International trade has always been a fine balance of opportunity and risk. Finding that balance today has rarely been more exciting – and exacting – as UK businesses cast their global nets ever wider to drive sustainable growth.

Right now, that’s front-of-mind for FDs – how to harness attractive new growth and mitigate the exposures inherent in any ambitious push into unfamiliar markets.

Through this issue of FD Gameplan, you’ll find insight, analysis and practical action plans to support you on that journey – whether you’re an established trade veteran or embarking on a planned expansion.

Dr Assem Allam, MD and FD at Allam Marine, offers his perspective on identifying the opportunities and competing to win in international markets.

Ed Massey, our Head of New Business, Mid & SME Financial Markets, considers an action plan for businesses concerned about volatility in international markets.

Harold Sirkin, Senior Partner at The Boston Consulting Group, focuses on the trade hot spots beyond the BRICs, and elsewhere we highlight a McKinsey Global Institute report on the value of a city-level strategic view of emerging markets.

I hope you find this edition of FD Gameplan helpful and inspiring as you explore new horizons.

If you’d like further information about our international support services, please get in touch with your relationship manager.

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Unlocking the potential of emerging-market cities

Most companies still take a national or regional view when allocating resources for global growth. They should shift their focus to fast-growing cities.

A MASSIVE WAVE of urbanisation is propelling growth across the emerging world. This urbanisation wave is shifting the world’s economic balance towards the east and south at unprecedented speed and scale. It will create an over-four-billion-strong global 'consumer class' by 2025, up from around one billion in 1990. And nearly two billion will be in emerging-market cities. These cities will inject nearly $25trn into the global economy through a combination of consumption and investment in physical capital. This is a very significant shot in the arm for a global economy that continues to suffer from pockets of acute fragility.

Yet few business leaders focus on the importance of cities when establishing growth priorities. In a recent survey, we found that fewer than one in five executives makes location decisions at the city (rather than country) level. Few executives expected this approach to change over the next five years, and more than 60% regarded cities as “an irrelevant unit of strategic planning.” As these new urban-growth zones flourish, there’s a cost to companies that lack a clear view of the emerging landscape – chiefly in the potential for resource misallocation.

Shifting investment away from established markets to more promising areas can be difficult, as our colleagues have shown in separate research.** Budgets are often 'sticky' because companies lock into current rather than future opportunities. And many middle-tier emerging-market cities, however attractive, may be unfamiliar. Take Foshan, Porto Alegre, and Surat – cities that are unlikely to be high on the priority lists of global executives, though each has more than four million inhabitants, fast growth, and a vibrant base of consumers. Indeed, each of these cities will contribute more to global growth than Madrid, Milan, or Zurich.
Emerging-market cities are poised to deliver close to half of global GDP growth

$14trn

Urban consumers in developing countries will spend an additional $14tn annually by 2025

≈ And they are far from isolated examples. Our research indicates that 440 emerging-market cities, very few of them ‘megacities’, will account for close to half of expected global GDP growth between 2010 and 2025 (Exhibit 1). Crafting and implementing strategies that emphasise such cities will require new attention from senior leaders, new organisational structures that take account of urban rather than just regional or national markets, and potentially difficult choices about which activities to scale back elsewhere to free up resources for new thrusts.

Companies that adopt such a strategic approach may gain early-mover benefits. For some, developing better insights into demographic and income trends – such as an understanding of the urban areas where the population of older, wealthier consumers is growing most rapidly will be sufficient. Others may need to dig deeper, learning the market dynamics of specific products in target cities. →

Exhibit 1
Approximately 440 emerging-market cities are poised to deliver close to half of global GDP growth.

Cities’ contribution to global GDP and GDP growth

Emerging-market cities

- 443 cities in the City 600
- Other large cities
- Small cities and rural areas

Developed-market cities

- 157 cities in the City 600
- Other large cities
- Small cities and rural areas

Global GDP, 2010, %

100% = $63 trillion (real exchange rate)

Global GDP growth, 2010–25, %

100% = $50 trillion (real exchange rate)

440

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To illustrate the different panoramas of opportunity that appear when companies use a city-specific lens, we looked at five business sectors, each with different demand profiles. We then ranked cities with the highest growth potential for each of the sectors (Exhibit 2). Among the takeaways:

- Companies marketing health care products to seniors would find Shanghai and Beijing topping the list of cities with growing populations of older consumers whose incomes are sufficiently high (above $20,000 on a purchasing-power-parity basis) to afford these products. Tokyo and Osaka are the only developed-world cities among the top ten – a sign that well-off, ageing consumers no longer are found exclusively in developed markets.

