have a large footprint in global trade, with an expansive branch network across geographies. Yet, the better and tech savvy customers are seeking open account platforms that enable buyers and sellers to streamline the process of cross-border purchase order and invoice management".

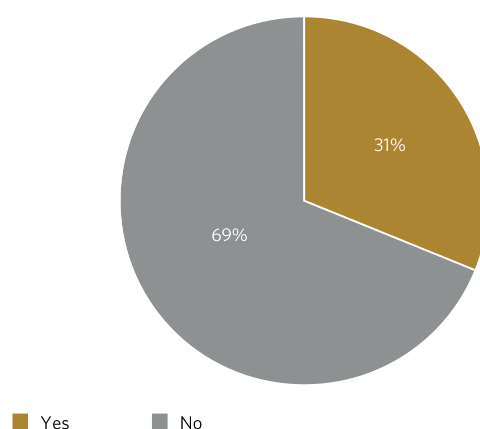
In response to the statement "what best describes your situation with respect to financing your open account trades," 43% said "we utilise no financing on our open account trades and are reliant on payment by the purchaser on the due date". The majority of respondents (86%) stated, however, that they have "credit limits in place for customers," possibly masking an internal divide between corporate treasury and procurement.

India is, therefore, rapidly becoming an open account export economy that utilises the treasury function to optimise cash management, often in conjunction with its banks. Yet, there is little evidence of a fully automated cash and trade offering taking hold in the country, preventing the corporates from benefiting from fully integrated cash and trade services. There is also a heavy bias towards localised banking, even among larger corporates and the resulting lack of emphasis on IT driven integrated treasury services only hinders the manufacturers from benefiting from cost reduction and increased transparency through streamlined reporting.

c) The Republic of Korea

Of the companies interviewed in Korea, 15% stated that their needs were fully automated through an IT platform provided by a third party, while a further 15% said they worked closely with their bank to organise their cash management needs. Meanwhile, approximately two thirds stated that their cash management services were organised internally, bringing in a range of financial services providers as appropriate. Again, the majority of respondents (70%) said their house bank was a national bank with no significant overseas presence, although 30% did claim an international/ global bank as their house bank – corresponding with the percentage claiming an external cash management offering. The vast majority of respondents (69%), however, agreed with the statement that, "the Korean banks lacked the technology to offer integrated cash management services" (see Figure 16).

Figure 16: Do local banks have the required technology to provide a fully integrated treasury solution?



Source: BNY Mellon and Celent Analysis 2009

With respect to the integration of trade finance with cash management, again the same 15% said that cash and trade were closely integrated using an IT platform provided by their bank. Meanwhile, more than half either replied that there was no degree of integration between cash and trade (23%) or stated "don't know" (31%); which probably means that integration between cash and trade is highly unlikely. Yet, 38% did state cash and trade work closely together internally, suggesting that Korea is a market wide open for further cash and trade integration, if only the local banks could develop an integrated IT based offering. Indeed, one respondent stated: "although Internet banking services have been developed, we think Korean banks do not offer services tailored to our needs".

This is further supported by the even mix of trade finance techniques utilised to support cross-border trade, with one company stating close to the median figures of 42% on open account and 38% on documentary credits (although 38% of respondents also utilised credit insurance). However, other respondents stated that trade was mostly undertaken on open account as, in the words of one respondent, "our export business is implemented between the Korean parent and our overseas subsidiaries" – a common exporting structure from the dominant Korean *Chaebol* trading and manufacturing companies.

Anecdotally, bankers support this proposition: "A number of Korean companies produce large, high value electronic goods and are, therefore, able to access trade finance without problems," says Richard Brown, Managing Director and Regional Head Asia, Treasury Services at BNY Mellon.

Some 46% of respondents stated that their open account trades are reviewed on a, "case-by-case basis for suitability for supplier financing"; with around one quarter stating that they, "utilise no financing on their open account trades and are reliant on payment by the purchaser on the due date".

Indeed, the impression given is that, for an OECD economy, treasury services integration has some way to go in Korea, with the corporates being ahead of the banks with respect to integration. It is, however, worth noting that Korea only joined the OECD in 1996, while the other OECD members in our survey are founding members (joining in 1961). This may explain why Korea appears to experience a non-OECD level of banking provision, hence only 15% claiming a fully automated cash management provision – and with an automatically triggered IT based supplier finance platform – plus the 15% that work closely with their bank to organise their cash management needs being part of the same 30% utilising the services of an international (i.e. non-Korean) bank. Therefore, a fully integrated and automated treasury services provision is making inroads into the Korean economy. As Korean banks partner with international banks, they too will benefit from the trend towards fully integrated treasury services.

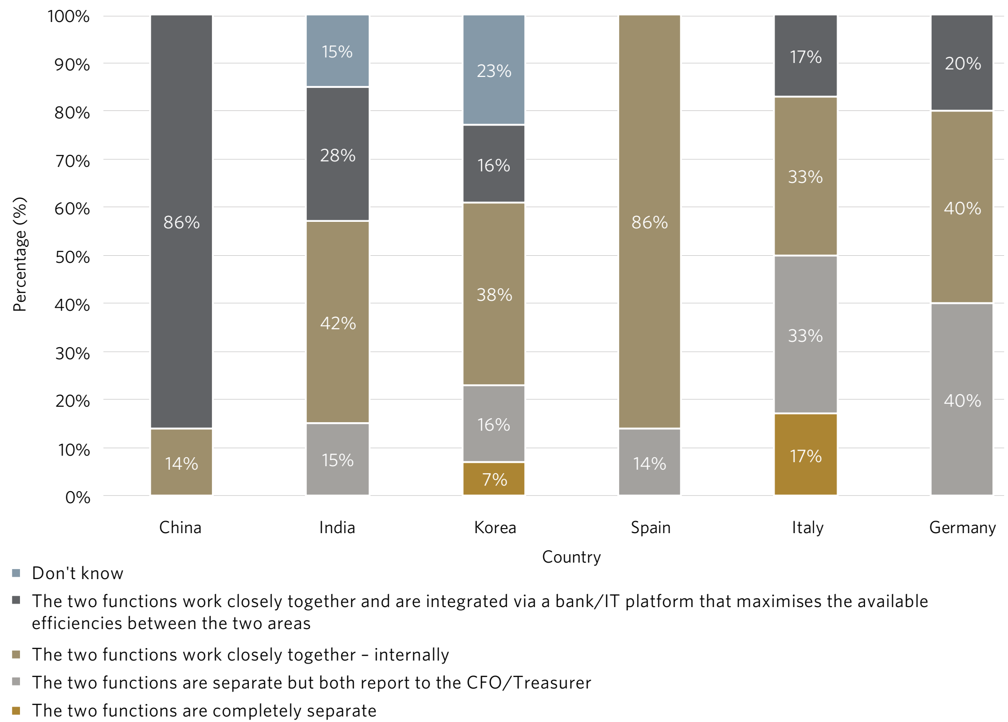
d) Spain

Of the companies interviewed in Spain, half organised cash management internally using a variety of providers, although around 17% used just one provider. A further 17% reported utilising fully automated cash management services through a bank provided IT platform. Also, a high proportion (over half) utilised a range of providers for their general banking provision with one manufacturer stating: "Our domestic bank frequently faces difficulties in handling the non-local leg of a trade transaction. Yet, global banks, which can take both legs of the transaction, often lack the local sales and relationship teams to deal with us".

This is supported by the nearly half of respondents stating that their house bank was a national bank only, with no presence beyond Spain. Yet, most considered their local bank technology as adequate, with only 16% agreeing with the statement "local banks do not have the necessary technology" for their banking needs.

