



KEEP THE SUPPLY CHAIN MOVING

Dominic Broom at The Bank of New York Mellon tells *Future Banking* how local and global banks can work together to help mid-cap companies with the pressures and challenges of supply chain liquidity management.

- Relaxed credit terms for mid-caps are no longer available.
- Banks are taking a formulaic view of a company's supply chain needs.
- The solution is local banks and specialist providers working together.

The principal role of banks in the financial supply chain has always been that of liquidity provider, but the credit crunch has seriously affected their ability to fulfil this task. The upshot has been a drying up of the funding pool, which means that access to cheap liquidity – the fail-safe problem-solver for supply chain management of the past – is no longer an option for even the most credit-worthy of companies.

As a result, treasurers of mid-cap companies are facing unprecedented challenges with respect to financial supply chain management, and these challenges are made worse by the conflict between buyers and suppliers that is, in turn, exacerbated by the liquidity shortage.

Suppliers are signalling that the relaxed credit terms that many mid-caps have so far enjoyed are no longer available. Payment

on delivery and in advance has become the order of the day. However, this policy does not sit well with buyers who are asking for a relaxation and extension of their credit terms, with the underlying threat of reduction or removal of business or payment default if the previously agreed terms are not relaxed. Buyers therefore want and need what sellers are unable to readily provide, and this is pulling them apart at a time when working together is more crucial than ever before. A key role for banks, in this respect, is to try and bridge the widening gap.

Cash is king

The supplier/buyer conflict should not come as a great surprise. In some ways, it is a case of 'business as usual'; proof that the supply chain is suffering from the age-old problems of distrust and short-termism. Indeed, cash and liquidity management have always been something of a headache for all the players in the supply chain, although the situation has worsened and, as a result, treasurers are finding it increasingly hard to plug liquidity gaps.

Each organisation is looking to exert power over business partners, with the danger that this tug-of-war will

damage relationships and interests of counterparties. After all, a customer or distributor forced into administration is of little help with liquidity struggles, and in these days of just-in-time inventory, the failure of a key supplier that cannot be rapidly replaced is a supply-chain disaster.

Changing tides

Before the credit crunch, congestion in the supply-chain could be eased by bank-supplied credit lines. Indeed, cash is the oil that keeps the cogs of the supply chain turning. Yet today, despite the efforts of central banks to pump liquidity into the banking system, cash is no longer readily available, which means that even some of the most financially stable corporates lack adequate access to liquidity. An absence of cash has also brought to the fore flaws in the credit risk-assessment system of banks that, until now, had been hidden by the abundance of liquidity.

Today's problems

Before the age of centralisation, local banks were capable and best placed to look at companies and assess their financial health and suitability as borrowers. The growth of the global economy, coupled with the proliferation of trade and the ever-tightening margins on basic banking services, has meant that such decisions have been transferred from local managers to head or regional offices. This has favoured the provision of lending on a more commoditised basis,

altering the bank loan-eligibility assessment model in a way that disadvantages midcap companies. This, combined with the recent economic turmoil, has created a disconnect between the funding decision-makers within a bank and borrowers requiring credit.

As a result of this shift, many local and regional banks have lost the necessary skills to perform detailed evaluations of individual prospective borrowers. This absence of

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local-level risk-management authority has also resulted in many local banks lacking the knowledge and understanding of what their clients require, at a time when business-to-bank understanding is vital.

Changing needs

The truth is that banks have been scaling down local corporate banking provision for some time. They have shifted their focus away from local subtleties and, in their place, have been increasingly taking a formulaic view of a company's needs with respect to the supply chain. This requires large IT-heavy systems best offered from regional, if not national or even international, hubs.

Yet this seemingly rational trend is potentially disastrous for mid-caps seeking trade facilitation in a downturn. For instance, after ten years of rapid growth of open account trading that carries no form of risk mitigation, suppliers are again demanding that trade is supported by letter of credit against buyers, an instrument that requires a strong credit assessment of the local buyer.

However, such an assessment is most efficiently undertaken by a local bank, a skill which has mainly been lost to centralisation. Transactional hurdles of this type are further in evidence where trade instruments such as letters of credit are used to improve the efficiency of a company overall. Indeed, if the end goal is a fully-integrated risk and cash management process that can also be used to help cash-strapped businesses unlock value from the supply chain, the need for local knowledge and credit assessment is acute.

Moving forward

Given where we now are, how can banks resolve these issues? It is certainly not too late to reintroduce local banks to the benefits of local credit knowledge. This is achievable through a combination of specialist technology and a shift in the risk-assessment model, with local bank managers drawing on local skills and experience to reassume their original role as local risk-mitigators.

Local banks need to re-develop these lost skills and they also need to be able to look closely at companies that come to them and examine their working capital position and cash flow dynamics. Yet how do the same local banks cope in terms of the technology required in an era of global trade and complex business arrangements?

The most obvious solution is to adapt the expensive systems developed by some global and multi-national banks and then outsourced to local banks, although there are some quite serious pitfalls to this solution. Making use of such a system is unlikely to generate the close bank/business relationships that survival in this downturn may require and there is the potential danger that a bank providing its larger peer with insight into its local business may well end up losing it to the larger bank.

Of course, there are specialist software and technology providers that have developed programmes to provide information management and collations functions, but such programmes are not often ideal, as they tend to be off-the-shelf products that are difficult to successfully fully integrate into the existing banking systems. For this reason, they are as much of a problem as they are a solution.

What mid-cap treasurers really need is for local banks to find a way to provide technology-based tools to streamline supply-chain liquidity requirements, assessed and executed locally. This can be achieved via non-compete partnerships between local banks and specialist global banking providers.

Non-competing partnerships

Partnerships of this nature are mutually-beneficial to the local bank and the specialist global banking provider alike. For their part, local banks add value through the customer relations they hold with their clients and such knowledge, when combined with the technological platforms developed by specialist global providers.

A partnership philosophy of this kind can lift an outsourcing arrangement beyond the realms of a tailored high service-level offering. It can build on the individual strengths of specialist providers and the local banks to form lasting, mutually-beneficial relationships.

The experience and transaction data shared through these partnerships means that local banks can ensure that they are better informed when it comes to making lending decisions, and see the mid-caps' needs in the round, not just based on that particular point-in-time appreciation. Furthermore, the greater insight they glean into their clients, the more they can move to providing value adding services, such as identifying efficiencies that can be implemented and suggesting creative solutions that may reduce a company's level of dependence on debt; thereby strengthening and preserving those key relationships. ^{FBA}

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