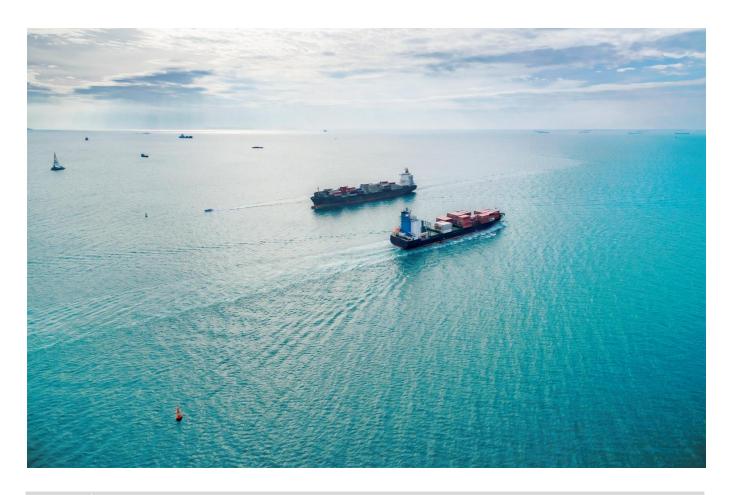
Supply chain challenges: Corporates source alternative ways of mitigating risks



Supply chain challenges

Corporates source alternative ways of mitigating risks



∸ကို= Key insights

- The digital transition by many corporate clients is fuelling a greater demand for adaptable escrow solutions
- ◆ The need for supply chain diversification post-COVID-19 is also prompting corporates to seek out escrow solutions
- Providers of escrow solutions must evolve their business models rapidly if they are to keep up with moving client dynamics and requirements

1

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In the last few years, corporates have been going through a period of rapid transformation, driven by a combination of factors including volatile geopolitics; changing customer expectations and major advancements in new technologies. COVID-19 has been a catalyst for further reform.

Moreover, it has forced corporates to source alternative ways of mitigating risks, particularly around supply chain, leading some of the major banks like HSBC to evolve their escrow proposition to adapt to an uncertain environment.

🎇 | Digital change in warp speed

Corporates have been aggressively digitalising their businesses for a long time now, but COVID-19 is forcing them to accelerate their plans even further. Simon Field, Global Head of Escrow at HSBC Issuer Services, says there has been a seismic shift by numerous companies away from traditional bricks and mortar towards online channels, evidenced by the exponential rise in e-commerce and e-wallets. The HSBC Navigator survey, for example, found that 38% of APAC companies said that digitalisation of their payment processes was now a development priority.¹

This trend is unlikely to change course anytime soon. However, the pivot towards digitalisation has created new challenges – most notably around asset safekeeping and customer protection.

In response, digital escrow solutions are now being rolled out to insulate vendors and customers from these risks. "In markets such as India and Singapore, regulators are insisting that protections be put in place for customers using online marketplaces so that their funds are safeguarded when in transit during transactions. This has led us to adapt our escrow proposition," continues Field. As corporates increasingly embrace this new digital ecosystem, so too have escrow providers.



Simon FieldGlobal Head of Escrow,
Issuer Services

Note:

1. HSBC Navigator Report, November 2019

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Reconfiguring client engagement

Few – if any - business continuity plans (BCPs) would have ever envisaged a scenario where entire global workforces were doing their jobs remotely, a point made by Giovanni Fenocchi, Global Head of Issuer Services at HSBC. Given the logistical impediments posed by lockdown measures notwithstanding the market volatility, it is vital that banks are able to communicate regularly and share information with clients seamlessly and quickly. This requires investment in technology.

Fenocchi says HSBC Issuer Services has devoted a lot of resources into enhancing its API (application programming interfaces) functionalities and online reporting capabilities, enabling clients to obtain comprehensive real time information on deals and transactions. Although the use of digital communication tools is critically important to business continuity, Sandeep Uppal, Global Co-Head of International Subsidiary Banking, Commercial Banking at HSBC, says maintaining relationships with clients is just as crucial. "Clients calls made by our relationship managers in Asia increased by 33% during lockdown. Corporate clients and CFOs value connectivity and this has been rewarded, as evidenced by the 18% year-onyear growth in the opening of international accounts," he says.

Additionally, this new way of working has put unprecedented strain on the operational and business models of many corporates.

It has also exposed a litany of new risks, principally around cyber-crime and data security, says Laura Galvin, Regional Head of International Markets, Commercial Banking at HSBC. By leveraging the deeply entrenched expertise of quality service providers such as HSBC, corporates can mitigate some of these issues.

Fenocchi stresses it is important that providers get the basics right during these unprecedented circumstances. "In these uncertain times more than ever, clients want certainty of execution, assurances about the provision of liquidity and the delivery of innovative solutions. Corporates value that HSBC is very flexible and receptive to their problems," says Fenocchi.



Giovanni Fenocchi

Global Head of Issuer Services



A new look for supply chain model

The frailties in the traditional supply chain model were badly exposed during the early stages of COVID-19. Research found that 200 of the Fortune Global 500 firms had a direct presence in Wuhan, while a separate study by Dun & Bradsheet estimated 163 of the Fortune 1000 had tier one suppliers in the city.² Despite these dependencies, a survey in Q1 by the Institute for Supply and Management said 44% of businesses did not have a plan to address potential supply chain disruption risk in China.³

Supply chain risk is now a matter of urgency for many corporates. HSBC's Navigator study found 67% of businesses said their top priority was to increase control over their supply chains.⁴ Meanwhile, 44% of firms polled stated their biggest priority was to improve transparency of their supply chains.⁵

Galvin says some companies are now looking to diversify manufacturing beyond China with markets such as Vietnam, Malaysia and Bangladesh being among the main beneficiaries. While conceding that trade tensions and the need to have better oversight of supply chains were drivers behind these moves, Galvin adds the costs of manufacturing in China have been steadily rising too, prompting corporates to shift production elsewhere.