With respect to the integration of trade finance and cash management, while no company stated it utilised bank offered IT solutions that dealt with both cash and trade, around 86% of survey respondents stated that cash and trade worked closely together internally (see Figure 17), with just 14% stating that the functions were entirely separate. Again, this was supported by the fact that open account was the most popular means of trade, with most respondents stating that between 50% and 70% of trade was conducted on open account. Of the open account trades, around 50% of respondents stated that their trade was not risk mitigated in any way, although around 20% stated that their trade was undertaken within company imposed credit limits. Meanwhile, supplier finance was used on trades for around 18% of respondents, although one third stated that their supply chain finance needs were run in partnership with their bank. Of the countries surveyed, Spain had the highest use of credit insurance applied to international trade – with over 30% of respondents stating that their trades were risk mitigated in this way, according to the survey. This is doubtless due to the fact that receivables financing (and the use of credit insurance) has been a popular and locally supported option for Spanish corporates for some time.

Figure 17: What statement best describes your internal situation with respect to cash management and trade finance integration?



Source: BNY Mellon and Celent Analysis 2009

The survey is supported by anecdotal evidence regarding the level of integration in Spanish treasury services: "While our clients see the benefits of a fully integrated cash and trade offering in terms of financing and supply chain and document management," says Ana Sancho, Vice President – Iberia for Treasury Services at BNY Mellon. "Implementing such a solution is probably not a short-term priority for them".

While many corporates are reliant on local banks, Spanish companies also seem used to shopping around for their banking provision, which leads to the conclusion that Spain is well placed for a locally offered, but internationally backed IT driven integrated treasury services offering, especially given the high levels of cash and trade integration at the company level.

e) Italy

Of the companies interviewed in Italy, only 20% stated their "cash management needs were fully automated through a third party IT platform provider," and a further 20% stated they "worked closely with their bank for cash management provision". Around 40% "organised cash management services internally using a variety of providers," with a further 20% using one provider. Yet, Italian corporates appear to be good at shopping around. Some 80% stated they "used a variety of banks for their banking needs," with one company responding that they used "one bank platform for their international/trade needs" (provided by a global bank, which also banks their subsidiaries) – "and another bank platform for their domestic needs".

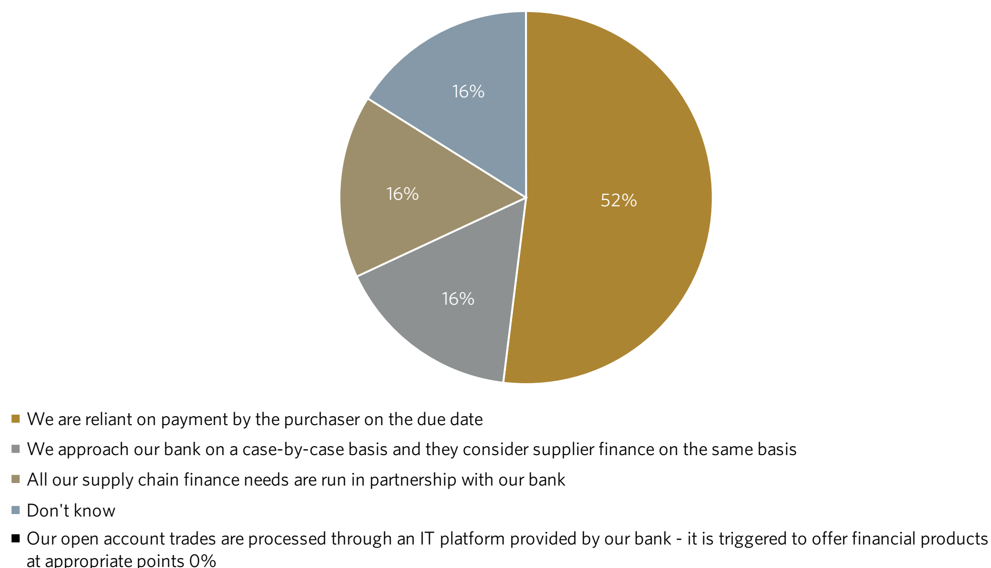
This evidence suggests a high degree of IT use in Italian treasury services, even if cash management is unlikely to be fully integrated with trade finance. All in all, the survey of the Italian corporates suggested a high degree of sophistication from local banks, with only 20% of corporate respondents agreeing with the statement, "local banks do not have the necessary technology," for their banking needs.

With respect to trade finance integration with cash management, only 17% stated that "cash management and trade finance were totally separate", with some 17% stating the two functions "work closely together via a bank/IT platform", although other companies were critical of the bank offering. One company stated: "Often, the separation of functions is due to a lack of clear strategy from the bank".

"When banks can not afford to take a given underlying risk – or chose not to do so – exporters will go to third party financial institutions (like ourselves) and establish or leverage on existing participation agreements, selling part or all of the LC risk then financing the domestic exporter on the short-medium term" says Mauro Bonacina, Vice President –Southern Europe for Treasury Services at BNY Mellon.

Integration is, indeed, encouraged by the trading profile of Italian companies, with a clear balance trading on open account (most likely between OECD countries). One company reported 100% open account utilisation while another reported 90% open account. A further company stated that their trades were "all documentary credits". The majority of respondents that used open account (52%) stated they utilised no financing on their trades but, "were reliant on payment by the purchaser on the due date." A further 16% stated that their open account trades were, "considered for supplier finance on a case-by-case basis" (see Figure 18).

Figure 18: What statement best describes your situation with respect to financing your open account trades?



Source: BNY Mellon and Celent Analysis 2009

Certainly, Italy is a sophisticated exporter market with some highly sophisticated banks. As expected, this has led to an IT based treasury services offering from a range of providers. Indeed, when asked to choose whether their house bank was a local, national, regional or international bank, around 80% responded with the answer, "a combination of the above". Nonetheless, the level of cash and trade integration utilising the IT platforms being developed is somewhat fractured. Italian exporters are (at least anecdotally) more reliant on and, therefore, more open towards foreign banks for their international trade provision. No matter what the IT sophistication of the local banks in terms of cash management, this fact alone will limit their ability to fully benefit from closer integration of cash and trade.

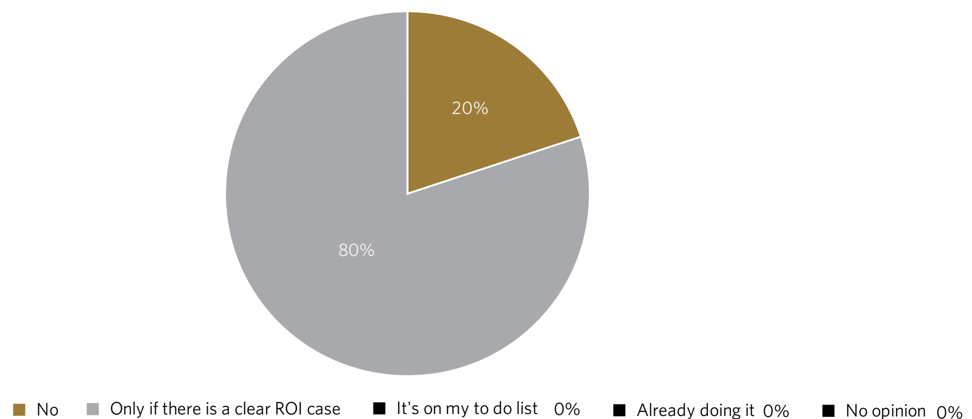
f) Germany

Of the companies interviewed in Germany, some 40% utilised an automated cash management platform from a third party provider – the highest level in the survey – and a further 40% "work closely with their bank to organise their cash management needs". The remaining 20% "organised their cash management internally using a variety of products and providers". This suggests that, of the countries surveyed, German companies are the most sophisticated in terms of their cash management arrangements.

