

Recognizing risk in the supply chain



With the rapid globalization of the chemical industry, the risks of engaging in trade around the world have increased substantially

JOSEPH CHANG/ NEW YORK

“THE CHEMICAL industry, like many industries has really benefited from massive globalization, particularly on the sourcing and manufacturing side,” says Stuart Roberts, director and North America Trade sales head at Citigroup Corporate and Investment Banking. “There are commodities going into Asia, particularly China, for manufacture or processing, and products being returned to North America or other emerging markets such as Latin America and the Middle East.”

The result has been that the physical movement of goods has often lost its direct link with financial flows. A North American chemical company may be sourcing products from China and selling them in Brazil. However, the money is going from North America to China to pay for the products, and from Brazil to North America to pay for the finished goods.

With products moving from one region to another and cash flows sometimes in dif-

ferent directions, companies should seek to understand their supply chain risk on an overall corporate basis.

Because certain markets like China, India and the Middle East are large net exporters and are attracting huge



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amounts of US dollars, the markets are awash in liquidity and local banks are more than willing to provide easy and cheap financing for export transactions.

“So to the extent North American chemical companies have evolved sourcing and sales in these markets, they haven’t had to think too much yet about some of the risks,” says Roberts. “However, we believe that right now, when we are at the high point of liquidity, the risks are at their greatest. Now is the time to consider this and put a structure in place to safeguard the supply chain on a financial basis, as opposed to when there’s no liquidity

and no one wants to take on the risk.”

While US chemical companies have typically managed their business risk well domestically, many have not considered the risks associated with the global nature of their operations, according to John Ahearn, global head of Trade Services and business unit manager at Citigroup Corporate and Investment Banking. “If you look at the US market, companies have done a good job in managing exposure and managing their working capital,” says Ahearn. “But most of these companies are very internationally flavored, and many of them are using rather rudimentary methods that they’re really concentrating on cleaning up now.”

Ahearn notes that a number of chemical companies recognize risk on an individual business unit basis, but not as a whole. “A company may sell into China, have another Asian subsidiary selling into China, and yet another Latin American unit selling into China,” he says. “If you aggregate it, they have significant amounts of risk tied to China, but they are recognizing it individually in certain units and not truly recognizing the global exposure they have.” ■

HOW DO COMPANIES ENSURE FINANCIAL SUPPLY SECURITY?

Not ensuring the security of your supply chain can lead to major unforeseen problems that can affect sales, profits, the balance sheet and standing with investors.

Let’s take an example where a US chemical company sources petroleum additives from China to deliver to Dubai. The US company would give the Chinese supplier a purchase order to manufacture that product, and the supplier would then get bank financing for that order.

“But if there were a banking crisis in China that dried up liquidity, all of a sudden, your supplier, who’s been relying on local banks, may find out it doesn’t have the working capital to fulfill that

order,” says Citigroup’s Roberts. The Chinese supplier would then typically come back to the US company to ask for financing. “That means you have to pay them much earlier, even before they ship, give them preshipment financing, and possibly even finance the purchase of the commodities that go into the product,” Roberts says. “That’s going to hurt your balance sheet and working capital and make your investors worry that you are banking your suppliers in emerging markets.”

If the US company does not step up with the financing to avoid business interruption, then it faces a revenue problem as it can’t fulfill that order for its customer in Dubai.

That is where a bank such as Citigroup would step in. The bank would essentially provide a backstop for the US chemical company’s Chinese supplier in the event it was unable to get financing from local banks.

Citigroup would work with the US company to attain visibility on orders it has with suppliers, and then be able to provide financing for those suppliers.

“We would prefer going to the North America chemical company with a corral of suppliers on board,” notes Roberts. The company would approach its suppliers about the program. “Even if they don’t use it, it’s there in case of any event that dries up liquidity.”