- Baby food is at the other end of the age spectrum. Combining income and demographic data – in particular, the numbers of households with young children – we found that cities in Africa offer great potential. More than half of the top ten cities enjoying rapid growth in the number of children who live in households with incomes from $7,500 to $20,000 (on a purchasing-power-parity basis) are in Africa.

- São Paulo, Beijing, Rio de Janeiro, and Shanghai rank highest in a targeted analysis of market growth for laundry products. In fact, over the next decade, São Paulo will experience more growth in the sale of detergents and related cleaning products than the national markets of France or Malaysia will. That’s just a small shard in the global-consumption mosaic for emerging cities. We project that urban consumers in developing countries will spend an additional $14trn annually by 2025.

- By 2025, cities worldwide will need to spend at least $10trn more per year on physical capital – everything from office towers to new port facilities – than they do today. In building construction, the new floor space required will be equivalent to 85% of today’s entire residential and commercial building stock; 40% of that growth will be in Chinese cities.

- Urban water-related infrastructure, another pressing need, will require $480bn in global investment by 2025, with 80% of that flowing to emerging-market cities. Mumbai and Delhi will be the leaders in that spending.

As the locus of global economic activity shifts to developing nations, companies should be aware of the growth dynamic that’s playing out in cities.

### Exhibit 2
A city-specific lens can reveal urban areas with the highest growth potential in a given market.

#### Top cities by growth in given market, 2010–25

<table>
<thead>
<tr>
<th>Rank</th>
<th>Elderly higher-income consumers1 (aged 65+)</th>
<th>Young entry-level consumers2 (aged 14 or under)</th>
<th>Consumer spending on laundry care products3</th>
<th>Demand for commercial floor space4</th>
<th>Municipal water demand</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Shanghai</td>
<td>Lagos</td>
<td>São Paulo</td>
<td>New York</td>
<td>Mumbai</td>
</tr>
<tr>
<td>2</td>
<td>Beijing</td>
<td>Dar es Salaam</td>
<td>Beijing</td>
<td>Beijing</td>
<td>Delhi</td>
</tr>
<tr>
<td>3</td>
<td>Tokyo</td>
<td>Dhaka</td>
<td>Rio de Janeiro</td>
<td>Shanghai</td>
<td>Shanghai</td>
</tr>
<tr>
<td>4</td>
<td>Tianjin</td>
<td>Ouagadougou</td>
<td>Shanghai</td>
<td>Los Angeles</td>
<td>Guangzhou</td>
</tr>
<tr>
<td>5</td>
<td>Mumbai</td>
<td>Khartoum</td>
<td>Mexico City</td>
<td>Tokyo</td>
<td>Beijing</td>
</tr>
<tr>
<td>6</td>
<td>São Paulo</td>
<td>Ghaziabad</td>
<td>Moscow</td>
<td>Washington, DC</td>
<td>Buenos Aires</td>
</tr>
<tr>
<td>7</td>
<td>Osaka</td>
<td>Sanaa</td>
<td>Bangkok</td>
<td>Dallas</td>
<td>Kolkata</td>
</tr>
<tr>
<td>8</td>
<td>Chongqing</td>
<td>Nairobi</td>
<td>Istanbul</td>
<td>São Paulo</td>
<td>Khartoum</td>
</tr>
<tr>
<td>9</td>
<td>Delhi</td>
<td>Luanda</td>
<td>Manila</td>
<td>Guangzhou</td>
<td>Dhaka</td>
</tr>
<tr>
<td>10</td>
<td>Nanjing</td>
<td>Baghdad</td>
<td>Johannesburg</td>
<td>Chicago</td>
<td>Istanbul</td>
</tr>
</tbody>
</table>

1 With household income >$20,000 at purchasing-power parity.
2 With household income of $7,500–$20,000 at purchasing-power parity.
3 Based on city-level market-demand-growth model.
4 Includes replacement floor space.

Source: McKinsey Global Institute analysis

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As the locus of global economic activity shifts to developing nations, companies should be aware of the growth dynamic that’s playing out in cities.
In addition to supporting geographic priority-setting, a city-level view can help companies sharpen their marketing strategies. Product adoption rates often are tied to local preferences that can vary across different cities within the same country—preferences that marketers may miss when they follow the time-honoured approach of plotting adoption curves that trace purchases by levels of household income and by product types within categories. Yogurt consumption shows the types of variations that a national view might not pick up: we found, even after adjusting for income levels, that typical households in Wuhan spent significantly more on yogurt than their counterparts in three comparable Chinese cities did (Exhibit 3). Awareness of different spending patterns by city across products should give companies a better basis for allocating marketing and distribution resources.