Some 60% of German respondents stated that, "their house bank is an international bank with a global presence". This is, again, the highest percentage in the entire survey, meaning that local banks were well thought of. One German manufacturer said they did not have one house bank but prefer to work with local banks that have relationships with international banks – continuing: "we are dealing with many countries and our subsidiaries in growing countries use the local offices of local banks". Another German manufacturer stated: "cash and trade finance conversion is kept at the strategic level, and that's where the international bank can provide guidance. For most of our operational needs, however, we prefer to talk to a specialist – i.e. our local bank".

The high levels of sophistication with respect to cash management were not fully matched with respect to trade finance, however, with only 20% of respondents stating that cash and trade, "work closely together and are integrated via a bank/IT platform". Having said this, some 40% stated that the two functions work closely together internally. Overwhelmingly, 80% of respondents said they would be prepared to pay a bank for supply chain services if there was a "clear return on investment case" (see Figure 19). Yet, German manufacturers were also very heavily reliant on open account, with 80% of respondents stating that they trade 100% on open account. Of these open account trades, some 40% of respondents stated that they were, "run in partnership with our bank in terms of supply chain finance". Some 40%, however, also utilise, "no financing on open account trades" – instead being reliant on "payment by the purchaser on the due date". Having said this, some 50% of respondents utilise receivables financing, and a further 50% utilise credit insurance on elements of their trade.

Figure 19: Would you pay a bank for supply chain finance services?



Source: BNY Mellon and Celent Analysis 2009

Germany is clearly a leading economy with respect to treasury services integration, not least because it has both the technology based offering from its leading banks and has been an early adopter with respect to the migration towards open account trading. However, the German market is still in the process of fully integrating cash management and trade finance, with cash management tending to lead this process.

"Before mid-2007 you could see German exporters shifting the majority of their trade processes towards open account solutions," says Daniela Eder, Vice President – Central Europe for Treasury Services at BNY Mellon. "The majority of German goods are exported to the EU and US. Long term relationships and price sensitivity were causing a shift to open account practices. This was, however, dependent on the country of destination and associated political risk. Indeed, in the 1990s, the external environment underwent significant changes. Globalisation, the elimination of the 'Iron Curtain' in Eastern Europe, European Union (EU) enlargement and the establishment of the European Monetary Union have all had a large impact on German exports and how German exporters view risk. While previously there was a greater demand for LC issuance and confirmations, the change in the external environment and in political risk, decreased the need for risk protection."

The current credit crisis has caused a pause in this process, although it would appear that the tide of history has not been turned. "During my discussions with German exporters and German banks," says Daniela Eder, "both expect the shift to open account practices to continue once the markets return to normality. Therefore, my conclusion would be that a fully integrated cash and trade offering is very appropriate for the German market."

g) How can the varying degree of integration amongst individual countries be explained?

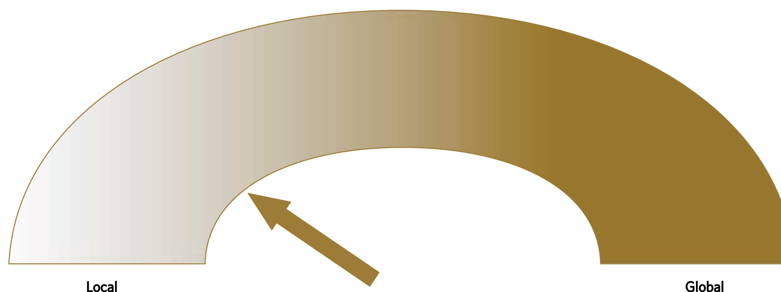
From the statistical and anecdotal surveys above, and from other evidence such as talking to bankers on the ground, it is clear that the central dynamic towards fully integrated treasury services is provided by the local banks. Where the local banks have invested in the technology required, integration has advanced – helped by companies that have embraced open account trading and so are keen to benefit from IT based supply chain applications. On the other hand, where the local banks have lagged behind in this respect, the local corporates have also been unable to benefit from the clear advantages of fully integrated treasury services, without reaching out to foreign providers. It is also important to take into account that OECD-based multi-nationals also have operations in non-OECD markets. Often, these companies will replicate their best practice treasury solution, which in turn puts pressure on local banks in these regions to have the necessary infrastructure in place.

Certainly, with respect to China, the slower integration of cash management and trade finance can be attributed to the banks. "The local small and newly established regional banks most favoured by Chinese corporates have not focused on the sophisticated IT infrastructure to support the blending of cash management and trade finance," says Henry Guo. "Meanwhile, the foreign – i.e. global – banks do not have the nationwide networks to reach out to the corporates." This has created a dilemma with Chinese corporates somewhat stuck in the middle.

Another limiting factor is the cost associated with implementing a fully integrated treasury services solution. From the survey, only 14% of Chinese corporates said outright that they would not be prepared to pay a bank for supply chain finance, although a further 57% said there would have to be a clear ROI case – with only 14% currently "already doing it". This is partly due to the Chinese exporter market being somewhat weighted towards SMEs – a factor that further suggests any advancement towards integration may well have to come via the local banks.

The barometers (Figures 20 - 25) reflect each country's estimated degree of treasury services integration. At one end of the spectrum is the term 'Local', which depicts a strong reliance on local banks (translating into limited access to global infrastructure). The other end of the scale is depicted by the term 'Global', which signals readily accessible global capabilities and a heavy reliance on global banks.

Figure 20: Estimated degree of treasury services integration in China

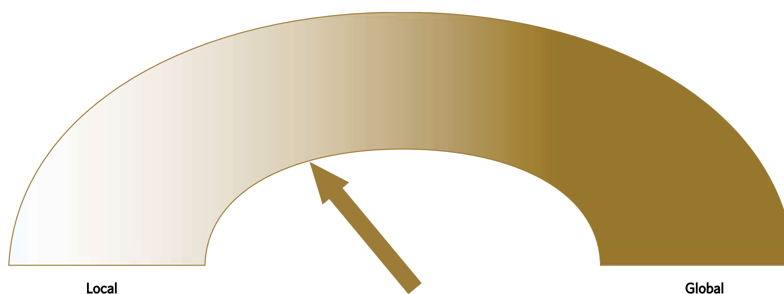


Source: BNY Mellon and Celent Analysis 2009

Indian banks are not proactively offering all the benefits of integrating the cash management and trade finance functions to their corporates. Indeed, 43% of respondents stated the two functions work "closely together internally", although of this group, one company stated their organisation "still allocated responsibility for trade finance decisions to the sales department". What is clear, however, is that the local banks still treat cash and trade as different disciplines, preventing a holistic attitude to the supply chain: this, despite the fact almost three quarters of surveyed Indian corporates stated they would consider paying for supply chain finance services to a bank if there was a clear ROI case.

"Supply chain finance is still a nascent business in India but is quickly emerging," says Aneish Kumar. "It will be a key product for exporters, importers and local banks in the near future. In order to achieve true supply chain efficiencies, however, both the physical and financial components of a company's supply chain process need to be working in close conjunction. In such an event, only a fully integrated cash and trade offering makes sense. Otherwise corporates will do all that they can to manage inventory and build goods in an efficient manner, only to lose those efficiency gains on the financial side of the process. Banks, by nature, are a critical link so for a fully integrated cash and trade offering to emerge, Indian banks need to keep moving towards this goal themselves or they may lose their place in the value chain".

Figure 21: Estimated degree of treasury services integration in India

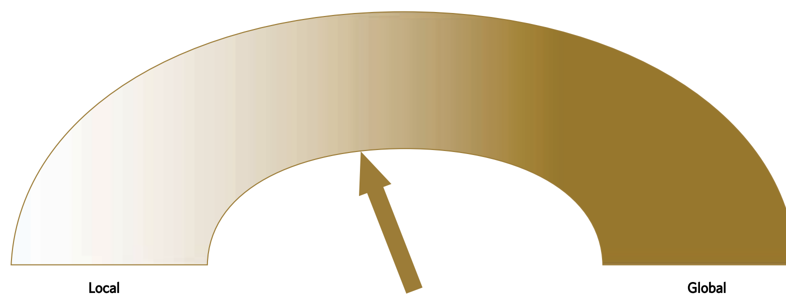


Source: BNY Mellon and Celent Analysis 2009

Korea undoubtedly has some of the world's strongest corporations – many trading on open account to both OECD and non-OECD markets. Yet, this has not led to a fully integrated treasury services environment – mainly because they mostly utilise local banks for their treasury services provision. Some two thirds of Korean corporates interviewed for the survey said their, "house bank is a national bank with a presence only in our country". A further 24% said they used a "combination" of local/national and global banks as their house banks, and the 15% of corporates who stated they had a fully integrated offering via an IT based platform, directly corresponded with the 15% stating they utilised the services of a global (i.e. non-Korean) bank.

