

Trade flows weave a tangled web

As global trade becomes increasingly complex, more efficient trade services are needed. How can companies mitigate the risk of doing business abroad?

Consultant's corner

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FROM THE single-proton hydrogen through to the elaborate elements of the periodic table, chemicals are literally the building blocks of life. In the competitive chemical industry, the key to success for importers and exporters alike is the ability to stay ahead of industry trends and respond

dynamically to market opportunities.

Accelerating globalization, high prices for raw materials and energy, growing competition from Asian players and increasing merger and acquisition activity are key drivers of change in the industry. Drawn by strong market potential for chemicals, traditional players are moving into Asia, especially China, while new Asian entrants are experiencing strong growth.

The growth of the chemical industry worldwide reflects the overall expansion of

the global economy and steadily increasing volumes of trade. According to the World Trade Organization (WTO), global gross domestic product (GDP) growth accelerated by 3.7% in 2006, the second-best performance since 2000, providing a favorable framework for the expansion of international trade. In 2006, the value of world merchandise exports rose by 15.4% to \$11,760bn (€8,752bn), and commercial services exports rose by 11% to \$2,710bn.

As for chemicals, the WTO reports that exports from Asia alone were worth a total of \$3,276bn last year – up by 18% from 2005 – and imports grew by 16% to \$3,032bn.

To continue to succeed in the global marketplace, chemical companies trading in Asia must engage in cross-border collaboration on an unparalleled scale.

The primary instrument for this cooperation is the global supply chain.

Technology has equalized the world of commerce to such an extent that the smallest subsupplier in an emerging Asian market economy has the same lightning-fast access to financial and market data and to cost-effective sources of liquidity as the world's largest companies. The resultant transparency benefits participants across the global supply chain by mitigating risk, improving efficiency and facilitating the cross-border flow of goods and services.

With increasing trade in chemicals between Asia and the rest of the world comes the need for efficient trade services. Historically, trade and supply chain finance products often did not have to address complex commercial flows involving multiple parties in multiple locations.

Accordingly, the products used to finance these flows tended to be simplistic in design.

However, there are now chemicals going into Asia for manufacture or processing and products returned to North America or 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.

While traditional products such as letters of credit (LC) and trade loans based on the strength of one counterparty continue to be part of the supply chain option, clients have

started to demand new structured solutions that address their changing business requirements in a more holistic fashion.

Although some chemical companies trading in Asia have been hesitant to make the transition from LCs to open-account financing, the latter is fast becoming the dominant product for multinational supply chain financing. And it is expected to become more popular, thanks to its streamlining effect on trade finance.

In India, there has been a rapid shift to open-account financing for both domestic and cross-border trade. As overseas trading parties become comfortable with India, so LCs are quickly disappearing as a tool.

In China, on the other hand, the transition to open-account financing is less evident. While Chinese and non-Chinese chemical companies use open-account financing for domestic transactions, 60–70% of their cross-border sales are still billed under LCs.

Chemical companies are comfortable with LCs, which they consider a safe instrument – an especially important attribute now, as the volume of business they conduct with China and the ticket size of the transactions continue to grow.

One major chemical client expects the split between open-account financing and LCs to remain constant this year. There could be a change by chemical companies operating in China toward open-account in the coming two or three years, but not this year, or in 2008.

NATURE OF THE BUSINESS

The prevalence of open-account financing in Singapore depends on the nature of the business. Companies that specialize in bulk chemicals are far more likely to use open-account financing than those who deal in specialty chemicals because the number of buyers is significantly lower. Companies have to take into account the cost of running a credit platform for a large number of small customers on an open-account basis.

Outsourcing the trade documentation process by chemical companies is in its nascent stage in Asia and has been taken up to a limited extent in some local economies.

Although not currently being implemented in China or other countries, document outsourcing to third-party service providers is an eventuality across the region. Chemical companies increasingly recognize that a technologically robust document outsourcing program can cut costs.

In Singapore, global chemical companies which use re-invoicing centers to handle large volumes of transactions are looking for trade banks to provide outsourcing services for the entire order-management process.

Typically, this function includes the preparation of all first-party documents, order management, collection and payment reconciliation. By using a third-party provider, the companies hope to increase speed and efficiency, while controlling operating expenses.

For example, the Singapore-based subsidiary of one of the world's 10 largest manufacturers of chemicals, fertilizers and plastics sought to improve the efficiency of its document preparation procedures while maintaining complete control of the process.

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Citi installed its proprietary document preparation system, Citibank Electronic Documents (eDocs), to manage the customer's full set of export documents called for under its LCs and open-account transactions. Citi's eDocs included inputting key shipping details and printing certificates of origin on behalf of the client. The system was tightly integrated into the client's SAP system, thereby ensuring the client's complete control over the process.

For chemical companies in India, which remains a relatively low-labor-cost economy, there is less emphasis on document outsourcing to banks and more on servicing efficiency and improved turnaround times.

On the import side in India, however, many companies are looking at outsourcing, particularly when ticket sizes are smaller and imports involve bulk invoices. Clients want to outsource the processing of invoices, track the due dates for payments and outsource the storage and retrieval of physical documents online and in real time. Outsourcing has gained a lot of traction on imports, but not as yet on exports.

Unlike India, Hong Kong faces a rising cost base. Here, the decision to outsource can be strategic as well as economic.

One client maintains an internal team of about a dozen people dedicated to handling payments and receivables. Now, instead of having these labor-intensive

processes done in-house, with the costly staff and infrastructure required, the client is considering outsourcing these functions to a bank with robust technology and redeploying those professional resources from back-office operations to a function where they can add real value – for example, sales, credit or customer service.

As a growing number of chemical companies conduct additional business across more and more borders, the global trade finance services required to support this expansion become similarly complex.

In this context, chemical companies are increasingly seeking a single provider to deliver end-to-end financing solutions across the global supply chain.

Chemical companies in India are at

the forefront of this trend. Over the past few years, pharmaceutical companies headquartered in India have started buying companies overseas for their local manufacturing facilities, or because of the strength of their local distribution channels.

Likewise, Indian petrochemical companies, which are becoming global enterprises with end-to-end operating capabilities (from exploration to product development), are looking for a supply chain finance provider with a local, on-the-ground presence and global scope that matches their own capabilities.

For chemical companies in Asia, gone are the days when a trade transaction involved a single buyer and a single seller.

Now, as these companies become truly global enterprises, their supply chains are getting more complicated, meaning that there will be an ever-growing number of participants in the global trading process.

Companies are increasingly recognizing the need to have a comprehensive suite of end-to-end financing and trade processing solutions to support their expanding dealer/distributor networks and their trading partners around the world.



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