As the locus of global economic activity shifts to developing nations, companies should be aware of the growth dynamic that’s playing out in cities. Leaders who give their strategies an urban dimension could find themselves positioned to allocate investments more effectively and to seize more readily the many opportunities at hand.

**Exhibit 3**

Awareness of cities’ different spending patterns across products can sharpen a company’s marketing focus.

Example: average yogurt consumption per household in 2010, by cities in China. Index: consumption in Hefei households with incomes <$13,700 = 1.0.

For every unit of yogurt consumed by lower-income Hefei households...

<table>
<thead>
<tr>
<th>City</th>
<th>Households with 2010 annual incomes &lt;$13,700</th>
<th>...other households consumed more (sometimes significantly more).</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hefei</td>
<td>+0.1</td>
<td>+1.1</td>
</tr>
<tr>
<td>Jinhua</td>
<td>+0.3</td>
<td>+1.1</td>
</tr>
<tr>
<td>Lianyungang</td>
<td></td>
<td>+0.2</td>
</tr>
<tr>
<td>Wuhan</td>
<td></td>
<td>+1.1</td>
</tr>
<tr>
<td>Hefei</td>
<td>+0.2</td>
<td>+1.7</td>
</tr>
<tr>
<td>Jinhua</td>
<td></td>
<td>+2.7</td>
</tr>
<tr>
<td>Lianyungang</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wuhan</td>
<td>+0.3</td>
<td></td>
</tr>
</tbody>
</table>

Households with 2010 annual incomes <$13,700

Households with 2010 annual incomes >$33,600

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For more, see the full McKinsey Global Institute report on which this article is based—‘Urban world: cities and the rise of the consuming class’.

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*McKinsey Global Survey results: Relocating for growth* was conducted in February 2012. The survey received responses from 2,962 executives, representing the full range of regions, industries, and company sizes. To adjust for differences in response rates, we weighted the data by the contribution of each respondent’s nation to global GDP.

**See Stephen Hall, Dan Lovallo, and Reinier Musters, *‘How to put your money where your strategy is’*, McKinsey Quarterly, 2012 Number 2.**

***Individuals aged 14 and under qualify as children for the purposes of this analysis.***
The shift in the balance of global economic power from West to East has been well documented, and currently shows little sign of abating. It therefore comes as no surprise that UK companies are looking to emerging markets for growth. But simply following the growth trend by expanding into or trading with rapidly growing geographies does not necessarily guarantee business success.

What is called for is local knowledge, insight and foresight. This means understanding your target market, just as you do your domestic market. And, as the article highlights, that can only be enhanced by extending your research to city level. Strategic decisions such as where the company’s operations are located (should it choose to set up an office in the target market), can have a significant impact on the success of the company’s overseas business – and different cities will present different challenges and opportunities. For the C-suite, it will be critical to be armed with on-the-ground intelligence: what drives customer demand in that market, for example? And which factors influence their decision-making process – is it price, quality, brand reputation or something else entirely? What is competition like locally?

For the FD, it is equally important to take the time to assess the lay of the land. What are the typical payment terms in the target market, for example? Do companies tend to trade on open account? And what is the preferred payment method? It will also be necessary to analyse the sources of financial risk in the chosen market, as these can vary substantially. Regulation will also be a key consideration.

**SCOPE OUT THE TERRAIN**

Much investigation into business conditions in the company’s chosen market can be done from the comfort of your desk – via organisations such as the UKTI. However, a trade visit can also provide useful first-hand experience of in-country conditions and city variations.

**ABSORB LOCAL KNOWLEDGE**

Whether you are researching your target market from afar, or on the ground, gaining local knowledge will be important. Where possible, make contact with other overseas companies already operating in that area – and ideally in that city – to discuss their experiences. Local regulatory bodies and industry associations are also useful sources of information. Your banking provider should also be able to offer insights into the trade landscape in your target market, and discuss ways to minimise payment risk, for example.

**MIND THE LANGUAGE BARRIER**

Consider whether it may be appropriate to hire local talent into your team – either in-country or in your home market. Chasing a payment when you do not speak the language can be extremely tricky, and can ultimately lead to cash flow disruptions. And if you are using a local agent or distributor, ensure any agreement is formalised in a clear written contract – with translations that match. Expert advice, either from the UKTI or a lawyer with trade-related experience, can be invaluable.