This is an undoubted challenge for the local banks if they are not to lose a higher percentage of their business to the global banking providers; although it is one likely to be supported by their local corporates; only 15% of whom stated they would not be ready to pay for supply chain finance services from a bank. Korea, in other words, is another market ripe for an outsourced offering from global treasury services providers (see Conclusion below).

Figure 22: Estimated degree of treasury services integration in Korea

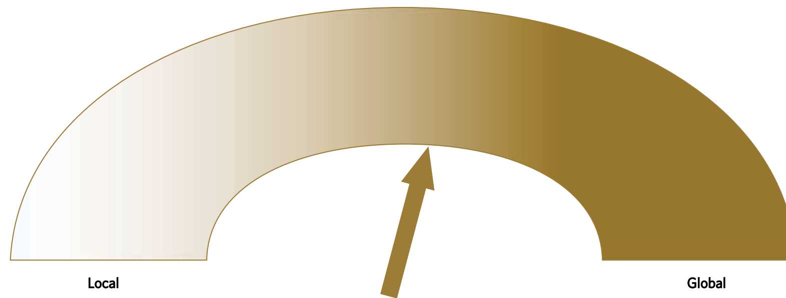


Source: BNY Mellon and Celent Analysis 2009

As with Korea, Spain seems to have very strong corporates, who are again held back by their bank's partial response to the challenges. "Local banks lack the technology," says one Spanish construction company, "and this has always limited our capacity to leverage important operations with local banks".

This has forced many Spanish companies to look towards global banks for their integrated and IT driven treasury services provision. Yet, local banks may be missing a major opportunity, as not only did some 86% of respondents to the Celent survey state that the "two functions [cash and trade] work closely together internally," the remaining 14% said the "two functions are separate but both report to the CFO/Treasurer." Meanwhile, 43% of respondents said they would be, "ready to pay for supply chain services to a bank," with only 14% saying they would not. Indeed, close to one third said some form of treasury services outsourcing was either happening or was on their "to do list".

Figure 23: Estimated degree of treasury services integration in Spain

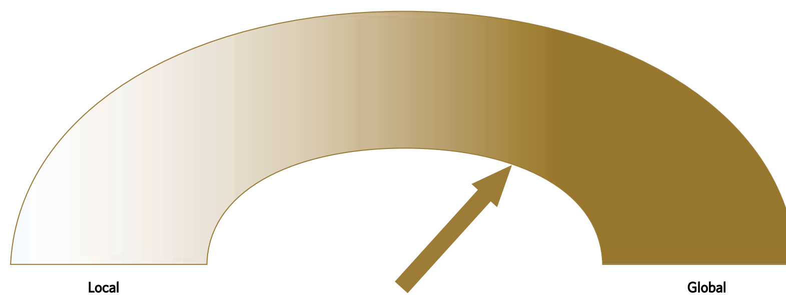


Source: BNY Mellon and Celent Analysis 2009

Italy is even further along the integration spectrum. "In Italy, the two elements of cash management and trade finance are intricately connected, and often the bank of choice of any exporter is the one who can actually provide both," says Mauro Bonacina.

Italian corporates were also very used to using global banks and have the most mixed use of banking providers of any country in the survey. Some 40% of corporates said they would be ready to pay for supply chain finance services to a bank as long as there was, "a clear ROI case". Yet, in the cases where there is poor integration it is caused – as the company treasurer quoted above states – by the, "lack of clear strategy from the [local] banks". Indeed, the same interviewee also went on to state: "we are expecting our banks to integrate their systems with our own, rather than imposing a new infrastructure": a clear challenge to local banks to avoid simply outsourcing the solution to a global bank peddling a proprietary system.

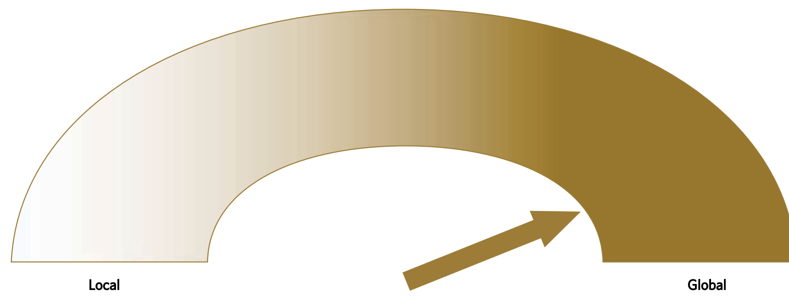
Figure 24: Estimated degree of treasury services integration in Italy



Source: BNY Mellon and Celent Analysis 2009

Germany is clearly the most sophisticated market in the survey, but this is not simply due to the global outreach of the corporates and concurrent strength of particular German banks. Many corporates still prefer to use local banks and are comfortable with the fact these local banks have strong relationships with international banks (even if also a domestic rival). This maturity was matched at the corporate level, with 80% saying they would outsource supply chain finance to a bank as long as there was a clear ROI case. Indeed, one German electronics company interviewed said it was "already using supply chain finance, particularly factoring and customer financing, where possible and feasible".

Figure 25: Estimated degree of treasury services integration in Germany



Source: BNY Mellon and Celent Analysis 2009

So is Germany the model market, or is it the United States? Certainly, bankers in the US proffer their model as a market leading route towards treasury services integration.

"There is a high degree of integration of cash and trade services in the US," says Mike McDonough, Managing Director and Head of Global Trade Product Management for Treasury Services at BNY Mellon. "However, this integration declines as the size of the companies shrinks. This may seem paradoxical as many SMEs are more likely to have a single person managing both the cash management and trade finance functions, but it is more than likely that they are managing these two areas separately on various IT systems."

Indeed, constraints on capital are the limiting factor to these smaller US companies, although the trend towards fully integrated treasury services was on the horizon well before the global economic crisis generated a pause in IT spend with many corporates. "CFOs and treasurers of some large US companies had the vision and foresight to see the benefit in freeing up liquidity from within the supply chain well before liquidity concerns gripped the market," says Mike McDonough, "in most cases working closely with their banking providers."

Chapter 3: How has the present global economic crisis changed this?

Thus far, this paper has ignored the impact or likely impact of the current economic downturn on the evolution of treasury services integration. This section will, therefore, seek to address this imbalance by assessing the likely impact of the recent economic dislocation on the advancement of fully integrated treasury services.

a) Liquidity management

The global recession has focused immediate attention on the importance of cash management and real-time cash visibility, in response to banks placing more stringent constraints on borrowers. Yet, this has coincided with the global trend for corporate treasurers, particularly in OECD countries (although also increasingly in non-OECD countries) to include trade generated cash flow into their cash management calculations. This is especially the case when corporates are able to utilise the new generation of online trade services platforms that are generating unprecedented level of confidence in the reliability of documentation and therefore the timeliness of trade transactions. Indeed, this inclusion of the full value chain of trade orientated cash flow into the overall cash management of a corporate has been – where adopted – well timed with respect to the credit crunch: in many cases driving forward an overall corporate strategy of liquidity enhancement that has reduced corporate reliance on banks for working capital.

