

L/Cs out and e-certs in

Letters of credit, the business lynchpin that has driven international trade for centuries, has always been the preserve of the banking industry. But as the IT revolution sweeps the world of commerce, established business practices are being shaken to the foundation, and even the sacrosanct L/C is under siege from Internet predators.

BY TIM COX

Online marketplaces and supply-chain enterprise software are radically changing trade between companies by utilizing the Internet as a communications medium. But when it comes to payment, the parties go offline and make settlement the old-fashioned way.

However, signs of change are afoot as banks start to offer selected services. The financial messaging system SWIFT is moving online and other financial institutions are getting together in an attempt to set standards. There are also a number of independent providers known as "third party gateways" trying to hook up with companies, exchanges and software providers. New York-based TradeCard Inc is launching an online letter of credit and payment solutions service for the e-marketplaces.

The migration of financial settlement to the Web has long been awaited, but this is not something to be rushed. Technical issues, as well as reticence by the banks to change a very profitable system, has allowed the mushrooming of startup payment gateways and transaction processors to vie for the lion's share of what must be an enormous market.

"The e-marketplace participants

will ultimately require a bank to make a debit or credit. One would also need identity verification, authentication, liability management as well as the guarantee, as is normal in a typical letter of credit infrastructure. Banks will be offering these services on the exchanges," says George Methanool Singapore representative of Identrus, a consortium developing standards for B2B e-commerce.

Security is paramount; digital certificates with 128-bit encryption are becoming accepted as the norm, as is interoperability of enterprise business software packages through effective electronic data interchange (EDI). What customers need is assurance of payment, a legal framework for liability, usability of the system and an attractive bottomline.

"TradeCard started out as an electronic alternative to the traditional L/C which is very document intensive," says Kurt Cavano, chairman and CEO of TradeCard. "But what we have found with the rise of the online B2B world is that these exchanges are looking for a way to settle transactions. So we operate in two modes: one is corporate to corporate; the other is underneath a B2B exchange the same way as a credit card is underneath a B2C operation. We don't care if people operate through the new exchanges or interact in the old way, they can still settle through us".

In reality, corporations will do their business in multiple ways; few will do business through only one exchange. Companies will use B2B exchanges for finding new buyers and suppliers. Strong existing relationships will continue to allow business to be conducted over an open account, with no need for an exchange or contemporary payment system.

"Not all customers want online payment capability right now, it is the streamlining of the supply chain [that is important]," says Mui Hoon, managing director of Sesami.com which facilitates S\$500 million (US\$289 million) a month in online transac-

tions at their exchange. "Many of these traders will have been doing business with each other for years, and the financial settlement is often based on trust," she says.

However, where trade goes first, financial settlement will follow. "There will be, for as long as we can see, a number of payment providers that can support the ongoing expansion of e-commerce. Internet vendors will have to support as many as possible so that they do not discriminate among the potential and existing customers", writes Anders Lindberg of Icon Medialab in Singapore. Open standards, a kind of technological agnosticism, must prevail.

Upon application to join TradeCard, companies are checked out and need a credit rating from Coface, the export credit insurer. A typical transaction goes like this. A potential

Payment is triggered by a patented process for compliance — in fact either party can decide what they want as the trigger for payment to be made. "We compare the PO against the packing list, the proof of delivery, inspection certificate and any other information that was required. All this is done electronically by the compliance engine. If it all matches, we notify Thomas Cook which debits the buyer and credits the seller electronically. This is backed up by a Coface assurance of payment covering the risk. We have a blanket insurance policy with Coface that insures every transaction," says Cavano.

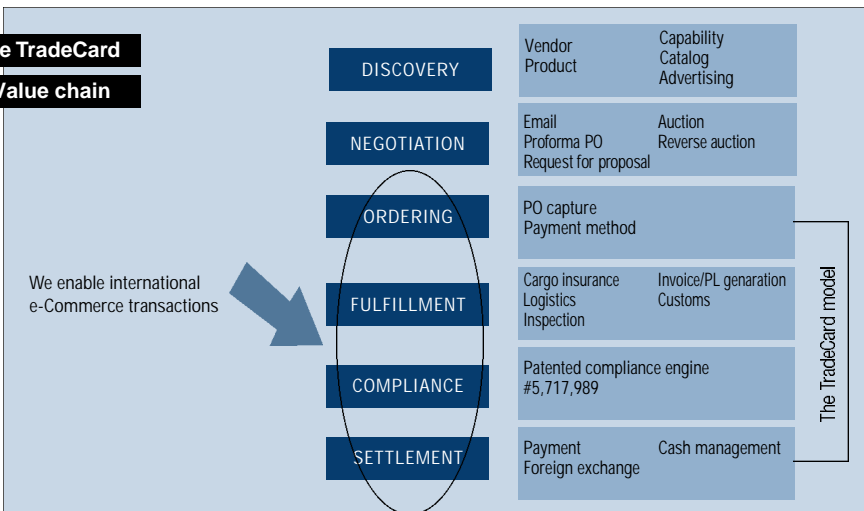
Security is handled in three ways. Verisign 128-bit encryption authenticates the client server. For user authentication, every TradeCard member gets a smartcard.

