

The Insight interview: Jacob Katsman

A time for realism in electronic trade

Prior to founding CCEWeb Corp., Jacob Katsman was the Director of Finance of a multinational steel trading company. He also managed trading companies in Asia, Europe and North America. His book 'How To Make Money Without Money, The Art of Transferable Letters of Credit and Assignments of Proceeds,' www.cceweb.com/book/ is regarded by the international banking community as a standard guide to the practical use of letters of credit in trade finance. Katsman also serves as Executive Director of the International Trade & Banking Institute www.itbi.net.

DCI *We now have a number of online trading systems – @GlobalTrade, Trade-Card, Bolero and so forth – and yet from what we hear global trade is still largely paper-based and e-Trade Services account for less than 1% of the total market. Why has the take-up been so slow?*

Katsman Primarily, it has to do with the practices that the market has been used to. It is very difficult to change overnight from being paper-based to, all of a sudden, not having the reliance and the legal backing that paper provides, because local law as well as the UCP has been based on paper documents.

Another reason is that if you would want to achieve straight through processing of electronic documents all parties would have to be using the same system, meaning that you have to have importers, exporters, banks and all other trade service providers registered on one platform. Be it a neutral multi-bank platform or a single bank solution, they have to be registered and they have to be authenticated.

If system access is protected by digital certificates, the software is fairly new and to manage it properly takes quite a bit of resources. There are parts of the world where there is no legal infrastructure to deal with digital certificates. There are other parts of the world where digital certificates cannot be used because of export restrictions. Such restrictions pose challenges to adoption and building

critical mass. Taking all of this into account, if you think about any platform that would need the buyer and seller on it plus parties in their respective trade chains on board before any transaction could start, that becomes a very challenging task

DCI *Yet, it has always been said that online processing would save money, that it would be cheaper in the long run. But in fact, what you are saying is that start up expenses are quite considerable.*

Katsman Most of the start up expenses for the platforms that are out there have been taken care of. The major challenges now are deployment costs. You have to consider that the business models that were put in place initially – for instance, with Bolero – made participation prohibitive for most middle- and small-sized companies. The initial targets for Bolero were the large corporations who would have the human resources and the money to pay for the connectivity to the Core Messaging Platform. The question then was what would one need in addition to that in order to have usable a product. And in the case of Bolero you would need to purchase additional interface software from a variety of vendors and have at least the importer and the exporter connected to the Bolero network.

Now with Bolero Surf the model has changed somewhat but it is still rather complicated and costly. The argument that using Bolero XML standards, having system interoperability and achieving straight through processing creates efficiencies throughout the transaction chain only works when you have a critical mass of people using the system.

As long as trade remains largely paper-based and there are no adoption of standards, such an approach remains academic. @GlobalTrade has adopted a much more pragmatic approach that is less fancy but can work today with paper and electronic documents and be a stepping stone towards eUCP credits. To

answer your question, you will certainly achieve more efficiencies when all parties are using the same platform. What we can do today is create significant efficiencies for exporters, their freight forwarders, carriers and other trade service providers, and create additional revenue for participating banks.

DCI *Is it also the case that there is ignorance on the part of the banking and trading community as to the advantages and how to use these particular systems?*

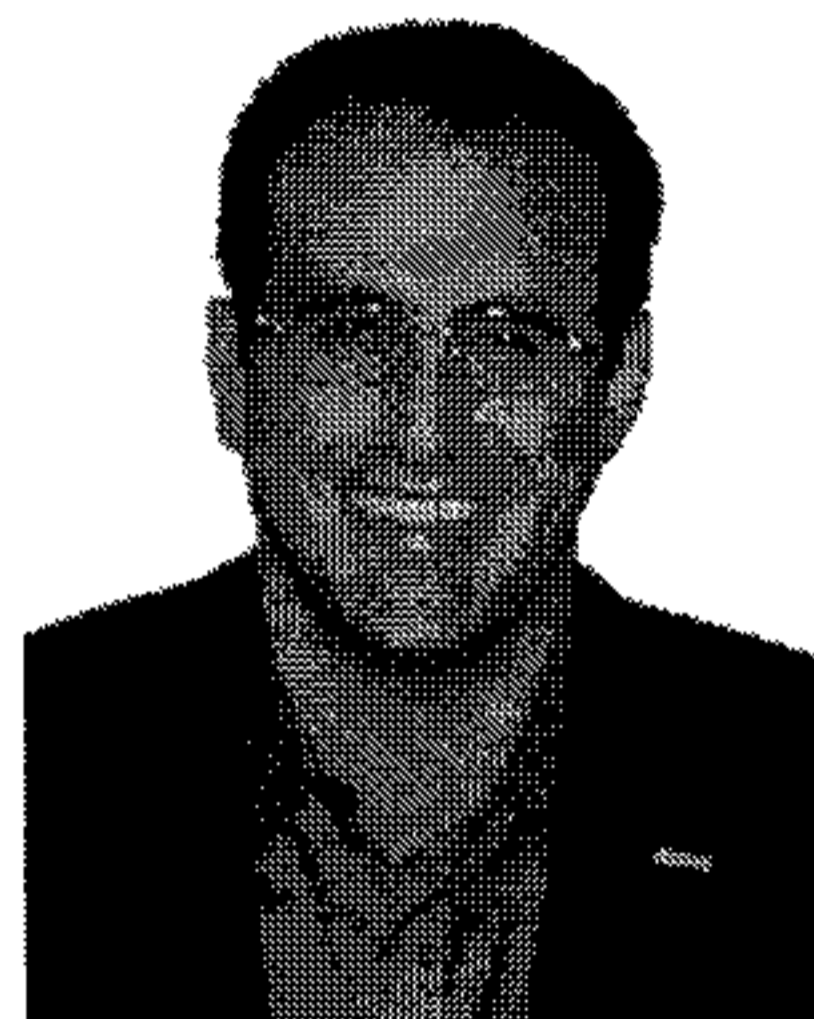
Katsman I would not say ignorance, but there is insufficient knowledge about the differences between various solutions. Another important element in today's economic environment is that the focus of companies is very much on their day-to-day operations. Banks and companies

in today's economy want to cut costs. Even if we give systems away for free, we have to make it clear to them what is the value proposition. It is very difficult to sell it to them in the present market climate if we cannot quantify where the efficiencies of the systems are and when they will come. Immediate quantifiable benefits must be shown.