The credit crunch should in theory result in the intensifying of a company's liquidity management efforts, in an attempt to reduce their reliance on short term working capital bank funding. Certainly, many companies are seeking an appropriate approach to enhance their liquidity management, especially by means of improving adequate liquidity forecasting models. The outlined improvements in IT, as well as advances in forecasting techniques, mean an increasing number of companies are beginning to rely on professional treasury information systems instead of using manual spreadsheets; in many cases integrated into an overall IT based cash management system.[13] While there is a greater intensity on potential liquidity enhancement outputs where corporates have invested in new systems, or outsourced cash management to specialist treasury services providers; there is also anecdotal evidence that where corporates are still evaluating such processes, there has been a delay in implementation due to constraints on investment projects caused by the global recession. This is despite the fact that outsourcing such treasury functions involves minimal set up costs and potentially offers substantial reductions in working capital requirements.

Furthermore, the issue of funding efficiency for the supply chain remains. Despite efforts from central banks to pump liquidity into the banking system, corporates are still struggling to secure credit facilities, with many mid-cap companies being entirely cut off from funding. Yet, changes in the way banks operate play a part here. Historically, regional banks undertook credit evaluations of prospective borrowers, a model now superseded by a head office model that favours lending on an industrialised and centralised basis. This change in banks' loan eligibility models, coupled with changes in the economic climate, have created a disconnect between those responsible for making lending decisions and businesses requiring credit.

Given all of this, a return to localisation is imperative for effective risk management. Local and regional banks must resume their past role as risk assessors of potential borrowers. As a result, local banks can re-establish the strong relationships they once enjoyed with local companies, and will regain awareness of clients' needs. Meanwhile, an enhanced IT offering can ensure that this local risk assessment is coupled with a global treasury services offering.

13 Zucknick, M., 2008. Cash management techniques. IBM - Sabine Schramm.

b) Increase in documentary credits

One, perhaps expected, consequence of the increase in risk perception in cross-border trading relationships has been an increase in the use of risk mitigation instruments such as documentary credits and a consequent decline, or at least halt in the growth of, open account trade. Despite the downturn in global trade, advanced country banks have reported approximately the same number of documentary credit transactions (i.e. guarantees and letters of credit) in October-November 2008, compared to the same period in 2007.[14] One explanation for this may be the fact that short term credit limits have remained largely unchanged at most trade finance banks, with trading entities choosing to apply documentary credits against countries or purchasers previously considered low-risk (i.e. open account) markets. Countries or purchasers that had previously required documentary credits may now require pre-payment.

Certainly observational evidence from trade financiers in our selected countries bears this out.

From OECD countries:

> "We are seeing a significant increase in use of traditional LC business – as well as of confirmations, silent confirmations, discounting and forfaiting and of public and private credit insurance," says Mauro Bonacina. "Open account solutions are far less appealing than they were until last year. This comes as no surprise, given the economic slowdown and the credit crunch experienced worldwide, with the consequent growing lack of trust among commercial counterparties and banks."

> "Before mid-2007, German exporters were shifting the majority of their trade processes towards open account solutions," says Daniela Eder. "But the global crisis has caused a tense atmosphere. German exporters are again seeking risk security, which has caused an increase in LCs, even between the US and Germany, and a need for guarantees."

> "It is fair to say the situation is trending back to where it was 10 years ago, but from an Asian perspective, financial crises are more common than they are in the West, so it is slightly better placed to deal with the fallout," says Richard Brown. "Specifically, Korean companies tend to be more sophisticated than their Asian counterparts, with a number of companies producing large, high-value electronic goods. Therefore, their ability to access trade finance is fairly unproblematic."

From non-OECD countries:

> "Since the crisis began we have seen deteriorating credit terms from Chinese exporters," says Henry Guo. "When the importers open an LC, they now often need to place cash deposits at their bank and also pay a higher fee for the LC opening. Open account remains widely used, especially by Chinese exporters dealing with established long-term relationship buyers. If the exporter is not fully confident with the importers' credit, they usually require the importer to pay some cash as down payment before shipment: perhaps one third of the contract value. Exporters are also buying more export credit insurance from local insurance companies to manage the payment risk; reflecting the increase in defaults and bankruptcies from importers of Chinese goods. Finally, more and more companies are using forfaiting or factoring services."

> "Exporters in India have shifted back to LC-backed transactions as they increase risk mitigation by using banks to guarantee each transaction," says Aneish Kumar. "As a result, LC trade has increased dramatically. Banks are being asked to scrutinise importers and exporters carefully; especially LCs from emerging, smaller, export-oriented economies in south-east Asia and central Europe."

14 2009. Survey of Private Sector Trade Credit Developments. International Monetary Fund.

The thesis that the credit crunch has caused a general movement down the credit scale is further supported by a decline in trade between riskier countries (i.e. south-south trade). Pre-crisis, such trade relied on documentary credits, so a reported 6% fall in south-south documentary transactions means that the worsening risk environment has had a direct impact on the ability of non-OECD entities to trade with each other. This is undoubtedly a backward step for treasury services integration as a fully integrated IT driven trade and cash management function should allow trade to continue: albeit triggering different instruments to support the trade. While these circumstances should encourage integration, the perceived set-up costs involved (especially those absorbed by the local and regional banks likely to offer the solutions as part of an outsourcing package) are off putting in such straightened times (see Conclusion).

According to a recent IMF report, in both OECD and non-OECD countries, the current negative trends are set to continue over the next year, resulting in no significant change in the number of documentary transactions for advanced country banks (but a likely increase in the number of letter of credit confirmations) and a 10% decrease for emerging market banks. As for the volume of short-term, trade related working capital lending, both advanced country and emerging market banks indicate no significant impact so far, although the expectation among non-OECD banks is that this will drop by around 8%. Both OECD and emerging market banks give the following reasons: less credit availability (35% of all banks), an increase in the price of trade finance (18%), a fall in demand (13%) and an increase in risk, as well as recent falls in commodity prices (10%).[15]

"One direct result of the credit crisis is that there has been a significant increase in the number of companies asking banks, such as BNY Mellon, to guarantee letters of credit, says Dominic Broom, Managing Director and Head of Market Development, Treasury Services EMEA at BNY Mellon. "In an environment dominated by open account trading, the role of banks can often be limited to the provision of payment services, but the return to the use of letters of credit and the tightening of liquidity requires the need for credit confirmations, specifically from exporters dealing with non-OECD markets."

This evidence is further supported by studies that indicate dramatic falls in trade financing in "crisis" countries: for instance in the 1990s and early 2000s. Non-OECD trading companies rely heavily on bank-financed trade credits to support exports at pre-shipment and post-shipment stages, as well as imports. Such financing is often provided by international commercial banks, channelled to local borrowers through leading domestic banks, and is an important source of working capital for many emerging market companies. For example, bank financed trade credits declined by as much as 30-50% in Brazil and Argentina (in 2002), by about 50% in Korea in 1997-98, and from US$6 Billion to US$1 Billion in Indonesia during the Asian crisis.[16] The use of trade receivables as security for working capital finance, therefore, suggests an informal integration of cash management and trade finance among non-OECD corporates, well before such relationships were formalised by IT driven solutions outsourced to, or purchased from, specialist providers. Yet, the evidence also suggests this informal arrangement breaks down during periods of heightened risk perception, demonstrating that the efficiencies possible from an IT based integrated cash and trade platform should be readily received by non-OECD trading companies.

Despite the temptation to do so, it is important not to exaggerate the impact of the credit crunch, which is likely to slow rather than reverse the trend towards open account trading in north-north and south-north trade. Indeed, rather than reverting from open account to documentary credits, many open account trades may simply add various insurance products as risk mitigation. In fact, half of open account transactions are enhanced by some form of credit insurance,[17] a percentage that is likely to increase with the additional emphasis put on export credit agency covered

15 2009. Survey of Private Sector Trade Credit Developments. International Monetary Fund.

