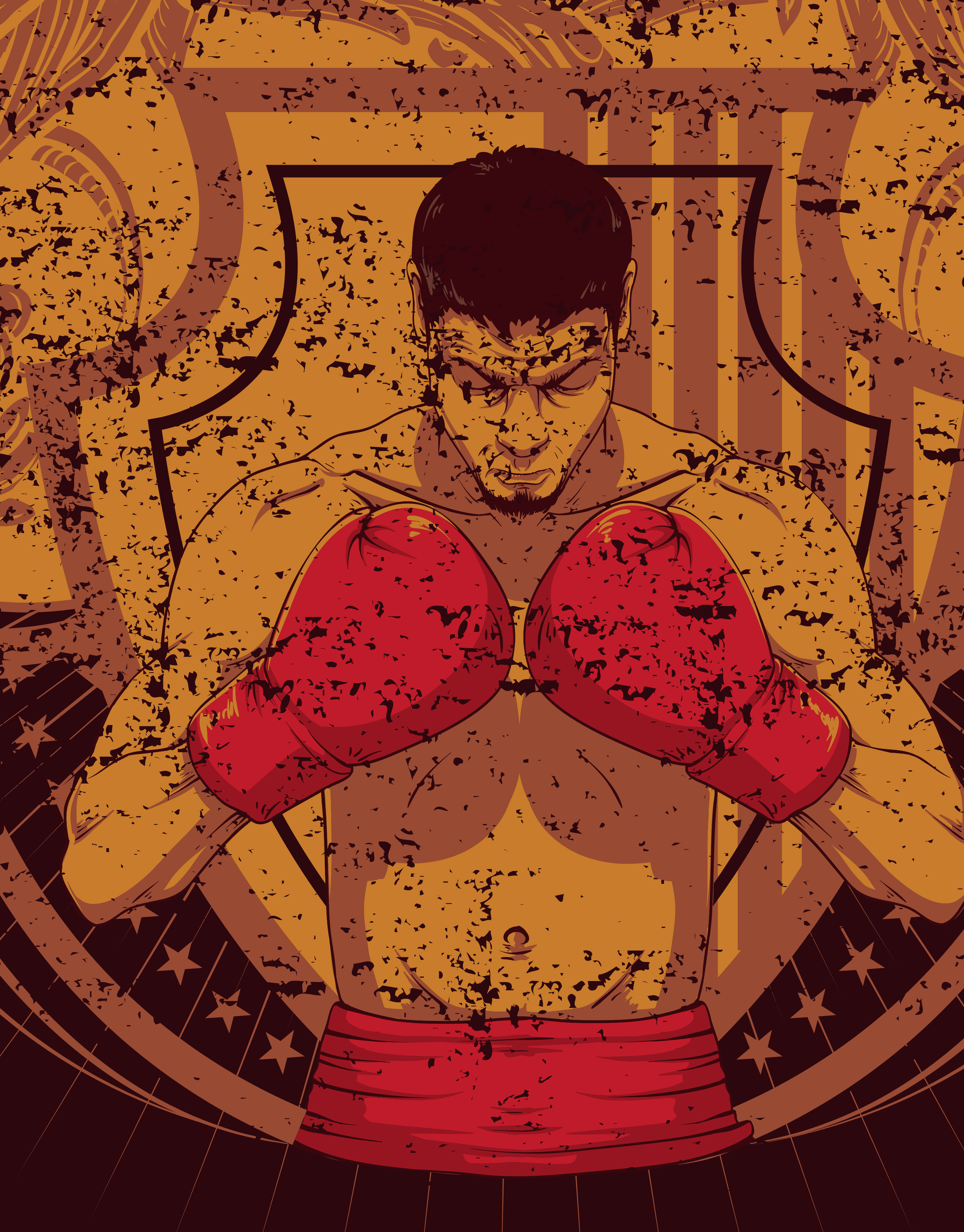

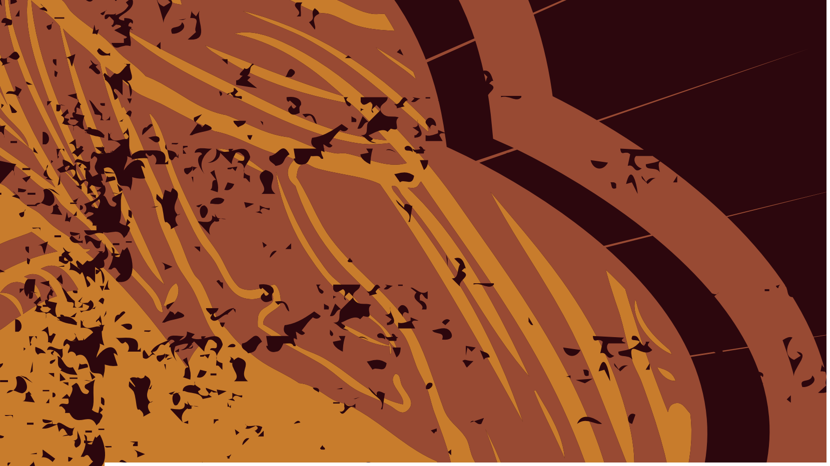

FLEXING ITS MUSCLE

Supply chain finance is an increasingly popular way for buyers to better manage their relationships with suppliers. Farah Khalique explains why

Supply chain finance (SCF) has been around for decades in numerous guises, but it is undergoing a transformation as the global trade business embraces the technological switch from a paper-based world to an e-world.

SCF can be broadly summarised as "any financial solution that can be used by a corporate to optimise working capital and to minimise the operational costs and risks associated with supply chain processes", according to David Hennah, head of trade at risk management software provider Misys. That can range from traditional products, such as letters of credit, to structured solutions, such as warehouse financing. But supply chain financing typically refers to invoice discounting and reverse factoring.

Invoice discounting allows suppliers to sell their invoices for early payment, typically to a bank or factoring company, in return for a fee. Reverse factoring is where suppliers take advantage of their buyers' superior credit rating, and use their bank credit lines to finance their receivables at a lower interest rate than what they would typically be offered.

Global companies such as Swedish truck manufacturer Volvo Group and British supermarket Sainsbury's have recognised SCF schemes for their suppliers across the world. And supply chain financing is a well-established concept across the US and Europe, where large companies and banks have long embraced the concept and set up programmes.

Now other pockets of the globe, such as Eastern Europe and Asia, are experiencing high rates of growth in use of SCF, according to Anil Walia, head of trade and supply chain advisory at the Royal Bank of Scotland. "Asia is waking up and increasingly we are seeing inter-Asia supply chain finance transactions," he explains.

Vinod Madhavan, global head of letters of credit products and receivables, supply chain finance, at Standard Chartered Bank, highlights that Africa is another region where solutions can be rolled out. "Africa is where Asia was 10 years ago, in terms of evolution of financial services and the availability of credit. Corporates going into Africa want access to distributor and supplier financing."