**UNLOCKING THE POTENTIAL OF EMERGING-MARKET CITIES**

DAVID WEATHERHEAD
Regional Trade Director, Lloyds Bank

**ANALYSIS**
IN LATE APRIL, Jim O'Neill retired as chairman of Goldman Sachs (GS). The 56-year-old British economist, among other accomplishments, left his mark on the still unfolding globalization story by coining the acronym BRIC, referring to the four rapidly developing nations – Brazil, Russia, India and China – that seemed ready a decade ago to challenge the economic supremacy of the United States, Japan, and Western Europe.

Since O’Neill invented the term in 2001, the BRICs have evolved in very different ways and have developed at very different rates. While China’s economy continues to boom, though off its torrid pace of a few years ago, Russia’s economic growth rate slowed last year to an estimated 3.4 percent, according to its Federal Statistics Service – down from 4.3 percent in 2011 and 4.5 percent the year before. Brazil’s gross domestic product grew just 0.9 percent in 2012, while India’s expanded at a 5 percent rate.

The four countries have very different sources of strength. Brazil and Russia, for example, are blessed with abundant natural resources, while India and China are blessed with abundant labor – though, as I’ve noted recently, Chinese labor is neither as abundant nor as cheap as it used to be.

As O’Neill bows out, perhaps a bigger story than the BRICs today – one that deserves more attention in the board room – is the large number of countries that are now competing with the BRICs, even outpacing them, often for the same reasons the BRICs have done well.

What this means, looking ahead, is that corporate executives, as they review their global plans, have more options than ever before available to them.

Turkey, for example, despite the
Recent violence there is a country with great promise, with a very modern and diversified economy straddling Europe and Asia. It has a rapidly growing high-tech sector and a strong banking sector. Its GDP, which averaged 9 percent growth in 2010 and 2011, expanded at a significantly slower 2.2 percent last year. This was neither unexpected nor unwelcome in view of the European debt crisis.

Mexico, whose 2012 GDP growth rate was 4 percent, is a natural fit for U.S. companies, with its close proximity to the U.S. and with free trade agreements not only with the United States and Canada, but with Chile, Costa Rica, Colombia, El Salvador, Guatemala, Honduras, Nicaragua, Peru, Israel, Japan, and the EU. Manufacturing is developing rapidly, with a focus on appliances and automotive clusters. Mexico’s standard of living continues to grow. While violence is still a concern, companies have learned how to work around it.

Indonesia is the world’s fourth most populous country and Southeast Asia’s largest economy, with a rapidly growing consumer sector. It has a developing labor force and relatively low wages. As the 2013 Index of Economic Freedom notes, “President Susilio Bambang Yudhoyono has attacked corruption and tried to encourage much-needed foreign investment,” which bodes well for the future. Indonesia’s GDP grew 6.5 percent in 2011 and an estimated 6 percent last year.

Other rapidly developing economies that are blessed with abundant natural resources and appear well positioned for sustained growth include the Republic of Congo, Guinea, Kazakhstan, Mozambique, Niger, Nigeria, Sierra Leone, Tajikistan, and Zambia.

The BRICs are good places to start, but there are significant opportunities for companies elsewhere, too, based on specific needs.

Panama will benefit from the expansion of the Panama Canal. Cambodia and Vietnam are taking advantage of their labor markets, becoming significant export centers. And in Europe, don’t overlook Estonia, Lithuania, and the Czech Republic. Since shedding the Soviet yoke, they have all liberalized their economies, now ranking among the freest in the world.

The BRICs are good places to start, but there are significant opportunities for companies elsewhere, too, based on specific needs.

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1 “China’s Worker Shortage Is a Global Problem,” Harold L. Sirkin, May 2013. www.businessweek.com

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EMERGING MARKETS BEYOND THE BRICS

According to the IMF’s July 2013 World Economic Update, global growth is expected to remain subdued throughout the year, reaching an overall annual average of 3.1%. And while the advanced economies are causing significant drag on global growth, emerging and developing economies, such as the BRICS (let’s not forget the addition of South Africa to O’Neill’s acronym) continue to outperform.

Nevertheless, as Harold’s article clearly outlines, the BRICS economies – the first wave of emerging markets really explored by Western corporations – are finding their astonishing growth rates difficult to sustain. What is more the BRICS are no longer a well-kept secret. So while the opportunities they present are still significant, there are other emerging market economies that offer equally interesting trade possibilities.

