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Industry News

Are On-Line Letters of Credit in Your Future?

By B.J. Handal

Like almost every other facet of business these days, international trade is being revived and reinvented on the internet through B2B exchanges-the marketplaces of the new economy. These new models for conducting international trade are linking buyers and sellers, many of whom have never before met or worked together in the international trade arena, to what seems an endless number of products and distribution channels all over the world. In this new technological age, Old Economy financial products such as letters of credit (LCs) have been customized for the internet and transformed into secure, expedient and efficient on-line payment alternatives. International Trade: On the Rise Again

Globalization and the internet are driving a steady rise in international trade. By the end of this year, the world economy is expected to achieve its best growth in more than a decade, with conditions remaining strong in 2001, according to a September 2000 report by the International Monetary Fund. A projection of 4.7% growth in world output this year would be the world's strongest economic growth since 1988. A growth rate nearly as strong-4.2%-is projected for 2001. The internet is playing an increasingly important role in this dramatic growth, making available new options for participants to initiate and complete transactions.

B2B Exchanges: The Marketplace

for the New Economy

The rapid growth rate of business-to-business e-commerce is being driven in large part by the exponential expansion of B2B exchanges and the new environment they offer for relationship building, access to goods, and opportunities to participate in ways both large and small-that were inconceivable only a few years ago. The prospects for the future are evident.

The number of B2B exchanges is estimated by AMR Research to be between 900 and 1,100 throughout the world. In addition, e-commerce is expected to account for 8.6% of worldwide sales of goods and services in 2004, according to Forrester Research. Also according to

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Forrester, the United States will continue to be the global e-commerce leader with on-line sales reaching \$3.2 trillion in 2004, followed by the Asia Pacific region (\$1.6 trillion) and Western Europe (\$1.5 trillion). Furthermore, an April 2000 Forrester survey of B2B exchanges showed that only 52% arranged credit and offered alternative-payment options, but 98% plan to offer these options by 2001.

The On-Line Letter of Credit: Old Economy Transformed through

New Economy Technology

Numerous factors have made financing international trade extremely difficult. Each country has different rules and regulations and, in spite of the business arena's migration toward electronic funds transfer, a limited number of electronic financing vehicles are available to importers and exporters because of the large amounts of funding required and initially the "faceless" nature of the transaction.

Letters of credit in their traditional form are used in 45% of all import-export order-fulfillment transactions. In the United States, 1,700 banks issue commercial LCs, with a total value of about \$108 billion annually, based on quarterly figures provided by the Federal Deposit Insurance Corporation (FDIC). Eighty percent of corporate customers surveyed by the Association for Financial Professionals (AFP) said the internet will become a venue for LCs, but only about 5% use the internet to initiate and execute them.

Despite the pervasiveness of LCs, their design and application are not standard, with each financial institution maintaining different ways of handling and processing LCs. The technology of the LC process has not matched demand for on-line management of the financing process. Understandably, the international import-export environment has little tolerance for current inefficiencies and fragmentation in the design and tracking of traditional LC delivery, and is looking for financing options suited to the wired world.

Introducing On-Line Letters of Credit

As globalization and the internet escalate participation in international trade, intermediary companies are providing internet-based trade financing products ideally suited to facilitate the entry or expansion of established financial institutions, buyers and sellers, and B2B exchanges into international trade. Realizing the rising demand for on-line financing, these intermediaries are introducing on-line letters of credit for B2B exchanges. This web-based financing option allows buyers and sellers to complete financing of their transactions on-line in an efficient and secure environment.

Representing significant improvements over existing LC products, these on-line systems enable buyers to apply for LCs on-line, and allow buyers and sellers to initiate and iteratively negotiate amendment and discrepancy requests on-line-eliminating the

fragmentation that can occur in the off-line process. Specifically designed to meet rising demand among B2B exchanges, such a service provides for acquisition of LCs from B2B exchanges, which are then executed by its bank payment partners, conducting all collection and transfer of data completely within a frame on the B2B site to ensure the site retains the customer at all times.

By offering the bank more cost-efficient access to the buyers and sellers who are meeting on B2B exchanges on-line-LC services provide a low-cost opportunity for the bank to serve the financing needs of this growing customer segment. The bank remains the ultimate arbiter regarding issuing, incremental fees, and timing of funds transfer.

Benefits of Using

On-Line Letters of Credit

Unlike paper LCs, on-line LCs base efficiency on the integration of the information in a one-stop on-line format that can be easily accessed in real time by all relevant banking and trading partners. Current transactions through B2B exchanges require an off-line payment mechanism, whereas on-line LCs offer on-line payment capabilities for transactions originating on B2B exchanges while still relying upon a bank's long-accepted role as a trusted third party in international trade transactions.

In addition, buyers and sellers can find timely information regarding each iteration of the LC amendment and disclosure process, expediting flow of information to all parties, reducing the uncertainty of critical financing and its exact arrival time, and providing a cost reduction through on-line document application.

Finally, supply-chain managers now have a sophisticated on-line tool to manage the trade-finance process with the same degree of efficiency, accuracy, and timeliness that they apply to management of purchasing, transportation, manufacturing, and distribution.

A New International Market

With many industries moving from an offline trading environment to the on-line world, new web-based financing alternatives provide buyers and sellers the ability to work more securely and efficiently in this new area of international trade.

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