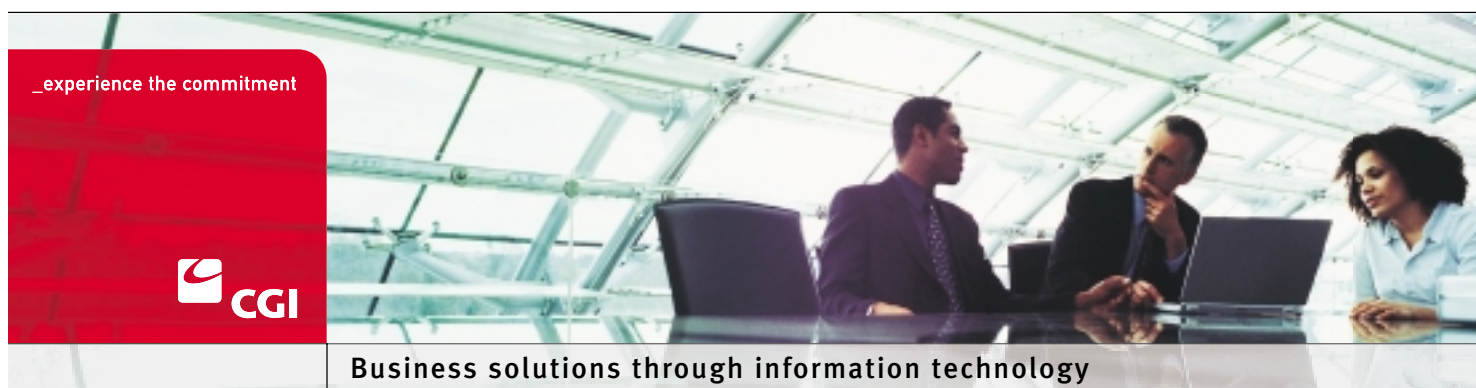


# Addressing global trade services processing needs



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### **The Challenge: change, costs and competition**

At a time when banks are being pressured to cut costs while improving efficiencies and customer service, a consolidation in the financial sector and a decline in the global economic outlook have thrown the business of trade finance into a state of transition.

Trade finance is an essential offering for most banks today, whether it is a core offering or a supporting line of business. It forms part of the corporate banking portfolio, closely linked to cash management and foreign exchange, and is often crucial to high-value corporate relationships. Although supporting traditional revenue-generating trade service products is generally cumbersome and costly, the requirement for such integral service offerings is thus not going away anytime soon.

In fact, the very nature of this complex trade business has changed very little in the last few hundred years. It continues to consist of various parties in the supply chain working together to build, buy/sell and eventually move goods around the globe. Banks have always been one of the key parties in this process, primarily providing risk mitigation and credit/settlement services most often related to the traditional Letter of Credit (LC) and documentary collection products.

However, after centuries of little change, recent advances in technology are setting the scene for a transformation in the dynamics of the trade industry - a transformation from which there will be no going back.

The Internet has contributed to this as it now provides significantly more information and lower cost transaction processing capabilities than were ever previously possible. This invisible network, coupled with the constant push by savvy buyers and sellers to find the best “mousetrap” to lower their costs at a reasonable level of risk, is forming the genesis for the evolution of new trading models. While the earlier adoption of web-based B2B and other similar solutions may not have gained enough traction to displace the longstanding LC incumbents, it is only a matter of time before some other business models take hold, changing the game as we know it. For instance, Open Account (OA) transactions are gaining ground rapidly except in Asia where LCs still dominate.

The changes afoot that impact the way banks provide trade support also offer opportunities to reduce costs and generate revenue. In fact, the swift pace of change in the trade business today requires banks to proactively pursue such opportunities to stay competitive.

Advances in technology are presenting radical new options for the way in which banks conduct their trade finance business and interact with customers. They hold the promise of automated processes, increased efficiency, enhanced data processing and lower fees. At the same time, these advances present customers with attractive alternative solutions that threaten to disintermediate banks from some parts of the global supply chain.