16 Humphrey, J., 2009. Are exporters in Africa Facing Reduced Availability of Trade. Institute of Development Studies Brighton.

17 Pierron, A., Sankar, S., 2008. International Trade & Trade Finance. Celent.

financing, as a response to the credit crunch by many OECD governments. This is especially the case with respect to larger export contracts of capital goods. Also, the rapid growth in south-south trade in recent years has resulted in renewed growth in traditional trade finance tools such as LCs and guarantees (indeed, the majority of LCs issued now guarantee intra-Asian trade). Again, this trend seems irreversible, although it may result, as track-records develop, in increased open account intra-Asian trading. As stated, both trends continue to encourage the integration of treasury services and will continue to do so over the long term despite the current hiatus.

c) Alternatives to documentary credits

The credit crunch has undoubtedly raised the cost of working capital loans (whether trade related or otherwise), which has in turn led corporates to source alternative solutions that, nonetheless, both remove credit risk and enhance cash flow. The result has been renewed growth in factoring and forfaiting. Invoice discounting of this kind accounts for 17% of international trade and is likely to rise, while other supply chain financing solutions are also emerging thanks to the tightening credit environment. Leading trade finance banks are adapting their business model to these changes, by providing integrated services such as insurance, treasury services, forfaiting and factoring, via IT systems that migrate a company's supply chain monitoring onto a bank sponsored online platform with automatic triggers for the offering of comparative instruments. Although this process has been underway since the early 2000s, it is a trend potentially supported by the credit crunch, and is certainly a major opportunity for the leading trade services banks to exploit a corporate's need to extract supply chain efficiencies; as it is for regional and local banks if able to offer the same supply chain monitoring platforms (perhaps via outsourcing arrangements with the major players).[18] As stated, the key barrier to this innovation in supply chain finance is the perception among corporates that the adoption of such a platform represents an unacceptably high investment in IT during a period of budget constraints.

d) Impact on cash management

Despite the clear advantages of cash management automation, even (or perhaps especially) in a downturn, the credit crunch is having a marked negative effect on what seems a natural evolution in the treasurer's role. Many corporate treasurers are being forced to focus on more tactical, or day-to-day activities, ahead of any wholesale changes in practices. Nonetheless, cost control and reduction is an obvious and immediate countermeasure against the threat posed by the current recessive economy, with the integration and centralisation of treasury functions providing instantly apparent cost benefits. Outsourcing as many treasury functions as possible may also provide the required instant cost benefit. So while IT investments are unlikely to be approved in the current climate, practical changes in working practices that reduce headcounts or other central costs are likely to win a favourable hearing, especially if, as with outsourcing, the set up costs are minimal.

Without doubt the global credit crisis has meant a much greater emphasis on funding, liquidity and risk management for corporate treasurers. Yet, the crisis also potentially exacerbates existing specific weaknesses in corporate cash management, hitherto masked by the availability of cheap credit: be it cash flow forecasting, cash pooling or inefficiencies within the purchase-to-pay or order-to-cash cycle. Indeed, many of the problems are based on the lack of systems integration, which exaggerates the lack of communication between departments and inherent inefficiencies within manual processes.[19] Despite the obvious problems with such a bold approach, the crisis is the perfect time to address such structural problems, which can often be masked in times of abundant liquidity.

18 Pierron, A., Sankar, S., 2008. International Trade & Trade Finance. Celent.

19 2006. Corporate trends in cash management. gtnews.com.

Also, the globalisation of both the supply chain and markets for goods and services is unlikely to be halted, let alone reversed, by the crisis, which means that the need for companies to take a global view of their financial flows continues to grow.[20] Such globalisation has led and will lead, to the ongoing movement towards centralisation among all corporates, regardless of their size and location. This is fuelling the need for more streamlined processes, with technology a key enabler in this respect. Regulation is a further factor driving corporates towards centralisation, with the pressure to ensure better controls and processes across the organisation growing at both a state, regional and international level, and which the current crisis only encourages further.[21]

A final factor worth considering, with respect to the impact of current economic conditions on the integration of treasury services, is that the credit crunch is encouraging a reversal in the trend of recent years towards fewer banking relationships, for both primary and secondary relationships. Concerned by their exposure to one (potentially vulnerable) provider, many corporates have been prompted to diversify their banking relationships with respect to both working capital funding, and cash and trade services. The impact of this is to expose many corporates to various new treasury services bank offerings, often for the first time. Certainly, once conservative organisations with long established treasury practices are discovering, often from their new banking partners, the potential for efficiency gains through the integration, or even outsourcing, of perhaps disparate treasury functions.

20 2006. Corporate trends in cash management. gtnews.com

21 2006. Corporate trends in cash management. gtnews.com

Conclusion: A roadmap towards collaborative treasury solutions

a) What do corporates need to achieve fully integrated treasury services?

While it is certainly possible to chart a roadmap for fully integrated treasury services, our findings from the survey in Chapter 2 reveal that smooth progress along the path is rendered difficult. Obstacles such as domestic banks' adoption of technology, or the composition of the major trading companies and their attitude towards risk mitigation with respect to their trading relationships (often dictated by the geographies of those relationships) can exist. Of these, domestic banking provision is by far the most important. In house attempts at treasury services integration will be incomplete without the injection of timely and appropriate banking services to support both cash and trade operations, and there is a great opportunity for local banks to undertake a larger role in the value chain if they move to offer their clients integrated treasury services.

The most important needs for those undertaking cross-border trade, for instance, will remain trade facilitation, risk mitigation and the expediting of payments: in short, financial supply chain management. Indeed, risk mitigation concerns have undoubtedly become more prevalent in the current climate as importers and exporters everywhere come under intense pressure, especially credit pressure. But if this is to lead to a renewed fashion for LCs, providers will need to live down their current reputation for being old fashioned (i.e. paper based), expensive and slow. The growth in open account trading is unlikely to be halted for long, which in turn will deepen the need (from both OECD and non-OECD corporates) for a comprehensive, fast and reliable Web based service that helps automate supply chain operations and trigger the provision of appropriate supply chain finance solutions.

Figure 26: How banks can become a key component in the supply chain
✓ Help facilitate risk mitigation programmes (use of LCs, insurance coverage, etc).
✓ Jointly review business models and offer opportunities to reduce costs and increase revenues.
✓ Evaluate internal organisation (integration of cash and trade) and identify opportunities to align the two groups.
✓ Review local and global capabilities.
✓ Evaluate positive impact of integrated treasury services (conduct ROI, etc).

Source: BNY Mellon and Celent Analysis 2009

Figure 27: How to evaluate a potential provider's Web based supply chain platform
✓ Allows trade banking products such as LCs (and working capital loans against LCs), collections, supplier finance, etc. to be automatically initiated at key moments in the supply chain.
✓ Includes cash management products (i.e. cash management forecasting and cash solutions).
✓ Offers a complete database of all trade finance activities, as well as existing purchase orders and financing needs, in order to facilitate cash management and other treasury services activities in the most efficient way possible.
✓ Enables electronic invoices to be uploaded directly from corporate enterprise resource planning (ERP) systems.
✓ Allows third parties throughout the supply chain 24-hour access to information on all of their trade transactions with a particular trading company (password protected).
✓ Operates as an online correspondent banking network for the automation of cross-border payments and is, above all, easy to install and operate and inexpensive for trading companies to adopt.

Source: BNY Mellon and Celent Analysis 2009

The aim of such systems is to help corporates improve their productivity, generate faster response times and reduce costs. In addition, importers using the system can extend the payment terms, which improves their cash flow. Simultaneously, the systems can also offer exporters the option of receiving payments up front, through the automation of supplier-finance offerings. The automation of trade in this manner brings with it the application of cash management efficiencies in the supply chain: in fact, irrevocably linking up the cash management structure to the trading value chain of a company with all the benefits in working capital financing reduction and cash flow optimisation that this brings.

