

The trade balancing act

The rules of the game in global trade are changing. As corporates' supply chains are threatened by a lack of liquidity, the time is right for global, collaborative efforts to revitalise trade, believes John Ahearn, Global Head of Supply Chain Finance, Structured Trade and Export & Agency Finance at Citi. **WRITER** *Heather McKenzie*



John Ahearn, Global Head of Supply Chain Finance, Structured Trade and Export & Agency Finance at Citi

The credit crunch is having a dramatic impact on corporates and their supply chains. Prior to the credit crisis, large companies rarely placed a high priority on working capital as abundant and relatively cheap credit meant that the cost of working capital inefficiencies was low. As the cost of borrowing has risen sharply in recent months, corporates are placing a renewed focus on optimising working capital and finding alternative sources of funding to reduce their reliance on capital markets. John Ahearn comments on the fundamental changes across the trade world over the past two years. "Where previously, the trade finance business was primarily focused on operational efficiency, today, a typical conversation with trade finance clients encompasses corporate financing and working capital management," he says.

The health and viability of their vendor and supplier base is another important consideration. Many multinational firms have intricate supply chains that span the globe and often, their supply chains comprise smaller companies with limited access to credit that are hardest hit by the global recession and financial crisis. A failure of a key supplier, for instance, would cause far-reaching disruption to the production pipeline. Supply chain stability is becoming a strategic consideration as companies aim to strike that balance between optimising their working capital position and ensuring the health of their main business counterparties.

BALANCING SUPPLY CHAIN RISK

From a distribution viewpoint, corporates are balancing revenue and risk as they look to drive sales in a credit-impaired environment. There are a number of options available to corporates, from extending their payment terms to their

key vendors, effectively using their balance sheet to help fund the cash flow of their distributor base, to discounting their product to shift inventory, which has broader commercial implications on their products. Others may choose to mitigate their distribution risk by working with banks on factoring and receivables discounting solutions.

On the supplier side, corporates need to ensure that they have an uninterrupted supply of components and materials from their key suppliers – the failure of just one critical supplier in the chain could disrupt a corporate's production momentum and the shipment of stock to its distribution network for months. Take, for example, the manufacturer of a well-known gaming device that relies on critical components from Taiwan. Citi has deep knowledge of this specialist electronics industry in Taiwan and was able to partner with both the manufacturer and their Taiwanese suppliers to ensure the supply chain is robust during this difficult economic environment. Key suppliers are allowed to take advantage of the credit worthiness of their buyers to access cheaper finance and, in turn, buyers have the assurance of continuous supply.

In another example, a large retailer that Citi works with estimates that it would save \$4bn in working capital by extending its days sales outstanding (DSO) by just one day. However, in doing so, the company had to ensure that it did not place undue pressure on its suppliers. "Today, only the very largest corporations can borrow in the commercial paper (CP) markets, and the longest terms available tend to be set at 30 days," says Mr Ahearn. "The CP market is facing significant challenges, so companies are looking at alternative sources of short-term finance." Citi worked with its client and their suppliers

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to establish a supplier finance programme whereby the retailer committed to future payments on an agreed timeframe, and Citi offered its suppliers immediate payment at a discount. The suppliers effectively gained cheaper finance while the retailer freed up cash on its balance sheet – cash that they do not need to borrow – by establishing clear payment terms via the forward-payment instructions. “These supply chain finance programmes not only accelerate the cash-conversion cycle but also strengthen the business relationships along the supply chain,” says Mr Ahearn.

CREATING CREDIT CAPACITY THROUGH COLLABORATION

Given the severity of the credit crunch, there is insufficient capacity within the banking sector alone to stimulate a recovery. Difficulties in raising cash are not restricted to one bank or one country. “It is a global problem,” says Mr Ahearn. “Citi continues to actively extend credit in this environment, but we cannot finance every company in the world. We believe the road to economic recovery involves collaborative action. By working together in unprecedented ways, corporates and their supply chains, transaction services banks, export credit agencies, government development agencies and credit insurers are all part of the solution to the problems facing the industry.”

Citi was influential in the publication of a recent paper by Washington-based Bankers’ Association for Finance and Trade (BAFT) that argues that the restriction on global financial capacity, brought about by the credit crunch, threatens to seriously inhibit global trade. It suggests that government guarantee programmes for credit risk mitigation can be expanded, and the secondary market for trade finance risk with export credit agencies can be

improved and adjusted to facilitate and accelerate trade financing in the emerging markets, through public/private partnerships with credit insurers, for example.

Citi has a longstanding relationship with a government-owned bank in Asia that primarily provides financing for long-term construction projects in its country. Citi worked with the bank to extend its mandate to provide guarantees for the export and import trade of some of its manufacturing clients in the country. The government wins because it is ensuring jobs for its citizens, and the manufacturers and suppliers benefit because the supply chain is guaranteed and they are getting good credit. “The programme proves that by breaking down traditional silos and melding the roles played by various market participants, we can increase credit capacity through holistic solutions that benefit everyone,” says Mr Ahearn.

Some financial institutions in the emerging markets are also acutely impacted by the credit crunch. Here again,

“WE CAN INCREASE CREDIT CAPACITY THROUGH HOLISTIC SOLUTIONS THAT BENEFIT EVERYONE”

Citi plays a constructive role through partnership to provide liquidity where it is needed. As an example, a customer of Citi’s, a major apparel retailer, was concerned that a number of its suppliers were having difficulties securing capital from their banks to source the materials and produce clothes in certain markets. To inject liquidity into that supply chain and ensure suppliers in the emerging markets have adequate working capital to stay viable, Citi took a multi-layered approach based on forging collaborative partnerships with banks in those markets, and extending risk participation through its export and agency finance connections.

LOCAL CONNECTIONS, GLOBAL ENGAGEMENT

In a rapidly evolving market where the rules of the game are changing from week to week and many commercial enterprises are in survival mode, Citi is in a unique position to help stimulate trade and sustain the availability of credit through partnership and innovation with its banking peers as well as with credit insurers, export credit agencies, multilateral development agencies and others.

For global trade to be revitalised, corporates must have confidence in the financial infrastructure of their vendors and work with their distribution channels to preserve cash flow and supply chain viability across the markets in which they operate. With its global footprint and embedded credit knowledge of the key participants in the supply chain, from large manufacturers to specialist suppliers across a broad spectrum of industries, Citi has the expertise, experience and balance sheet strength to lend and leverage connections in more countries and markets than any other financial institution. 