Indeed, competition is increasing from e-commerce offerings and non-bank competitors, with major exporters, importers and logistics management companies all seeking to expand their trade-related services. This competitive pressure has the effect of making global banks more aggressive in local corporate markets, with advanced technology and lower pricing. As a result, banks of all sizes, in all markets, are feeling the pinch.

At this time of change, banks need to take stock and determine the importance of trade finance within their service portfolio. They must fully understand the costs of providing that service internally, analyse where their competitive advantage really lies and focus on customer service.

Indeed, the costs of being in the trade finance business are high. The cost of processing trade documentation is over five per cent of total world trade value. Offline processes are manually intensive, incurring substantial support costs. Inefficient workflow processes and old-fashioned physical documents that support trade finance eat into revenues and inhibit customer service.

One of the core challenges within the trade services market today, especially in larger banking institutions with a global presence, is the inefficiency associated with older non-integrated technology. It is not uncommon for a global bank to be operating multiple trade finance systems and versions from different vendors throughout its organization. While the desire for a common fully-integrated trade platform often exists, the upfront costs associated with achieving this goal are usually prohibitive.

Banks are being squeezed to cut costs and improve efficiencies, and it is increasingly difficult to support these demands without access to new technology. Those banks that want to retain a leadership position in the industry need to attract trade finance business from other banks by offering better prices and enhanced services, while others that simply need to stay in the game are increasingly seeking ways to reduce their trade services operating costs.

In addition, new technology makes it possible for corporate customers to have secure access to documents within a matter of hours rather than days, for example. Further, technological advances help to raise customer expectations and the demand for cohesive, integrated services that weave together all the elements to deliver a high quality of service that suits individual customers' needs.

In response, corporate treasurers are looking for tools to automate LCs. Larger global banks are extending their trade finance capabilities for online use. More companies are turning to providers of electronic trade services for help in managing the document and accounts receivable processes inherent in international trade. The ultimate solution is an international electronic trade system with uniform standards governing technology and document exchange feeding directly into corporate treasury and enterprise resource planning (ERP) systems with the flexibility to respond to changing market conditions and customer demand. While this is still some way down the road, the drive to develop uniform standards to govern electronic presentation is underway. The electronic version of the Uniform Customs and Practices (eUCP) governing trade finance provides the first international legal standard to govern the virtual marketplace. Service providers such as bolero.net, LCconnect and TradeCard are offering partial or point-to-point electronic solutions, although these have not yet secured the widespread acceptance necessary for success.

However, the technology-driven future trading models are by and large unproven and bring with them 'bleeding edge' risks. How can banks protect their eroding market share by satisfying customers' demands for quicker and better service without risking investing in technology applications that may or may not survive? While some of the largest banks may be able to afford to hedge their bets by investing a little in each of the emerging models, the smaller to mid-size players who are already running a tight margined business cannot possibly do so. They also cannot easily predict which of the alternative solutions will survive.

### **Reaching into the financial supply chain**

Another trend in international trade finance is incompatible with aging legacy systems. While there are many paths banks can take to broaden their future trade offerings, one of the most rational and attractive is extending their reach into the financial supply chain business. The term financial supply chain (FSC) refers to the flow of data, documents and money between trading partners. While numerous companies have invested in solutions around automating the physical supply chain for many years, the automation of technology and business processes around the FSC is still a nascent business. In order to achieve true supply chain efficiencies, both the physical and financial components of a company's supply chain process need to be working in close conjunction. It makes little sense to manage inventory and build goods in an efficient manner, only to lose those efficiency gains on the financial side of the process.

Banks, by their nature, are a critical link in the FSC process. They are not only the ones to eventually extend credit and move money; they also have an overriding knowledge of the trade business environment in general to potentially help with some of the other elements of the FSC process. Industry researchers Killen and Associates have estimated that a typical Fortune 500 company can save as much as US\$32 million a year through optimizing their FSC. Some of these savings could certainly be redirected to banks and their related solution providers if they provided the right services to help companies achieve this level of efficiency and effectiveness in moving their data, documents and money.