That is why we have had to rethink our business model as well as the technology in

view of today's business environment in order to bring to market a service that people could use today, not five years from today. That means a system that can be used without having all trading parties necessarily registered from day one. It should also be a system that could create efficiencies for the exporter, the advising/negotiating bank and the trade service providers and lead to eUCP and paperless trade later connecting the issuing bank and importer.

In short, we really have to look anew at what the market needs and how we can give the market in gradual steps what it is ready for. When a baby is born, it does not walk and run right away. It goes through various growth stages until



Katsman: "I think that there will be a second wave of the e-commerce boom"

it becomes a person who can walk and talk. We are taking something that is completely new and it has to have a staged approach to the market and a good understanding as to who is really going to be the driving force behind the move towards the paperless cross-border trade.

Not enough thought or pilot studies were made to find out and understand who would be the main driving force towards the paperless trade. Is it the importer, the exporter, the bank or the trade service providers? From our own pilot studies, we are convinced that the driver behind e-trade services solutions is going to be the exporter.

DCI *So all of us more or less overestimated the facility with which people would move from paper to electronic and we're now in the second stage where we all have to rethink what has to be done to make this work.*

Katsman You are absolutely right. If you take yourself back two years ago, when we had the NASDAQ over 5000 points and when the word "Web" was very sexy, you had a flood of B2B market places and open account resolutions. There was a tremendous excitement in the market about everything that had to do with the Internet. We were all blinded by what we wanted to see and the market rally created more fog that clouded our judgment.

Now we are going through a second stage of consolidation where companies that are going to survive will have to find the right approach to the market. These are the companies that will listen and adapt. If they have enough flexibility, and if they have the funding in order to survive and get going, then they will be the drivers in the market.

DCI *Let's now look at letters of credit, specifically with regard to the recent adoption of the eUCP. A number of online platforms, such as Bolero and @Global-Trade, say that they are now "eUCP compliant". I have never quite understood what that means.*

Katsman I can talk to you about our experience with the eUCP. Perhaps Bolero can speak for themselves as to what they mean by "eUCP compliant". But in terms

of @GlobalTrade, we have built our solution in line with the eUCP rules. That means, when we were building the solution, we have incorporated features dealing with a "Notice of Completeness" that is called for in the eUCP.

Another issue involved in the eUCP compliance revolves around certain rules for authentication of parties and documents. What does that mean? Can you sign a document with a facsimile signature or with a digital certificate? What we have done is to provide a solution that deals with these issues for letters of credit according to the eUCP and the UCP.

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DCI *Would it be right to say, however, that other online traders, such as TradeCard, would not take that route, that they would want to bypass the letter of credit entirely?*

Katsman That is correct. This approach makes many trade finance bankers worried and causes them to ask the question "What rules are we playing by?". The bankers, as we all know, are very conservative. They are used to dealing within the UCP. And they say that if a letter of credit calls for a bus ticket, we will accept the bus ticket. If a letter of credit calls for a negotiable bill of lading, we will accept a negotiable bill of lading. They are used to these rules, they are comfortable with these rules. So when a product like TradeCard comes along and says: "We are not a letter of credit, we are something different", the bankers need to understand the risks and liabilities before they establish a level of comfort.

What we have done is to ask the question: "Why do we need to replace the rules? Why not make letters of credit simpler, using the UCP as the backbone?" Following this philosophy we created a simplified electronic documentary credit, that we call "FastTrack eDC" which essentially works within the UCP or eUCP and could be priced competitively by the banks.

DCI *So, you would not agree to what some people say that with online trading*

the use of letters of credit would diminish and in time would fade away?

Katsman I do not think that that is true because of human nature. You can go back in history and think about various payment methods we have had that are based on trust, starting from these nice graphs in the trade textbooks about maximum risk/minimum risk for the buyer or maximum risk/minimum risk for the seller and going through cash in advance, escrow, confirmed documentary credits, unconfirmed documentary credits, guarantees/standbys, documentary collections, and open account.

It is my personal view that as long as human nature is what it is, there will be a variety of payment instruments to meet the needs of a buyer and a seller in a trade transaction. Whether they do it electronically or in paper form, these instruments will remain. The preference for a particular type of instrument will depend on the economy and market conditions. That is how I look at it. I do not see technology or another solution replacing the trust that these payment methods provide to the trading community.

DCI *Looking to the future, when do you see this new realism creating a truly viable market place so that electronic trade can live up to its promise?*

Katsman I think that there will be a second wave of the e-commerce boom. This wave will help to speed up market penetration for the solutions that were created and have survived after the first wave.

It could be three years from today that we will see a meaningful market penetration. I believe there will be a gradual penetration starting from the middle of next year with the companies that survive and can find the right business model that is appropriate to the present market conditions.

The real benefit will come when there is a certain critical mass on any platform, and when a certain number of other providers – like ocean carriers, freight forwarders, insurance companies and government agencies – are also participating. ■

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