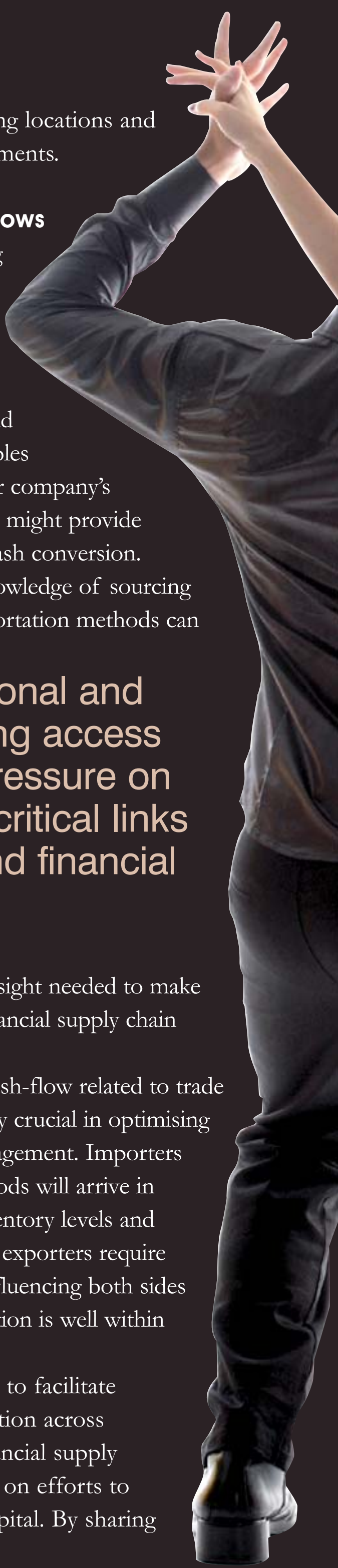
Stepping out

International trade in Latin America is booming, but the spotlight is increasingly being cast on how companies in the region can better manage their working capital, says **Mike J. McKenzie**, regional executive for Latin America at JPMorgan Treasury Services.



Until quite recently, corporate treasurers in Latin America did not focus on the impact international trade had on their financial metrics. As long as the sourcing, manufacturing and movement of finished goods ran smoothly, they left many of the processes surrounding the physical supply chain to 'operations people' within their organisations.

But Sarbanes-Oxley, along with trade agreements such as Mercosur in South America (involving Brazil, Argentina, Uruguay and Paraguay), the North American Free Trade Agreement (NAFTA) and the Central American Free Trade Agreement (CAFTA), as well as other local government regulations and mandates, have placed responsibility for compliance squarely on the shoulders of CFOs.

Complying with complex international and regional regulations, and improving access to credit and managing risk, have put pressure on treasurers to break with tradition and more closely examine the critical links between their organisation's physical and financial supply chains.

In order to gain more visibility of operational working capital, corporate treasurers in Latin America have had to obtain a better understanding of the nuances of supply chain management and how decisions within the physical supply-chain process can affect their organisations' working capital. For example, will a cumbersome US-Mexico border process slow the delivery of vital replacement parts to a manufacturer and endanger its ability to produce goods for sale? Will a major buyer in China be unable to make a timely payment to a Brazilian exporter?

What is needed is a more holistic approach to the treasury planning process in which the examination of non-finance functions can help identify the synergies capable of delivering greater efficiency, reducing risk and increasing cash on hand.

By expanding business into more countries, treasurers are compelled to focus on areas that have a growing impact on growth and profitability – procurement, shipping, regulatory compliance and risk management. Decisions on these areas can have a marked effect on an organisation's cash position.

A treasury's increased involvement on the physical side of supply chain management enables it to function as a central hub linking various business areas within the organisation, in order to assess the financial impact of what are often considered non-financial decisions. The net result can be greater efficiencies across the supply chain and, potentially, significant gains on the corporate balance sheet.

Case in point: For the US subsidiary of Mexican building materials multinational Cemex, pursuing supply chain management has proven tremendously beneficial. Cemex's US treasurer has partnered across treasury, procurement and supplier functions of the organisation in a bid to achieve greater visibility throughout the supply chain. This has enabled the company to extend the payment cycle, as well as to consider the benefits (and risks) of new vendor relationships, sourcing locations and outsourcing arrangements.

Trade and cash flows

Companies operating or simply doing business in Latin America need treasurers who are willing to look beyond payables and receivables to consider how their company's physical supply chain might provide a way to accelerate cash conversion. Gaining in-depth knowledge of sourcing strategies and transportation methods can provide the added insight needed to make the organisation's financial supply chain more efficient.

For treasurers, cash-flow related to trade operations is certainly crucial in optimising working capital management. Importers must know when goods will arrive in order to manage inventory levels and cash positions, while exporters require prompt payment. Influencing both sides of this buy-sell equation is well within the treasurer's realm.

Treasury's ability to facilitate the flow of information across the physical and financial supply chains bears directly on efforts to optimise working capital. By sharing

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information at every stage – from the cross-border movement of goods to the transfer of title; from risk mitigation to timely payment – inefficiencies can be reduced and the transaction lifecycle condensed.

Thorough knowledge of sourcing strategies, payment terms and delivery methods will allow treasurers to plan cash requirements with greater precision, take advantage of investment opportunities, and more effectively manage risks. This level of understanding also allows treasurers to identify new opportunities to improve working capital efficiency.

True cost

Procurement departments typically determine how and when to pay suppliers, often focusing on securing the lowest possible cost of products or services without necessarily considering the impact of payment terms and methods on the ultimate cost of goods.

