WHITE PAPER SERIES: GLOBAL TRADE AND INTERNATIONAL PAYMENTS

Commercial Payments

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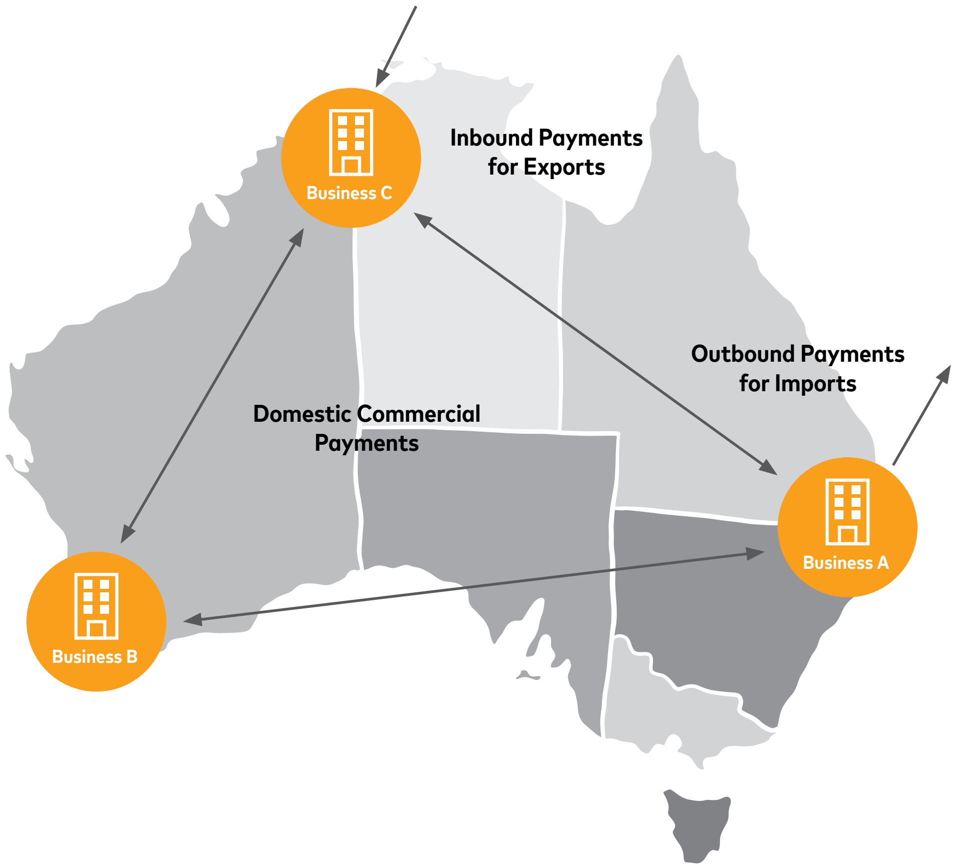
mastercard

RFi Consulting

About This Series

In Australia, according to the Department of Foreign Affairs and Trade, close to 40,000 businesses exported a total of $312 billion in merchandise and services. As a country, we import goods and services to the value of $349 billion. This trade represents $661 billion in cross-border payments in 2015-2016. This paper in the series will be exploring Australia's global trade and the corresponding international payments. Mastercard has partnered on this series with RFi Consulting (RFi), an independent consulting firm focused on the financial services sector and with a strong specialisation in the payments industry.

Introduction



The majority of these payments are facilitated through the SWIFT (Society for Worldwide Interbank Financial Telecommunication) system, and form part of the $1,204 billion p.a. (12 months to March 2016) SWIFT transfers reported by the Reserve Bank of Australia (RBA). The majority of this total involves high value transactions conducted for the commercial banks themselves or on behalf of corporate customers, transferring capital between their headquarters and subsidiaries in and out of Australia - for example, an overseas company repatriating profits or an Australia company lending money to one of its overseas subsidiaries.

Australia exports a total of $312 billion (2015-16) in goods and services

Over the same period, Australia imported goods and service to the value of $349 billion

These transactions are supported by $661 billion in cross-border payments

However, these values do not include the large volume of intra-bank transfers conducted by international banks. Hence, total cross-border commercial payments may be around double this SWIFT activity. One Asian-based bank with whom RFi spoke suggested that SWIFT would represent only about 40% of their total cross-border B2B transfers. Additionally, many large companies with overseas operations and / or suppliers will operate overseas bank accounts to manage their own foreign exchange risk and to facilitate payments. For example, one of our case study companies has local bank accounts in the UK, the US, Singapore and Thailand, which are used to pay suppliers in those countries.

Global Trade and Supply Chain Finance

For most major Australian banks, the payments surrounding global trade and supply chain finance are primarily driven by commodities, with one bank quoting 40% imports and 60% exports. Depending on the individual bank, these trade movements may not be constrained to Australia, but could include, for example, shipments of commodities from Brazil to Europe. Similarly, the currencies involved can vary, but a significant portion of international trade is undertaken in USD, such that one bank quoted 60% of its flows being in USD and 40% in AUD.

Against the common assumption that global trade is naturally accompanied by cross-currency risk, respondents noted that many large corporates often transact in the same currency and/or hold funds in USD. This may arise for various reasons, including: natural hedging techniques (e.g. keeping costs and revenues in the same currency); financial hedges; and balance sheet "plays". The "top end of town" have sophisticated treasury functions and practices focussed on these areas, activities that do not exist in smaller companies - with SME's normally laying off their commercial and foreign exchange risks to the bank.