Such platforms are clearly at the cutting edge of treasury services integration and it would be easy to state that the adoption of such platforms by all exporting companies would be a key moment in the development of a fully integrated treasury services world, especially when offered by a corporate's local banking partner rather than a global bank. Indeed, the provision of locally sourced trade services was a key preference in all six of the countries surveyed, although most considered the current offering inadequate.

China: respondents revealed a strong preference for local banks, with 85% agreeing that "local banks are more committed to local trade" and the same percentage agreeing that "local banks should not allow global players to push them out of the market". However, 58% agreed with the statement "local banks lack the skills required to perform deep evaluations of prospective borrowers", with 85% agreeing that local banks "must re-assume their original role as assessors of risk".

China is a classic non-OECD market, with companies showing loyalty to their local banks, despite full knowledge of the banks' deficiencies. Over the long term, however, this position may be eroded if the local banks fall too far behind in their provision of integrated treasury services.

India: respondents were close to evenly split between those who agreed or disagreed with the statement "local bank managers have lost touch with the needs of local businesses." Meanwhile, 60% of surveyed respondents said they believed local banks must "re-assume their original role as assessors of risk;" with two thirds believing "credit analysis has become superseded by a head office model favouring lending on an industrialised basis". All surveyed respondents agreed that "local banks must not allow themselves to be pushed out by the global players".

The survey reveals that Indian corporates are looking for banks that can cope with open account trading and engage at both ends of the supply chain, and are essentially looking at banks that have a large footprint in global trade, with an expansive branch network across geographies. The more technically savvy Indian corporates, meanwhile, are seeking open account platforms that enable buyers and sellers to streamline their cross border purchase orders and invoice management processes. Yet, there was also a great deal of support for indigenous Indian banks despite the fact they were clearly some distance from fulfilling their potential as fully integrated treasury services solutions providers. How long they are likely to enjoy this support, in the face of IT driven solutions offerings from global providers, is unclear.

Korea: 92% of respondents agreed with the statement that "local banks lack the skills required to perform deep evaluations of prospective borrowers". Meanwhile, 83% agreed that "local bank managers have lost touch with the needs of the local businesses" while three quarters of respondents said that "local banks must re-assume their original role as assessors of risk". The potential of these local banks is clearly understood, as over 90% agreed with the statement that "in times of economic difficulty, local banks are more committed to trade," and that the "knowledge gained from close relationship banking is critical". Finally, the overwhelming majority agreed that "local banks must not allow themselves to be pushed out by the global players".

The survey results provide further evidence that Korean companies are way ahead of their local banks in their thinking and show a need for local banks to offer integrated treasury services. Stemming the loss of business to foreign banks, however, will require local banks to improve their offering with respect to seamless treasury services.

Spain: Spanish respondents were evenly split regarding whether "local banks lack the skills required to perform deep evaluations of prospective borrowers" and whether "local bank managers had lost touch with the needs of local businesses". Yet, all the companies surveyed agreed that the "knowledge gained from close relationship banking is critical" and a strong majority agreed that "local banks must not allow themselves to be pushed out by global players," although the roughly even split re-emerged with respect to the statement "in times of economic difficulty, local banks are more committed to local trade".

Some leading Spanish banks have shown aggressive intent in this area of banking, which may leave the more localised Spanish banks vulnerable, unless they can keep up with developments in treasury services and with the expectations of their corporate clients.

Italy: 80% of respondents agreed that "local banks lack the skills required to perform deep evaluations of prospective borrowers," although there was an even split with respect to their agreeing/disagreeing with the statement, "local bank managers have lost touch with the needs of local businesses". However, all respondents agreed that "the knowledge gained from close relationship banking is critical" and 80% agreed that "local banks must not allow themselves to be pushed out by local players".

As with Spain, among Italy's many banks are one or two internationally aggressive players that are keen to win a dominant position in the domestic market. Locally focused banks need to respond with a strong treasury services offering of their own.

Germany: All respondents disagreed with the statement "local banks lack the skills required to perform deep evaluations of prospective borrowers". Meanwhile, around 80% disagreed with the statement that "local banks have lost touch with the needs of local businesses," although around 80% agreed with the statement that "credit analysis is superseded by head-office model favouring lending on an industrialised basis". This suggests that there has been some centralisation with respect to German banking and with 60% agreeing that, "the knowledge gained from close relationship banking is critical" (the lowest in the survey), the suggestion is that German companies are, when compared to companies in other surveyed countries, more relaxed about the loss of local banking skills to a centralised bureaucracy, perhaps due to the fact such a system has brought additional efficiencies for German companies.

In summary, it seems that local provision of any combined cash and trade offering is a clear preference, although, outside Germany, there is a widespread call for local banks to offer integrated treasury services and proactively take on a key role in the financial supply chain. Indeed, the combined corporate needs of both an automated trade and cash offering and of locally provided banking services make uncomfortable bedfellows. As the survey also showed, many corporates, especially in Asia but also in Italy and Spain, felt that their local banks lacked the technology required to support their needs. This suggests that the provision of this automated online platform for treasury services should be outsourced, most likely to a global bank with the resources to develop and maintain such a platform.

b) The challenge for local banks

At this point, it may be worth returning to our high level progress chart (Figure 13 in Chapter 1) to establish where our surveyed countries are placed. Clearly, Germany benefits from having attained the central goal of "fully integrated treasury services" although, while the corporates clearly have access to this nirvana, it is not universally offered by local banks. Indeed, those that fail to offer such IT led integration are at a clear disadvantage. Of the other markets, Italian corporates certainly have an IT led treasury services offering at their disposal, although full integration largely relies on corporates utilising the services of non-Italian banks. This remains the pattern elsewhere, with the level of integration for corporates depending on the level of treasury services provision from non-domestic banks, and applies until, in Korea, we have the 15% claiming full integration exactly corresponding to the percentage utilising non-Korean banks for their treasury services provision. India and China, meanwhile, are the outliers, probably largely due to the limited penetration of foreign banks, with China still occupying the outer edges of our centripetal journey (i.e. risk mitigation being the primary objective of trade finance and with treasury functions only beginning to consider cash flow optimisation as a worthy goal).

In all cases, therefore, local banks will lose ground to banks with a greater international footprint, unless they can find a way of offering their corporate clients their own fully integrated treasury services. Outsourcing, at first glance, appears to be the obvious solution for local banks.

c) The advantages and disadvantages of outsourcing

No matter the location, OECD or non-OECD, Europe or Asia, it appears from the survey that the key requirement from a corporate seeking to benefit from the possible and available efficiencies of fully integrated treasury solutions is a banking partner, preferably local, who is able to provide these services in a timely and cost effective manner, all delivered via an IT platform accessed online. Few corporates have the scale and international reach to undertake integrated cash management and trade finance functions alone, and many that do would still require banks to participate in aspects such as FX, hedging and financing to suppliers, meaning that even the largest corporates still find partnering with a bank advantageous.

Where integration of treasury services is incomplete or even non existent, our survey has found that an important reason has been the corporate's reliance on local banking partners with less integrated cash and trade offerings. The preference for local banking partners means, however, that this is far from a manifesto for the dominance of global corporate banks. Despite the fact many local banks will have concluded that integrated cash management and trade finance processes depend upon a costly and closely monitored IT infrastructure that currently offers them sub-optimal returns, many will have also concluded that their best option, if they want to continue to compete in this area, will be to outsource these functions to major treasury services providers, whether they are the global banks or specialist software providers.

Certainly, regional and local banks in many markets are proactively evaluating options to build or buy the needed capabilities to offer their clients integrated treasury services. Many are already reasserting their position in supply chain management through outsourcing contracts with providers, rather than waiting to build in-house capabilities. No longer content to be mere intermediaries between their clients and technology based solutions offered directly by the networked global banks, and at risk of being cut out entirely, many local banks now realise they must become primary service providers in this changed environment, or lose their corporate customers. As such, many opt for outsourced solutions from external providers (mostly the global banks) offered on a white label basis, thus avoiding the potentially hefty initial investment costs mentioned in Chapter 1.