The emergence and strengthening of OA as a powerful transactional medium in the trade arena provides a natural growth opportunity for banks looking to provide new services. Providing such value-added services to allow customers to reduce their own internal costs and improve processing efficiency will enable banks to secure more business.

### ***Service Options***

Some examples of the services that banks could offer to their customers, assuming they have the right technology and related partnerships, include:

- **Order management** - The ability to provide transparency of the entire order process to all members of the supply chain by providing solutions to automatically take Purchase Order (PO) data directly from ERP systems or electronic data interchange (EDI) networks of large importers and share this data electronically with other members of their supply chain. In addition, the facility to automatically match the PO data with electronic invoices would greatly reduce the paperwork, labor and discrepancy fees that are associated with these typically manual processes.
- **Document preparation/collaboration** - The ability to help various members of the supply chain create their shipping documents electronically. While traditional document preparation solutions have existed for some time, they are of little value without the ability to electronically share this data with others. Banks could additionally offer full outsourcing services for managing the entire document creation process for their customers. This is an area that has traditionally been handled by the logistic provider community, but one where banks, supported by appropriate technology, could gain market share with their expertise in the trade arena and their strong customer relationships.
- **Cross border compliance** - In today's world where tightened security and vigilance have become the norm along with more stringent national and international trade regulations, cross border compliance checking is becoming ever more important. Significant penalties can be levied if goods are moved across borders without checking for items such as denied parties, export control regulations, product classifications and landed cost shipment tariffs. As trusted third parties, banks can start to offer compliance services with the right technology and third party content databases at hand.

### *Minimizing risk*

While these opportunities may sound intriguing, there are inherent risks in the evolution of the trade business. The bursting of the Internet and B2B bubble has shown the prudence of caution in exploring these newer processing models. Risks can be minimized by:

- Choosing providers and partners wisely - Recent history has shown that even the strongest of companies can go out of business almost overnight. Choosing the right solution providers and partners requires the proper level of due diligence by the banks to ensure companies will be around for the long haul. Given that numerous third party solutions are generally required to build up a fully comprehensive offering, this quickly becomes a daunting task.
- Establishing critical mass for long-term success - For solutions to work, and solution providers to continue offering a service, a significant number of transactions are required to flow over the network. Without movement in the market to help build this critical mass, the risk remains that new solutions dissolve as quickly as they came, leaving a bank and its customers stranded.
- Better cooperation across banks - Critical mass applies to banks, too. Banks need to be more open to working together to help expand their marketplace. Building proprietary solutions that a bank only markets to its own customer base makes little sense from a customer's perspective when that customer often does business with multiple banks. When extending their offerings from pure banking services into the FSC marketplace, banks need to try standing in their customer's shoes, or run the risk of being displaced.
- Integration - Essential for achieving critical mass, integration is not simple but the right technology can help. This can happen on many fronts, for instance in connecting a bank's myriad of back office systems to newer processing systems from outside vendors. A probably more important integration point is the connection of members of the supply chain. Fortunately, the advent of new technologies such as web services means that sharing data across external systems will get easier over time.
- Focusing on core competencies - While banks should certainly be encouraged to venture into the FSC space, they need to do so with a clear understanding of their particular skills and of where they should draw the line. Whether it be on the technology side, or with integration or consulting services, partnerships with reputable software development and systems integration firms are critical for rolling solutions out to a large customer base in a reasonable time period.

However, the provision of these services, particularly in the financial supply chain business, requires an investment in systems. Investing in what is often inefficient, aging and non-integrated technology can be very expensive. Instead of trying to modify the bank's own existing technology, the option of 'renting' technology as a means to provide customers with access to these innovative services may be attractive.

