No.: 1-17019-21
Publish Date：2017/08/01 v.1

HSBC — Trade Finance Optimization

Jong-Peir Li & Eugenia Huang [1]

1. Introduction

At a regular meeting of the Hongkong and Shanghai Banking Corporation (HSBC) in July 2016, the host, CEO Jong Peir Li, wanted to review the trade finance business trends. The sales department used to attribute trade finance business decline to either economic downturns or sluggish exports, explaining that the considerable decline in Taiwan's foreign trade volume had naturally negatively impacted the trade finance business of every bank. However, Li did not consider economic downturns and sluggish exports as the only causes of the decline; therefore, he requested the strategy department to scrutinize and study the following questions. First, what are the challenges facing the trade finance business, and what are the new opportunities? How do international banks maintain competitive advantages in trade finance business? Second, are the functions of HSBC's current online trade finance platform sufficiently competitive, and do Internet companies have any measures worth referring to? Li announced that a strategic meeting would be convened a month later, and all related departments must send a representative to attend the meeting.

2. Detailed Analysis and Discussion at the First Strategic Meeting

The first strategic meeting was convened in the afternoon on August 3. Chief Strategy Officer Chang opened the meeting with, "Good afternoon, fellow colleagues. We have held several pre-meetings before today's meeting. In the last preview meeting, we mentioned that we have to explore how Taiwan's GDP decline has affected the trade finance business. Therefore, I would first like to identify and explain the influences in brief. Imports and exports account for an overwhelming proportion of Taiwan's GDP. In 2015, the total imports and exports of Taiwan were approximately US$270 billion and US$300 billion, respectively. Even after 14 consecutive months of decline, the total imports and exports of Taiwan were still estimated to be US$550 billion in 2016, a figure which kept Taiwan ranked within the top 20 countries worldwide in the volume of imports and exports. Given this grand scale, as long as we increase our market share, the trade finance business can still be

[1] Jong Peir Li is a PhD Candidate of Department of Man-agement Information Systems of National Cheng- Chi University. Eugenia Y. Huang is Distinguished Professor of De-partment of Management Information Systems, National Chengchi University.

immensely profitable. For example, large domestic financial holding companies such as Mega International Commercial Bank still earn considerable profits from trade-related businesses mainly because they have a substantial market share and a customer base that includes large enterprises, small and medium-sized enterprises (SMEs), and microenterprises."

Li asked, "What percentage of the total imports and exports stands as a potential opportunity for trade finance?"

Chief Strategy Officer Chang responded, "As far as experience is concerned, approximately 35% of the imports and exports require trade finance services. If Taiwan's banking industry has an average interest rate margin of 1%,[2] the potential business opportunity for trade finance equals approximately US $1.995 billion. Moreover, trade finance is the primary facilitator of the overall product chain, and therefore market share is extremely vital. In this context of product chain, trade finance facilitates capital management, and therefore customers usually place their idle funds in the same bank for cash management. Assuming that domestic deposits and foreign deposits increase by approximately US$70 billion and US $18.6 billion, respectively, from imports and exports every year, then the average interest rate margin of Taiwan's banking industry indicates approximately 20 bps[3] of interest revenue after the interests for deposit accounts are deducted accordingly. The greatest advantage of multinational banks is that they can collect different currencies in different countries while obtaining the timely capital levels information, retaining appreciating currencies and decreasing the holding of depreciating currencies."

"In addition, factoring creates another added value, which is the business of foreign exchange. If the accounts payable and accounts receivable are in different currencies, and assuming that the demand for TWD/USD currency exchange every year is equivalent to approximately US$154 billion, then the additional annual demand for exchanging the third currencies (i.e., currencies that are not TWD or USD) of approximately US$430 billion will make a total foreign exchange demand of US$584 billion. If each transaction made in NT dollars can generate approximately 1 bp of revenue, and each transaction made in foreign currencies can bring approximately 1–10 bps of revenue (depending on different currencies and liquidity), we can create a large sum of additional revenue every year."

Chang continued, "The third added value of factoring is asset management. Particularly, SMEs in Taiwan are willing to place their assets under the management of the banks because the banks undertake the risk of accounts receivable for them. When the deposits turn into assets, assuming that all the cash of the previous year is converted into funds charged with 1.25% of processing fee, the

[2]Average interest rate margin refers to the interest revenue net of financing costs and other amortization expenses.
[3]1 basis point (bp) = 0.0001.

potential market revenue we can create is significant as well."

Li asked, "So the overall market still has plenty of business opportunities. Then, what are the challenges we face?"

Chief Strategy Officer Chang answered, "The first challenge we face is that our loan policies are focused on major businesses in the electronics industry. When small and medium-sized suppliers of components or raw materials sell goods to Company F, and Company F sells goods to Company A, buyer-led programs bear the credit risk of Company F or A without giving a line of credit to SMEs. By contrast, in terms of seller-led programs, if Company H sells products abroad, many banks in Taiwan would not be willing to bear the credit risk of the wholesale buyers because they are not familiar with them. Therefore, if we can help upstream small suppliers and downstream wholesalers find financing opportunities in this problem-solving process, we would be able to rejuvenate the market."

Li analyzed, "This is actually a typical problem in credit investigation. In addition, we need to heed how the rapid development of the red supply chain affects the trade finance business. In the past, the red supply chain only affected several aspects of the electronics industry in becoming component suppliers. However, after investing a large amount of capital and human resources, the red supply chain has gradually shown a trend and potential to replace the overall supply chain. In view of this, we must strive to include upstream suppliers and the ultimate buyers downstream in order to maintain our advantages."

Chief Strategy Officer Chang observed, "In addition to the credit policies and the red supply chain, the account opening process is another factor that affects customers. Currently, some applications are processed manually from filling forms to keying in data, which is error-prone and costly. Meanwhile, in response to the increasingly stringent international anti-money laundering regulations and sanctions, many clients who have opened an account are required to fill out the forms again. These additional requirements need to be considered when conducting trade finance business. Nevertheless, this is the trend of international regulations, and both banks and clients should try to understand and comply with this requirement. According to the current anti-money laundering policies, our clients must produce the bill of lading and all the transport documents. Most firms are still adapting to this new requirement."

Vice President Chen of the Office of Chief Strategy Officer indicated, "Another crucial reason for the decline in trade finance is that many clients lose the opportunity to invest in high interest rate margins. For example, the US dollar used to depreciate and the US interest rate used to be low, while the exporting countries' currencies appreciated and main- tained a high interest rate. Previously, customers could borrow US dollars and invest in export countries' currencies to enjoy the benefit, but