Long sales-terms put an extra burden on the seller; shorter sales terms tend to push the financing costs to the buyer. The payment method has a direct bearing on financing options and payment risk. If these arrangements are negotiated without a full understanding of their impact on the entire supply chain, they may yield unexpected consequences.

Operating in the expanding economies and higher inflationary environments of many Latin American countries, procurement often finds itself dealing with suppliers that have little desire to extend receivables if payment terms are already lengthy. The costs incurred by suppliers in accepting extended payment terms may well make their way back into the cost of goods. For this reason, corporate treasurers in the region are beginning to explore such supply chain financing solutions as payables discounting as a means of providing favourable financing options to suppliers in exchange for meeting the buyer's desired terms.

Supply chain financing programmes rely on banks or third-party financing to provide suppliers immediate payment at a discounted rate, which is typically more attractive than factoring or straight working capital financing. In this way, buyers can increase their days pay outstanding, while maintaining good supplier relationships and a stable supply base – helping to ensure they receive goods on time and at a reasonable cost.

For suppliers, extended payment terms can mean increased risk, and while a supply chain financing programme gives sellers the chance to get paid faster – improving liquidity and reducing risk of non-payment – such programmes are not always an option, compounding the risk of cross-border sales.

Many Latin American exporters selling natural resources – copper, coal or fish meal, for example – to new customers in growth economies such as China can be exposed to conflicts with their internal credit policies, as well as significant payment, foreign exchange and macroeconomic risks.

Treasurers should understand the risks posed to their business represented by counterparties, sales terms and payment instruments. Banks such as JPMorgan – with a global network and trade expertise – can work with clients to provide customised risk mitigation and liquidity management tools.

Risk and compliance

The global supply chain presents ever-growing risk and compliance challenges for CFOs and treasurers. Treasury is accountable for managing a rising level of operating risk within the business environment, while complying with increased risk-related regulatory oversight. Without the necessary controls and procedures in place to meet regulatory requirements, companies can be exposed to potentially ruinous fines and penalties.

An even bigger threat to efficient working-capital management can be found in the uncertainties surrounding trade processes and logistics management: if a transportation network proves to be unreliable, extra

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inventory must be kept on hand as a buffer; missing a key delivery window reduces profits; delayed shipments expedited by air increase costs; a labour strike at a key port can cut a supply line for weeks. Building a stable and resilient supply chain and understanding the financial implications of various scenarios is an important ingredient for a successful cross-border supply chain.

Such exposures are exacerbated by the heightened regulatory emphasis on risk, which can drive additional inefficiencies in the cash conversion cycle. If goods are held for inspection due to improper or missing paperwork, then the transaction is disrupted and payment delayed. Importers can earn 'fast track' import privileges, or lose them. Exporters may require licences to ship certain goods. Companies must factor into the cost of doing business the additional expense associated with both local and regional trade regulations.

Furthermore, such requirements underscore how increased concerns around issues of security related to global supply chain activities – such as the risk of a tampered shipping container – have a direct impact on the treasurer and CFO by putting a company's reputation at risk. To manage these challenges and create a more secure and compliant global supply chain, treasury should first access processes, then look to automated tools and professional advisory services to help minimise the risk of delays in the supply chain, penalties, rising expenses or the loss of key customers.

For corporates doing business in Latin America, understanding of the region's unique requirements for buying and selling goods is vital. Trade agreements within the region's three major trading blocks have been ratified so trading partners can take advantage of favourable duty treatment and special trade programmes. Mercosur, NAFTA and CAFTA all provide opportunities for further growth. However, these programmes also bring additional administrative requirements and participants need to be mindful of maintaining adequate compliance processes.

Treasury turns to outsourcing

As globalisation intensifies, CFOs and treasurers operating in Latin America are increasingly recognising the importance of fully understanding the breadth of business processes that affect their organisation's working capital.

With improved visibility, they can achieve a better understanding of how they can most effectively manage their cash. By understanding the interaction of sourcing, supply chains, finance and risk, the same treasurers can employ a broader variety of management tools and increase their leverage over the balance sheet.

Corporates and multinationals are also challenged to understand multiple local clearing systems, trying to find the most efficient payment methods and managing other intricacies of cross-border payments specific to the region. To address these challenges, while improving working capital efficiency, CFOs and treasurers are turning to banks and third-party logistics providers for comprehensive solutions that can integrate cash management, trade settlement and finance, and logistics management.

The trend toward outsourcing supply chain management is expected to continue over the coming years, and the linkage between physical supply chain metrics and financial performance has become clear. Global service providers such as JPMorgan can play a significant role in enabling companies to manage information across physical and financial supply chains. Banks are also becoming instrumental in helping corporates and multinationals to manage credit and financing, as well as assisting with cross-border payments.

Financial institutions have a growing responsibility to CFOs and treasurers to serve as a reliable source of knowledge, expertise, solutions and education. Increasingly, banks are being called upon to partner with their clients to help them navigate the complex environment of global trade.

Financial institutions with an understanding of the supply chain as a key component of financial strategy and regional experience in providing financial services to Latin American businesses are uniquely positioned to support a treasury's efforts to manage and optimise working capital, bringing a greater level of structure and financial accountability.

The growth in international trade will only increase – which is good, but can be challenging, for companies trading in Latin America. Corporate treasuries will need to rise to the challenge of becoming strategic operational centres if they want to support their organisation's goal of maximising the opportunities for growth and improved financial performance provided by global trade. ❑