**The Solution: harness technology through outsourcing**

The push to enter the financial supply chain business, combined with the need to remain competitive is forcing many banks to consider upgrading their aging legacy systems. The cost of building or buying a new trade finance solution can be very considerable when the true technology costs associated with buying and maintaining these newer applications is taken into consideration. In this context, the outsourcing option - and, in particular the outsourcing of infrastructure and technology only to support trade processing - begins to look very attractive, as highlighted in the table below.

Technology Cost	Build or Buy Option	Technology Outsourcing Options
Trade finance vendor software licenses	For mid to large size banks, these primary trade finance vendor costs may exceed millions of dollars for all components listed.	Typically no upfront license fees
Vendor software maintenance	Generally 18-20 percent of software license fees.	Built into the transaction price
3rd party software licenses and related maintenance	The software licenses for the supporting imaging/workflow, Web application servers, and middleware technology can equal the primary trade finance vendor's software price.	Built into the transaction price
Hardware and related maintenance	New costs required for setting up the data center and disaster recovery infrastructure and storage costs are generally seen in the form of monthly charge-backs to the business.	Built into the transaction price
Integration and consulting fees	These internal and external fees may amount to millions of dollars.	Typically costs less to link to an existing infrastructure than to build one from scratch
Support	Usually at 20 percent of the licensing costs, the technology help desk, application support, technology operations, and data center operations costs can add up.	Built into the transaction price
Ongoing R&D investment	Regular upgrades to new vendor releases and ongoing costs for new software investments are common in a dynamically changing trade market.	Upgrades to new releases are built into the transaction price

Just how does the technology outsourcing option differ from more traditional forms of outsourcing in the trade finance arena? The traditional outsourcing model in the trade finance arena involves one (insourcing) bank handling the entire trade services business process on behalf of another (outsourcing) bank. In most cases, the insourcing bank processes the outsourcing bank's transactions on its own, in-house system. There is usually no integration with the outsourcing bank's back office systems, with only periodic reports back on the transactions processed. It is hard to track service level agreements in such an environment.

In addition, frequently only part of a bank's trade portfolio is outsourced (typically the import side). The bank still retains its own trade processing system (and the associated technology costs) in order to record export transactions and any other trade-related business. In this scenario, the outsourcing bank relies on the insourcer's business strategy for any new functionality to be added to the underlying trade system. It is rare for both banks to share similar strategic goals.

A new twist to the traditional model is where the insourcing bank processes another bank's transactions, often in a low-cost, offshore location like India or China, utilizing that bank's own system. This ensures the retention of any previously existing integration to the outsourced bank's back-office systems. However, the threat of competition remains, as well as the danger that consolidation and changes in focus will impact negatively on outsourcing relationships.

Yet, the drawbacks relating to functionality and systems integration are only part of the story. Traditional trade outsourcing involves the hand-off of both the transaction processing and the underlying business processes, including related customer service and customer interactions. It is here that competitive concerns come into play, with potential issues around ownership of the customer, quality of service and impact on the outsourcing bank's brand image.

In contrast, the technology outsourcing model leaves the business processes in-house, with customers continuing to be serviced by the bank owning their business. As a partial outsourcing solution, it provides an opportunity for banks to test the waters. By outsourcing only those aspects of their trade finance operation that can most readily be passed to a third party, banks can better consider whether to move the entire process outside.

### **Newest trend**

As the newest trend in the trade outsourcing arena, technology outsourcing allows banks to utilize world-class technology on a per-transaction basis for processing services, i.e., for use of the outsourced technology. This means banks can ensure that operating costs are kept in line with business volumes. Where the underlying technology has been designed for outsourcing, and banks are offered a world class "one-stop-shop" for all trade-related technology, technology outsourcing is very appealing.

More specifically, the benefits of outsourcing trade finance technology and using it on a pay-per-transaction basis include:

- predictable operating costs since fees match business volumes;
- lowered costs with infrastructure costs shared among all banks using the platform; giving rise to reduced in-house technology costs;
- increased transaction processing throughput due to efficiencies from being a fully integrated platform;
- transfer of the application risk outside their own IT departments;
- establishing a community of corporate customers linked by a common infrastructure.