Indeed, the advantages of outsourcing do not end with the avoidance of the initial investment costs for a global proprietary system. The key advantage is that local banks are able to focus on their core activity of lending to local businesses, while all "non-core" elements are dealt with by the in-sourcing bank. These include the maintenance of correspondent banking relationships with banks that operate in their key currencies (which could be a sizeable number and subject to change); as well as the yearly obligation to undertake know-your-customer (KYC) and anti-money laundering (AML) checks with their correspondent banks. They also include the need to support payments made on behalf of their corporate clients by utilising cash reserves, which adds counterparty risk that, in turn, requires its own expensive and consistently monitored risk mitigation infrastructure. Outsourcing treasury functions can also reduce costs in documentary processing (a banking function that is often unprofitable) and collections. Meanwhile the more profitable aspects of a corporate banking relationship, such as payments processing and cash optimisation, can be maintained by the local bank, with the IT platform automatically calculating and triggering such offerings.

The tangible benefits of outsourcing to a specialist provider are undoubtedly numerous. Outsourcing can turn a fixed cost into a much lower variable cost around which the business can then budget almost on a "pay-as-you-use" basis. A further fiscal benefit is the control outsourcing banks have with regard to the payment of fees. For example, in some cases, the service contract can even be open ended with a pre agreed monthly fee, as the payments provider can simply calculate a fee based on the outsourcing organisation's previous two years' transaction volumes. This charge can be adjusted at a later date should the transaction volumes increase or decrease. As for any future expenses, such as system upgrades and regulatory adaptations (should the transaction volumes of the outsourcing bank change), these too largely become the responsibility of the in-sourcing provider, thus eliminating "future risk," as well as system interoperability concerns that can often be a barrier to potential merger activity.

Outsourcing can also have its disadvantages for the local and regional banks unable to develop their own treasury services platforms. Many find the loss of control inherent in outsourcing to a global commercial bank concerning. Indeed, the most acute disadvantage to many banks is the discomfort of disclosing the inner workings of a client-bank relationship to such a bank, who may be a competitor for corporate accounts. Outsourcing to software providers is another option,

however, the local bank would still be responsible for core functions such as risk monitoring, compliance and counterparty maintenance. Outsourcing arrangements have, therefore, evolved and are increasingly being replaced by more collaborative, partnership based, agreements offered by treasury services banks, including BNY Mellon, who do not compete with local banks for corporate business. While mirroring the outsourcing arrangements with the global banks in terms of depth of functionality and breadth of offering, they have the major advantage of restricting the information flow to potential competitors.

d) SWIFTNet TSU tips the balance in favour of collaboration

Partnership or collaboration arrangements have another distinct advantage for local banks; they do not force banks and their clients to utilise system software and processes built to serve the needs of a global bank. In many cases, the outsourcing offering is simply an "add on" for a global bank to generate additional revenue: a means of feeding a machine created to suit themselves and their clients. Indeed, many of the outsourced offerings are thinly veiled, white labelled services that require local banks to adopt standardised trading practices created to suit the giant flow business machines of the global banks located in regional hubs.

This is a situation that has been revolutionised in recent years by the development of SWIFTNet's Trade Services Utility (better known as the TSU). Launched in 2007, the TSU fundamentally shifts the balance of power towards the collaboration/partnership model and away from the outsourcing model, because its centralised matching utility is designed to allow all banks to meet the challenge of supply chain automation. Banks that are members of SWIFTNet can use the system to offer open account trade services to their corporate clients, in addition to traditional documentary credits. Yet, crucially, it applies a standardised interface that not only dispenses with the need to adopt the proprietary systems and processes of a global bank, but which empowers other supply chain parties, such as logistics companies, to be seamlessly included in the electronic and automated financial supply chain.

The TSU allows users to compare standardised and reusable data elements quickly and accurately. Each transaction first establishes a "baseline" through matched data (typically from purchase orders or commercial invoices) using both the buyer's and seller's banks as sources. Subsequently, commercial and transactional data sets are compared and a report generated, thereby providing regular status updates throughout a transaction's lifecycle. Finally, local banks can bridge the gap between this platform and their own systems by using a tailored interface with the TSU.

e) For local banks, supply chain collaboration is the goal

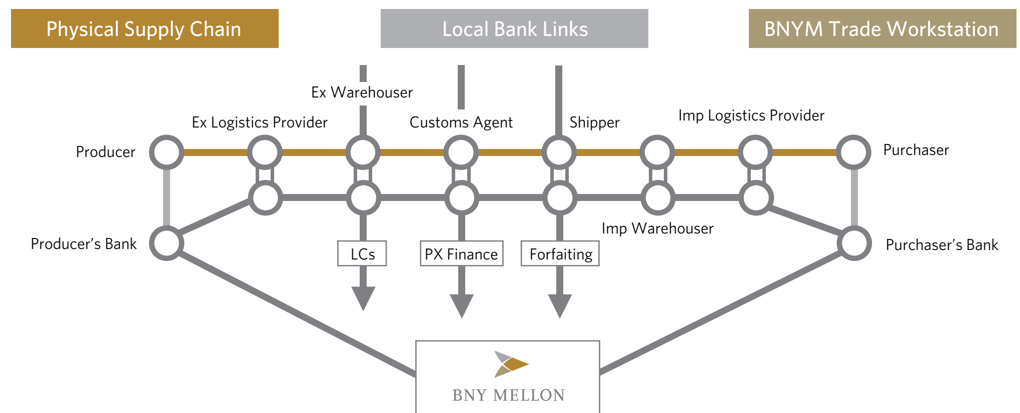
While SWIFTNet TSU is a valuable tool towards the full integration of cash management and trade finance, it is only one potential answer. The real choice facing local banks is between outsourcing to a bigger bank that is also a potential competitor, or collaboration with a non-competing provider. This solutions driven (rather than product driven) approach opens up local banks to a far greater number of options than would be the case with outsourcing, which usually involves adopting the proprietary system of a single global bank. It also widens the potential circle of usage for modern trade finance techniques considerably, creating capabilities within small and medium sized import and export entities, as well as their respective banks. This is important considering that the value of the average import letter of credit is just US$40,000, with the average open account trade likely to be even smaller.

Indeed, SMEs can often feel excluded from the modernisation of trade services, despite making up the bulk of activity in trade, especially in the emerging markets. Yet, a key issue in securing SME engagement in supply chain solutions (particularly in the emerging markets) is the fact most smaller companies bank locally, using small banks that are currently unable to provide the electronic infrastructure used by larger banks in the developed world.

Like outsourcing, therefore, collaboration brings together the core intermediaries between a supplier and a buyer (including banks, logistics companies and agents) to generate a common communications platform for both the physical and financial supply chain. Unlike outsourcing, however, collaboration enables local banks to directly offer bespoke services in conjunction with other providers along the supply chain, in effect competing with the global banks. Indeed, some local banks are now able to offer pre-and post-shipment financing and liquidity services against open account trading, an area where they had previously struggled to find a role. Some can also assist in the provision of end trade processing services, to both the buyer and the supplier.

In conclusion, the research points towards a potentially substantial advantage accruing to those local banks adopting the collaboration model (see Figure 28) over the outsourcing model; both in terms of helping them cope with the challenges they face in developing bespoke, cost effective and flexible treasury services for their corporate clients and in allowing them to retain core competencies, generate cost efficiencies and deepen and widen their treasury services offering. In short, a giant leap towards standardised, IT driven, fully integrated treasury services for corporates globally.

Figure 28: The collaborative supply chain



Source: BNY Mellon and Moorgate Communications Analysis 2009

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