Take Vietnam, for example. Previously one of the world’s poorest nations, the country has undergone unprecedented political and economic reform since 1986. It is now one of the most dynamic economies in Southeast Asia – and has been designated one of UKTI’s 20 High Growth Markets. Having joined the World Trade Organisation in 2007, Vietnam is currently negotiating a bilateral free trade agreement (FTA) with the EU which will further foster trade activities.

South Korea is another exciting trade destination. In fact, in 2012 Korea reportedly overtook Italy as the eighth largest trading nation in the world. The country’s government has recently established FTAs with major trading countries and regions, including the US and the EU. These FTAs not only remove barriers to trade, but lay down business and ethical standards – making it easier for UK companies to do business in what is an increasingly exciting market.

Opportunities abound – however, entering a market that is just starting to emerge will require particularly careful planning.

**CHOOSE FLEXIBLE TRADE FINANCE**

Overdrafts are no longer considered to be the optimal way to finance trade – structured, flexible solutions can prove extremely useful in emerging markets. Banks and bodies such as the UKTI will be able to assist in determining the most appropriate trade finance package, as well as providing local intelligence on favoured trade instruments.

**GIVE IT TIME**

Venturing into a new market is exciting, but challenging. Make sure all the research points towards a winning strategy before stepping into the breach.

**RECONCILE THE RISK**

Finally, it is important to address the paradox of new markets – where opportunities are greatest is also where operational risks are perceived to be greatest. Market scoping and the use of appropriate risk mitigation tools should assist in striking the right balance between risk and opportunity.
Currency volatility: are markets nearing an inflection point?

AS NASSIM NICHOLAS Taleb writes in his latest book ‘Antifragile’: “It is far easier to figure out if something is fragile than to predict the occurrence of an event that may harm it.” While it may not be possible to predict exactly when the current period of relative market stability will end, nor is it possible to identify the trigger event which will bring forth a new era of market volatility, signs that the global monetary system may be becoming less stable should not be ignored.

Ironically, one indicator that currency markets may be increasingly unstable is the current lack of volatility observable in the currency options market. Three month implied currency volatility for euro-US dollar (EURUSD), for instance, is currently below 8%, and remains close to its lowest level since 2008. This relative stability is present in a number of other major currency pairs as well: US dollar-Canadian dollar (USDCAD) volatility is currently trading at about 7% and sterling-US dollar (GBPUSD) is only slightly higher at about 8%. Implied volatility is a little higher in US dollar-Japanese yen (USDJPY) – about 12% – and for certain emerging market currencies, but overall currency market volatility remains relatively contained – at least on an implied (forward-looking) basis. Actual volatility¹ has begun to pick up recently in certain currency pairs such as EURUSD (Exhibit 1, on next page), implying that the options market sees this increase in volatility as a temporary phenomenon.

Perhaps surprisingly, such low levels of implied volatility can sometimes mean trouble ahead. In a recent International Monetary Fund (IMF) paper, economist Sheri Markose writes: “The financial system looks strongest when it is most fragile…the volatility index, often taken as a proxy for market risk, is typically low during bull market conditions. The paradox is that it experiences its lowest point when the market is at its highest point prior to an extreme fall...hence market data paradoxically signals least risk just before a major market collapse.”² →

KEVIN LESTER
Validus Risk Management
Perhaps surprisingly, such low levels of implied volatility can sometimes mean trouble ahead.

Professor Markose is referring specifically to the equity market (the equity market volatility index, known as the Vix, tends to be low when equity markets are high – see Exhibit 2, on next page), but a similar phenomenon is often visible in the FX markets (e.g. EURUSD implied volatility hit its all-time low in June 2007, just before the onset of the global financial crisis).

Another signal which indicates that financial markets generally, and currency markets specifically, may be nearing a critical juncture, is the strong reaction in the financial markets to the conflicting messages coming from the US Federal Reserve concerning the future of its quantitative easing (QE) programme. The Fed’s recent comments that it would potentially slow down the QE programme later this year pushed the USD index to a three-year high earlier this month. Subsequently, the Fed appeared to reverse course, sending the USD sharply lower.

The strength of the reaction of financial markets (especially bond markets) to the Fed’s apparent mixed messages (messages which could hardly be construed as being particularly radical – after all, they were talking only about the possibility of a gradual slowing of monetary stimulus) indicates the degree of fragility, and therefore risk, which is currently embedded within the global financial system.