SCF has the X-factor

SCF is growing in popularity as both buyers and sellers recognise the benefits. Suppliers can vastly improve their working capital while buyers can cement their business relationships and earn an early discount settlement.

Last year, UK prime minister David Cameron convinced 38 leading FTSE 100 companies, including drinks manufacturer Diageo and supermarket Tesco, to sign up to the government's SCF scheme. This government initiative to provide more funding for UK small- to medium-sized businesses has helped to improve the image of SCF, according to Axel Miller, partner in the financial services practice group at consultancy firm Oliver Wyman. "If you dial back a couple of years, invoice financing had a very bad reputation," he says. "Only a company that couldn't get funds from traditional banking relationships would look into factoring or invoice

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discounting. Now, with the crisis, that reputation has changed."

Indeed, since the global financial crisis, companies are more proactive about managing their working capital and diversifying their sources of funding. Traditionally, SCF has been popular in the manufacturing and retail industries, where there is often a big disparity between the size and strength of retail buyers, such as Tesco, and their many suppliers. But bankers say that the advantages of SCF are also coming to the attention of other industries.

"This year we set up programmes for utilities, which two to three years ago, people wouldn't have imagined," says Walia. "Going ahead, supply chain finance will move into the services industry."

Stumbling blocks

The advantages of SCF programmes may be clear-cut, but the implementation process is not. The biggest challenge to putting an SCF programme in place is convincing suppliers of the benefits and reassuring them that they won't become too dependent on their buyers for funding, according to Phillip Kerle, CEO of working capital solutions provider Demica.