Global trade and supply chain finance for large corporates is seen as a "risk transfer business" by the bank, which can take on the settlement risk, counterparty risk and country risk. It can also include the translation exposure (the risk that a company's equities, assets, liabilities or income will change in value as a result of exchange rate changes), which might be taken by the bank's own foreign exchange department or transferred centrally. The primary drivers for the banking activity are:

- Finance (to facilitate the trade);
- Risk transfer;
- Information transfer to counterparties.

Although they are still used for certain transactions, there appears to have been a move away from traditional Letters Of Credit (LOC), towards transacting on an Open Account basis, with "Self-Liquidating Finance" such that the supply chain funding extended by the bank is settled directly by the payment received from the buyer. As an example, the three payments associated with a LOC on a commodity export cargo (usually on loading, on discharge and after quality determination) are now replaced by one payment on the acceptance of discharge. However, without any "up front" payment, the need to fully finance the cargo through to discharge has become greater, especially considering the fact that a large producer would have several shipments in transit at any one time, thus increasing the working capital requirements dramatically.

Regardless of the reduced number of payments, transactions involved in global trade and supply chain finance still involve voluminous documentation (e.g. bills of lading, warehouse receipts, information on port of loading, information on port of discharge, etc.). Indeed, local regulations can also cause specific procedures to be followed, such that different destination countries for the same export product will require different documentation. This complexity has meant that the move onto digital platforms has been slow - however the move to electronic formats is occurring, and front end software and systems do exist.

Solution providers such as Bolero offer e-presentation services, "which allow the electronic transmission of all trade documents required under a letter of credit agreement, including the bills of lading, between all parties involved in a trade transaction." Bolero sees itself as "specialists in trade finance instruments, electronic presentation and document matching, reducing the inefficiencies associated with paper based trade documentation processes, and securely exchanging documentation and information for trade finance transactions; a Software as a Service business that is transforming global trade." SWIFT has a similar capability, but this appears to have achieved more widespread adoption in Europe than in Australia.

In terms of generating revenue for the bank, income streams in global trade and supply chain finance come from:

- Margin spread on the funding of trade finance;
- Fees on certain types of transactions, e.g. LOC;
- Facility fees (do not always apply);
- Payment settlement fees;
- Margin spread on foreign exchange rates (significantly more important than fees).

Revenue is generated on the Fx spread rather than on fees, with the pricing of the spread dependent on transaction size, frequency and the overall client relationship (understanding that, as one bank respondent noted, "payment is an ancillary service to a total relationship"). Fees become more prevalent on smaller retail/SME cross-border payments.

A newer approach to syndicated bank finance for supply chains is the combination of an integration and funding platform for example from PrimeRevenue or Octet, offering "powerful solutions focused on optimising and unlocking cash flow for suppliers/exporters and buyers/importers while reducing the risk of supply chain disruptions." The PrimeRevenue trading platform provides a suite of applications to optimise working capital and improve margins, such that "the unique multifunding/multibank structure of OpenSCi provides flexibility with access to over 50 different global funding sources, allowing our clients to receive financing in multiple currencies and countries." The uptake of such a service again emphasises the drive for efficiency in the B2B space.

Cross-border Payments

Offshore sourcing requiring cross-border payments with foreign exchange were once the province of only larger companies, but increased (and lower cost) travel, globalisation and the internet have meant that even the smallest SME's can look overseas when purchasing their inputs. This growth in foreign currency transactions has not gone unnoticed, and many new entrants have come into the market to compete against the banks - making customers more price sensitive. As in all markets, however, there are different segments, for example: some businesses look for ease of use, some prioritise security and others hunt for the lowest price.

Banks have responded to the competitive threat in various ways:

- Improving the ease of access/use of cross-border transactions on their online banking platforms;
- Making it easier to open foreign currency accounts and offering hedging facilities;
- Emphasising the security and trust accompanying the bank brand;
- Highlighting the need for regulatory compliance (e.g. Anti-Money Laundering) and risk of fraud;
- Providing more bespoke services, such as batch processing and back-end ERP integration.

Respondents noted that a large number of smaller commercial entities still want to use fax or email for providing cross-border payment instructions to the bank, and resist the use of the online banking platforms made available to them. In contrast, some larger companies have adopted integrated electronic solutions, with some requesting that the bank accept the file format issued by their ERP system and others adopting/accommodating the bank's preferred format. However, Medium Market and SME's also use card payments to pay overseas suppliers, as they view this as a "tried and true" way of making foreign currency transactions and is simple to use.

In a similar way, smaller companies do not understand the regulatory and the risk issues involved in cross-border transactions, including AML/Counter Terrorist Financing (CTF), listed persons, government/UN sanctions, etc. Large entities, on the other hand, appear willing to select compliant services in order both to fulfil legal requirements and avoid risks/complications.

Further growing the cross-border payment market has been the entry into Australia in recent years for many overseas retail operators, including Costco, Zara, H&M, Uniqlo, Forever 21 and GAP. Many of these retailers have centralised sourcing from overseas locations, leading to more cross-border payments.

Understandably, corporates want their bank to help them grow and to solve their problems, preferably providing a "one stop shop". As Australian corporates have become more active in overseas markets, new requirements have been placed on their Australian banking providers, such as

- The ability to make domestic payments in overseas locations;
- The cross-border pooling of funds in the various accounts held in different countries and currencies;
- Providing improved connectivity;
- Keeping up with the increased pace of activity and movement of funds;
- Delivering value for money.

To address some of these needs, banks are investigating new approaches, such as distributed ledger technologies (e.g. Ripple, blockchain), which might provide more speed at a lower cost. The impact on commercial cross-border payments is believed to probably be in the 5-10 year timeframe, and could erode volumes through SWIFT. The longer timeframe is likely due to legacy systems, the conservative nature of larger corporates, potential changes needed with ERP integration and possible changes required in company policies.

Next in the series: Middle Market Perspective