The unprecedented hyperactivity of global central banks over the past five years, in which central bank balance sheets have expanded from about 14% to 32% of global gross domestic
product(GDP), has created a number of ‘known unknowns’, (there are inevitably a number of ‘unknown unknowns’ as well!!) such as:

- How will financial markets (equities, bonds, currencies) react to a reversal of the most extreme monetary policy experiment in memory?

- Will this vast ‘printing’ of global currencies lead to inflation? Or will a reduction and restructuring of public and private sector debt loads lead us down a deflationary path?

- How will emerging market countries continue to be affected by, and react to, the use of unconventional monetary policies by the Fed and others (e.g. Bank of Japan (BoJ), Bank of England (BoE)), which are widely blamed for stoking domestic inflation and damaging competitiveness?

It is certainly not inevitable that currency volatility is set to break out of its recent period of relative tranquillity and cause havoc for international investors and corporate treasurers. However, it is important not to confuse a relatively low level of market volatility with a low level of market risk. While volatility amongst most major currency pairs remains near five-year lows, the level of market risk is arguably near its highest levels since 2008 due, in large part, to the increasing uncertainty over the future path of central bank activity. When it comes to managing risk, it pays to use market tranquillity (when liquidity is typically both available and affordable) as an opportunity to implement hedging strategies to protect against future risks. Interpreting a lack of volatility as a sign that overall market risk is low can be a very short-sighted, and dangerous, approach.

Exhibit 2
VIX Volatility Index vs. S&P 500.

Source: Bloomberg

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Managing market volatility is, as Kevin rightly says, not about trying to second guess the market. It’s about understanding the financial implications of market volatility on your company and developing a holistic framework to manage the associated risks.

And while volatility has been in a “recent period of relative tranquillity,” the impact it may have on a business is nonetheless significant. Look at GBP/USD, for example, over the last 6-12 months, there has been between 7-10% volatility in the currency pair – from a low of 1.49 up to 1.63. If a UK business has a 20% profit margin on a dollar-denominated contract, getting the exchange rate risk management wrong, could potentially reduce the company’s profit margin by 50% on such a contract.

As such, FDs need to have an appropriate risk management strategy that enables them to constantly assess and review: assumptions and budgets; any new contracts being entered into; and any outstanding hedging – to ensure that the hedging strategy remains dynamic and reflective of the changing underlying requirements of the company.

That said, formulating the company’s hedging strategy is in many ways the last piece of the jigsaw. First and foremost, a company must identify the relevant market variables and assess what effect they have on the business. Then it is a question of determining what levels of risk the business is prepared to afford. From there, work can begin on defining the right strategy for the company.

1. **UNDERSTAND THE CRITICAL CASH FLOW TIMINGS**
   Typically an internationally active business will have twice the working capital need of a purely domestic one. An appreciation of the critical trade finance timeline will help to ensure you adopt an optimal FX risk management strategy.

2. **ASCERTAIN RISK APPETITE**
   Your risk management strategy should be derived from a thorough appreciation of how FX risks impact the underlying business in terms of bank covenants, profitability, cash cover ratios, and operating/working capital.

3. **ASSESS THE FUTURE ACCOUNTING IMPLICATIONS OF HEDGING STRATEGIES**
   Consider the effect that new changes under IFRS 9 might have on the company’s balance sheet and/or financial ratios.

4. **SHARE DECISION-MAKING RESPONSIBILITY**
   Today’s FDs should aim to consult their wider management team/the Board on all hedging decisions and, where possible, adopt a defined treasury management policy.
Ease of Doing Business

Singapore has topped The World Bank’s ‘ease of doing business’ rankings for the seventh consecutive year.

Top 5:
1. Singapore
2. Hong Kong SAR, China
3. New Zealand
4. United States
5. Denmark


Since 1980, world trade has grown on average nearly twice as fast as world production.

Respondents to a recent survey cited ease of finding customers, agents or distributors as the most influential factor when deciding when and where to export.

Top 5 responses:
- 80% Ease of finding customers, agents and/or distributors
- 77% Cash flow and payment risk
- 74% Know-how/skills
- 70% Financial resources and access to finance to expand
- 68% Availability of export information and support services


British businesses received £4.3bn of government support through UK Export Finance in 2012-13 – up from £2.3bn the previous year.

Source: www.gov.uk

The value of deals won to date by UK companies from the Brazil 2014 World Cup and Rio 2016 Olympic and Paralympic Games.