There is a user ID and password and then the smartcard

US\$1,500. TradeCard charge US\$150 (for trade values up to US\$100,000). "We bulk-buy the debit and credit from Thomas Cook, we eliminate all the paper and the associated people — we have a box from Sun Microsystems," says Cavano. Value-added trade services are provided by third parties. For example cargo insurance can be bought for 15bps.

After paying Coface and Thomas Cook, TradeCard's margins are in the 20% to 50% range. "But what is interesting is that, as the cost of transacting comes down we expect to see the number of transactions to go up, and their size go down," says Cavano. "We work with a disk-drive manufacturer in South Korea. It used to ship

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buyer sends a purchase order (PO) via email or an EDI file to TradeCard which notifies the seller. Both parties then negotiate the order over the Web, then digitally sign the PO to make it a contract. The seller sends TradeCard an invoice and gives the goods to a freight forwarder, which provides electronic proof of delivery.

generates a unique one-time PIN that will only be generated for the client. Digital certificates then authenticate the documents and data.

So how much does it cost? "The all-in fee between the buyer and seller for using a traditional L/C in a US\$50,000 transaction would be about US\$1,000 to

US\$200,000 worth of goods at a time. TradeCard, meanwhile, has lowered its charges, enabling the company to ship smaller quantities that are valued between US\$25,000 and US\$50,000, resulting in smoother inventory control which has huge savings."

TradeCard aims to get members in three ways. By forming an alliance with exchanges and encouraging them to get their members to use TradeCard; by selling directly to corporations; and the ultimate distribution model is the banks. They sell TradeCard to their corporate customers for around US\$15 of the US\$150 fee on each trade. For a marketplace to use TradeCard's processing system, a one-off fee of US\$25,000 is levied. TradeCard have also

signed up with the marketplace platform provider Ventro to be automatically embedded in their marketplaces.

This system does have some pedigree. Five years ago the World Trade Centres Association (WTCA) approached Cavano

with the concept of TradeCard and asked him to build a system to replace the L/C. Cavano had previously spent 15 years consulting in corporate banking and processing methods with the US-based firm AMS. The WTCA filed for the patents and venture capital was sourced from Warburg Pincus. The VCs advised them to set up TradeCard with independent management so Cavano and his team left AMS and

bought the concept out of the WTCA.

Still private, TradeCard has one year worth of cash at the bank and commitments from investors for more funding if the opportunity for IPO doesn't arise. Warburg Pincus own 40%, the second biggest stockholder is the employees. Other investors include Mitsui, Mitsubishi, Softbank, the WTCA and some private investors.

TradeCard decided to initially focus on trade between buyers in the US and sellers in Asia in an attempt to fine-tune the model before rolling it out to the rest of the world. The system went live in the US in May 2000. Since then it has

launched in Hong Kong, Singapore, Taiwan and South Korea. However, China and India are challenging places because of regulations. Systems such as this are not yet permitted.

The L/C is firmly in the preserve of the banks. Cavano wants some of that business. Citibank, Standard Chartered and HSBC are now developing their own online payment gateways. They say "bank with us and use our services". TradeCard is an open network allowing the customer to use any bank. Maybe banks with small L/C businesses will join TradeCard for that resellers' cut, but would the ones with big L/C businesses risk damaging what they have?

TradeCard's competition is from several fronts. Fast settlement between banks and financial institutions is presently often achieved by the SWIFT system, a 25-year-old cooperative owned by 3,000 member-banks. Sending transaction messages valued daily at US\$5 trillion between 7,000 financial institutions, this kind of network is difficult to compete with. This system is moving from a private network onto the Internet as SWIFT.net. The change will likely facilitate reaching more customers, as well as a reduction in costs.

Identrus was formed by many of the world's major banks in 1999, and since then more have joined. Heralded as a major development in the banking industry, is this the system to allow B2B exchanges to fulfill their potential? Setting standards for e-commerce they go further than technology. Legal and audit frameworks are defined alongside best business practices and digital certificate management techniques.

With the Identrus network, it is the financial institution that becomes the certification authority, issuing digital certificates to

their corporate customers. All parties to an online transaction exchange certificates to ensure authentication and integrity as a kind of passport to engage in e-commerce. Maybe the banks are the correct body to be the certification authority; they already have the trust of business. Government entities can also fulfill this role, whereas a small Internet company may not be viewed as the right manager of corporate security.

Bolero.net is another company with a set of standards enabling businesses to exchange trade data and documents. Acting as a neutral third party Bolero.net has a legal structure that allows the transfer of ownership of goods online. Like Identrus, this is not a proprietary system. Third-party partner vendors develop the Identrus or Bolero solutions and market these to users.

Bolero.net is owned by SWIFT and the TT Club, the investment vehicle for the world's port authorities and logistics operators. Many of the banks signed up with Bolero are already on the Identrus roster. Demonstrating the need to remain open, banks must be prepared for companies, traders and exchanges that may opt for any one of the standards.

TradeCard does not follow the Identrus standards, saying that the same result is achieved through its relationships with Thomas Cook and Coface. However, if the Identrus/SWIFT alliance becomes the system of choice of the world's financial institutions, merchants and exchanges will follow. Pricing of Identrus standard solutions is being left up to the banks and the developer-vendors. Here, TradeCard may well have a price advantage. However, the big question with the Internet is legal liability — on this the jury is still out. ■

Demonstrating the need to remain open, banks must be prepared for companies, traders and exchanges that may opt for any such attacks