In addition, there is the opportunity to cut costs through system-enabled process improvements that can reduce resource requirements and operational costs. Additional savings are made since costs for system infrastructure and development are shared among all banks using the outsourcing service.

World class technology can also offer additional revenue-generating opportunities for banks through new product functionality such as OA processing. It can also provide the ability to insource another bank's processing, whilst enabling the outsourcing bank to retain its corporate image and position with customers. Finally, technology outsourcing enables banks to transfer the application risk outside their own IT departments, to expert technologists who have been managing mission critical systems for a long time.

From a functionality point of view, companies assessing potential technology outsourcing providers should look for at least all of the basic trade product processing capabilities, integrated customer front-end system and back-end systems that are accessible over the Internet, embedded imaging and workflow capabilities and embedded ad-hoc reporting for both corporate customers and back-end users. The technology provided should encompass global capabilities such as multi-bank, multi-currency, multi-time-zone processing and 24/7 performance. This will enable banks to reorganise their operations and cut on-going costs, by consolidating their processing center operations and setting up/retaining customer-focused service centers in local markets.

A fully managed environment in secure, geographically dispersed data centers should support these capabilities. The supporting infrastructure provided should include high-performance, redundant connections to all the major Internet backbone providers. Equipment should be provided and serviced by top-tier solution providers. The entire network and data center operations should be monitored 24/7 by expert staff to quickly identify system faults and attempted security breaches. A system technical architecture should be in place with multiple firewalls that filter all unauthorized incoming, external traffic, with each communication link to the bank secured via VPN technology, encrypting all data. Services should include 24/7 technical support help desk, technical operations and data center engineering support, and application, infrastructure, and security monitoring, plus defect resolution, dedicated customer testing and marketing environments and service level agreements for system availability, incident turnaround and other key areas.

Who can reap the most benefit from the technology outsourcing option? A strongly held view in the trade arena is that you have to be a major player with new technology and the know-how to use the technology in order to compete. Also, there is a belief that the market will consolidate and only the large, global players will survive. Not so. The outsourcing of trade technology allows smaller players to take advantage of new technology platforms, as well as the powerful knowledge base and expertise of the technology owners, with very little upfront cost. This means that these players can remain highly competitive in their own right and profitably retain their place in the market.

### **Conclusion**

The trade business will not stand still. Banks must keep moving forward to retain their place in the value chain. Fortunately, the technology advances that have driven this requirement also enable the solutions through which banks can continue to play a significant role and prosper from international trade finance.

For many banks, technology outsourcing presents an attractive alternative to more traditional outsourcing models and to in-house options. To achieve maximum benefit, institutions considering such a move need to ensure that they gain access to world-class capabilities that will continue to evolve, solving tomorrow's problems as well as those of today. They need to select a provider carefully, looking for deep industry expertise and a real understanding of the changing face of trade finance, in addition to strong technology, systems integration skills and an unswerving commitment to customer service.



### **About CGI**

Founded 1976, CGI has worked with clients in a wide range of industries to help them leverage the strengths of information technology (IT) to optimize their business performance and produce value-driven results. We also offer a comprehensive array of business process outsourcing (BPO) services, enabling us to help manage and improve our clients' day-to-day business processes while freeing them up to focus more on strategic decision making. Our consulting, systems integration and outsourcing services provide a total solution package designed to meet our clients' complete business and technology needs. We approach every engagement with one objective in mind—to help our client win and grow. CGI provides services to clients worldwide from offices in Canada, the United States, Europe, as well as centers of excellence in India and Canada.

CGI combines trade services knowledge with industry-leading transaction processing and customer self-service software through our Proponix Integrated Trade Finance Platform service offering. To explore this topic and how we can help, contact your CGI account manager or visit [http://www.cgi.com/web/en/head\\_office.htm](http://www.cgi.com/web/en/head_office.htm) for the location of the CGI office nearest you. Other information about CGI can be found at [www.cgi.com](http://www.cgi.com).