Source: UKTI

£4.3bn

£120m
TRADE SECRETS: STAYING AHEAD OF THE GAME

While international trade is fast becoming part of day-to-day business for UK companies of all shapes and sizes, innovation in the trade and supply chain space is enabling forward-thinking FDs to act even more strategically and secure competitive advantage, says John Bugeja, Head of Trade Sales, Lloyds Bank.

For many, the word ‘trade’ conjures up images of heavily laden container ships and fleets of lorries speeding goods to customers – the physical side of trade has always been in the spotlight. But behind the scenes, the financial supply chain is quietly evolving, with new solutions bringing international trade into the 21st century.

One such innovation is SWIFT’s Bank Payment Obligation (BPO). A BPO is an irrevocable undertaking given by one bank to another that payment will be made on a specified date after a successful electronic matching of data. According to SWIFT, “BPOs enable banks to mitigate the risks associated with international trade to the benefit of both buyers and sellers. They enable flexible financing propositions across the supply chain, from pre-shipment to post-shipment. They provide an assurance of payment to the seller similar to that obtained under a confirmed letter of credit.”

Based on ISO 20022 messaging, electronic BPOs issued via SWIFT’s Trade Services Utility (TSU) – an interface for corporates to communicate with several banks – can enable corporate buyers to overcome any reservations they may have about dealing on open account, not least with suppliers in
emerging market economies. Not only can the BPO provide financial and risk management benefits, it can improve buyer/supplier relationships by securing the supply chain, as well as allowing companies to expand their business horizons and potentially improve their competitiveness in overseas markets.

The International Chamber of Commerce (ICC) has been heavily involved in promoting the BPO and the Uniform Rules for Bank Payment Obligation (URBPO) were adopted by the ICC in April 2013 and became effective on 1st July this year. This is expected to lead to a significant rise in BPO usage. Of course, such innovation does not do away with the need for traditional trade instruments. These will still be critical in certain sectors and geographies, but keeping up with developments can only be beneficial for the FD. Indeed, another important trend in this regard is the growing adoption of supplier finance.

SECURING THE FINANCIAL SUPPLY CHAIN
When it comes to settling an invoice, buyers and suppliers inevitably have opposing objectives. Whereas suppliers look to receive payment as soon as possible, buyers typically prefer to delay payment. In the UK, the Government has been working with some of Britain’s largest companies and key banks to address this buyer/supplier disconnect through supplier finance.

No longer dominated by top tier corporates, supplier finance is growing in popularity among mid-cap companies – helping them to secure their supply chains, whether at home or in new international markets. Sometimes referred to as ‘reverse factoring’, supplier finance is a form of receivables-driven financing. A balance sheet efficient solution, unlike many other supply chain initiatives, supplier finance is initiated by the buyer – through the buyer’s bank – rather than by the supplier. It allows the supplier to leverage the buyer’s credit rating. As in a factoring arrangement, the supplier is able to access (an agreed percentage of) the due payment up front from the bank.

Through supplier finance, the buyer is able to benefit from early settlement discounts or extend out payment terms without impacting the supplier’s cash flow, and without having to pay any kind of arrangement fee. Buyers will also have the peace of mind that critical suppliers are receiving the financial support they need, which in turn provides protection for the buyer’s supply chain. At the same time, suppliers can access immediate cash for approved invoices at a competitive finance rate.

Supplier finance can also help companies to become preferred buyers, and thereby secure an advantage over their global competitors. For example, a good supplier finance programme should allow the buyer to better manage supplier relationships and increase supplier loyalty – great for keeping specialist suppliers close to the company. In addition, given that supplier finance provides much needed support to SMEs, it qualifies as a corporate social responsibility (CSR) initiative.

From the supplier’s point of view, not only will they have the opportunity to receive funds earlier, but they also have a guarantee that the invoice will be paid on time – as it is settled by the bank on the due date. Importantly, supplier finance also allows the supplier to retain an element of control over its accounts receivable, which is not typically the case in a factoring or forfaiting arrangement.

Just as supplier finance is now reaching a wider range of companies, it is also establishing itself in different territories across the globe, including Latin America and Asia – territories currently of great strategic interest to many companies with ambitions to expand global activities. FDs looking for new ways to optimise their financial supply chain in international trade markets would do well to consider supplier finance among their strategic armoury.

1 www.swift.com/resources/documents/Bank_payment_obligation.pdf
Firmly at the helm of generator manufacturer Allam Marine Ltd, Egyptian-born Dr Assem Allam believes continuous efficiency savings and his strategy of holding stock have been rewarded with strong and sustainable growth in international markets.