Uppal agrees that geopolitical developments, in particular the negotiation of international trade agreements, are a key determinant of supply chain positioning for corporates. However, reshaping supply chains in response to these developments can take time. "Moving supply chains can take several years," Uppal continues.

Although many companies have said they are looking to diversify their production sources across the region, they are not exiting China altogether. Uppal says multinational corporates are adopting a policy of "China plus one." In other words, companies are retaining manufacturing hubs in China to cater for the country's increased domestic consumption, but are establishing production centres in other markets in the region to satisfy global appetite.

Escrows have a played a strategic role in supporting these changing supply chain dynamics. As a global provider with deep rooted local expertise, Field says HSBC is in an excellent position to support corporates with their complex cross-border transactions. Uppal concurs "We have observed a number of Hong Kong-based clients with factories in mainland China attempting to shift some of their operations to Vietnam.



Laura Galvin

Regional Head of International Markets, Commercial Banking

Deloitte – COVID-19: Managing supply chain risk and disruption, February 2020
 Willis Towers Watson (May 14, 2020) Re-thinking supply chain risks in the face of Covid-19
 HSBC Navigator Report, November 2020



As a result, they are selling their land but the demand from multinationals is not quite there yet. Instead, these Hong Kong companies are dealing with Chinese MMEs with whom they have no prior relationships.

As a result, these Hong Kong clients are leveraging our escrow solutions to ensure transactions are completed with transparency and as quickly and efficiently as possible. Similarly, we have noticed a lot of bolt-on acquisitions in India with multinational companies procuring pre-existing factories in the country to save on the costs of building operations entirely from scratch. This trend has also led to an uptick in organisations using escrow," says Uppal.



Working with the right partner in a changing environment

Companies have repeatedly made it clear that they want to consolidate their bank wallet share, so as to simplify their operational processes and net cost synergies. This strategy preceded COVID-19 but it has gathered momentum since the pandemic.

"CFOs have been rationalising their banking relationships. With people working from home, organisations want to coordinate their requirements with fewer banks," says Uppal. Galvin says HSBC's reputation—namely its strong balance sheet, global network, commitment to local markets and product depth – have helped the bank win sizeable mandates from leading multinational corporations. By providing corporates with access to issuer services solutions along with CMB, HSBC is able to act as a one stop shop. With corporates consolidating banking relationships, this is a powerful proposition which positions the bank as a strong market player.

Simultaneously, corporates are looking to escrow products as a risk management tool during this extraordinarily volatile period. Providers with strong credit risk ratings and balance sheet strength make for an appealing counterparty. It is also imperative that providers are able to react to change quickly and tailor their solutions accordingly.

Field says escrows are now being used in less conventional transactions beyond the standard M&A. For example, Field adds a number of companies have been utilising escrows to procure PPE from new suppliers during COVID-19.

Furthermore, HSBC Issuer Services recently started providing escrows to support a number of high profile sporting events. "The first event we supported in 2019 was the first of its kind and it perfectly underscored the versatility of the escrow product. We continue to work closely with our Corporate Banking clients to identify new ways in which escrow solutions can support their transactional requirements." comments Fenocchi.



Sandeep Sandeep UppalGlobal Co-Head of International
Subsidiary Banking, Commercial
Banking

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Case study 1

An HSBC global banking (GB) client located in Mauritius (Party A) was selling its two subsidiaries in India to an Indian company (Party B). Party A issued convertible notes to a Mauritius based entity (Party C). Parties A and C entered into an escrow agreement in Mauritius whereby sale proceeds from the Indian company sold to Party B were credited. An escrow was required to ensure that once funds were received, they were utilised to pay for the cancellation of the convertible note.

The escrow was set up for 90 days with the funds being released to Party C as per the escrow agreement. HSBC Issuer Services in India acted as the remittance agent (a specialised function in India) for the CMB client. Meanwhile, the HSBC Issuer Services team in Mauritius served as escrow agent on the transaction. This deal was highly complex involving multiple buyers and sellers and payment flows across both India and Mauritius. HSBC GB, CMB and ISV all collaborated in the deal process to support the client and deliver seamless execution during this complex cross-border transaction.

Case study 2

HSBC helped support a significant cross border deal involving a buyer - who was a major Commercial Banking client located in China and a seller that was a listed US entity and major Global Banking multinational corporation customer. The seller split into two independent publicly listed companies and spun off its non-US assets into a Singaporean-based new company, into which the buyer would make an equity investment post-partition. Singapore was chosen by the clients as an ideal escrow location because of its neutrality. As part of this deal, HSBC provided a Holdback Escrow and Purchase Price Escrow. The transaction involved close collaboration between Issuer Services, Commercial Banking and Global Banking to ensure that the escrow was established within three weeks of the mandate date.

Case study 3

A digital publishing company and Commercial Banking client was acquiring a UK publishing company in a £110 million transaction. The consideration was held in a cash confirmation escrow between the buyer and its financial advisers to support it with compliance with the UK's takeover code. Again, this is a good example of the excellent support ISV provides to Commercial Banking clients during public M&A transactions.