"The name of the game for us is ‘don’t rest’. We constantly look at our overheads and costs so that we can offer the most competitive prices. And we pride ourselves on quick delivery for our global customer base," asserts Dr Assem Allam.

Based near Hull, East Yorkshire, his company, Allam Marine Ltd, currently exports a range of diesel-fuelled power generators to around 40 countries worldwide, including Africa, the Middle and Far East, and Europe. Its customers range from private buyers and businesses to NGOs and governments in places where the grid supply of electricity is not reliable, and in unstable regions where infrastructure has been disrupted by conflict.

Egyptian-born and an accountant by training, Assem bought out his former employer, generator manufacturer Tempest Diesel, in 1981, renaming the company and later relocating it from Stamford to Hull. Since, he has overseen strong continuous growth year on year in his dual role as MD and FD. The value of the company’s order book has climbed from £3m in 1993 to £140m+ this year, and it now manufactures around 24,000 units a year at the purpose-built factory and head office at Melton West it moved into in 2012.

His export strategy shows an instinctive understanding of his target markets. Focusing on the developing world, Assem →
selects markets for having potential customers with deep pockets of foreign currency. After all, Allam Marine’s generators are high-value products – the smallest, ten kilowatt unit starts at £2,500, with prices up to £250,000 for the largest sizes.

“Firstly, we choose to enter markets with a large demand for off-grid power,” explains Assem. “Secondly, there must be purchase power for our products. For example, we targeted Nigeria, where demand is big and there is income from oil. But we didn’t target Ghana next door – although the demand is there, the finance and foreign currency are not.” The only regions Assem has not explored yet are North America and Latin America – purely, he says, as his company has been too busy to investigate those fully.

The other cornerstone of his export strategy is responsiveness to the needs of his customer base in the developing world – and this means immediate supply. “Our products provide →
electricity, light – it’s not a luxury, but an essential. Once you have it, you can’t live without it.” So, if their regular electricity supply is threatened with interruption, for example due to conflict, people will spend money on a solution – but it needs to be supplied fast.

“I took the view that, when people decide they want light, they want it tomorrow – our research of our markets showed that stock availability is key. However, when ordering a generator from another manufacturer, a customer would often have to wait between three and ten months for delivery. I’ve tackled it differently.”

Instead of practising the usual ‘just in time’ stocking, Allam Marine holds substantial stock, allowing it to fulfil orders immediately. “So, in my factory I have at least £40m worth of stock,” says Assem, who is confident that this strategy is working. The company’s growth has been achieved “with absolutely no marketing”, but rather by distinguishing itself through rapid supply and keen pricing.

Assem believes that Allam Marine’s other strong selling point in emerging markets is the ‘Made in Britain’ badge on every unit, as well as using engines from internationally known names such as Perkins, Volvo and MTU. However, keeping his manufacturing base in the UK has required heavy investment in equipment to drive efficiency. “We are showing that you can sit tight in the UK, provided you have the courage to spend money on capital equipment to reduce labour costs. I don’t think any of our competitors who have moved production to the Far East have managed to achieve the growth we have.

“What’s more, I’m pleased to say that, because of our control on overheads and our drive to constantly improve efficiency, we were the only company I know of in our sector who didn’t make one person redundant last year. And we’ve taken on four new staff in the first half of this year.”

He anticipates continued export growth in the years ahead as new markets open up in the Middle East. “We’re closely watching political and economic developments in this region – when things settle down a bit, the demand will be massive there because the infrastructure in some countries has been damaged by recent events.” And, with economic confidence in the eurozone slowly improving, he also expects orders from countries like Greece and Cyprus to pick up again.

The innate risks to a business based on exports – such as delayed payments and foreign exchange fluctuations – are mitigated by maintaining a buoyant balance sheet. “Most of our profits are retained within the company to strengthen its cash position and have a strong balance sheet. And when it comes to paying suppliers, we ensure that we don’t suffer from a shortage of cash.”

A strong banking relationship is very important, confirms Assem – the company moved to Lloyds Bank earlier this year and recently completed a £45m refinancing deal, comprised of trade finance, working capital and term funding. “Our strong balance sheet puts us in a good position for borrowing from our bankers. We always negotiate a good overdraft facility.”

Assem’s top tips for export growth are, he says, “really simple. It’s competitiveness – look at your prices and keep control of your overheads. Look at smarter ways of producing to save labour and improve efficiency. We never rest on this matter – continual improvement is vital.”