"We hear suppliers say they are not sure they want to get too close to the buyer, because then it would be difficult to walk away from the attractive funding," he explains. "It [also] becomes an operational nightmare if the supplier is dealing with lots of buyers."

Furthermore, current SCF offerings usually require suppliers to be enlisted on the buyer's bank portal, while suppliers would often prefer to be served by their own bank. The buyer's bank also has to perform Know-Your-Customer checks on suppliers, adding to the implementation time.

The supply chain financing community is working to remove these stumbling blocks. Earlier this year, the International Chamber of Commerce and payment messaging services provider SWIFT introduced legal rules and technology standards for SCF. The Bank Payment Obligation is a new payment method

TIPS FOR A TOP-NOTCH SCF PROGRAMME

◆ It's good to talk. To set up and maintain a successful programme, it is crucial that the buying company, its suppliers and the banks involved work together as partners. Ashutosh Kumar, global head of corporate cash and trade at Standard Chartered Bank, says: "Even during the crisis, we saw a lot of strength in supply chains. Some companies would offer banks better visibility, which ensures the whole proposition is viable."

◆ Talk to the right people. One of the biggest challenges for a company launching an SCF programme is persuading its suppliers to sign up. Suppliers will look for a catch or they simply might not understand the concept. Many small suppliers do not have a dedicated corporate treasurer, but it is worth finding someone with a working knowledge of finance. Steve Cochrane, owner of fashion retailer Psyche, launched his company's programme earlier this year. He says: "Make sure you're explaining it to a financial person rather than a salesperson."

◆ Buyers, keep it simple. The key tenets of SCF are straightforward, and it's best to keep it that way to attract suppliers. Marcelino Castrillo, head of SME banking at Santander Bank, says: "Banks can gold-plate everything [but] go with something that is simple. You can put add-ons later. Don't overcomplicate it."

If you're interested in SCF, you will also want to read our feature on e-invoicing on page 40

for buyers and suppliers to secure and finance their trade transactions. It also allows banks to work more closely with correspondent banks to offer supply chain financing to their customers. This is particularly relevant to suppliers in emerging markets, such as Southeast Asia, which use small, local banks and would benefit from a correspondent banking relationship.

Hennah says: "This is a watershed moment. Until now, the market has evolved into a three-corner model with one bank [and the buyer and supplier]. Going forward, it will evolve into a four-corner model where buyers' and sellers' banks will have to work together."

The Bank Payment Obligation could ultimately change the face of supply chain financing by offering working capital solutions to suppliers long before they reach the invoice stage.

André Casterman, head of corporate and supply chain markets at SWIFT, believes that financing on the back of agreed purchase orders instead of on approved invoices is the way forward. "The supply chain starts when the purchase order is agreed," he says. "This is where SMEs need funding to buy raw materials."

Purchase order financing, also known as pre-shipment financing, is currently a limited option for suppliers, but there is demand for it, according to Ashutosh Kumar, global head of corporate cash and trade at Standard Chartered Bank. Standard Chartered offers such financing, but despite the higher fees that bankers can charge, the risks involved are off-putting to most banks.

"Only a few banks like Standard Chartered and small local banks offer it. With post-shipment finance there is a clear payment obligation from a large company to a supplier. But with pre-shipment finance you need to understand the performance risk of the supplier," he says.

Market participants say that it is too soon to assess whether the introduction of the Bank Payment Obligation will kick-start the expansion of SCF, but it is certainly a move in the right direction.

FASHION BOUTIQUE AND SCF

British businessman Steve Cochrane has been passionate about retail since he opened his first fashion boutique, Sliced Tomatoes, in the North East of England back in 1982. He is now the owner of Middlesbrough boutique Psyche, which employs 64 staff and generates turnover of almost £5m.

Cochrane's passion for fashion remains undimmed, but his relationship with his bank soured, prompting him to look to pastures new. This led to him discovering the benefits of supply chain financing.

"I wasn't happy with my current bank, so sat down with a few others and one bank mentioned [supply chain financing]. Initially, I was sceptical, but then I thought it was the answer to some of our challenges," he says.

Psyche's suppliers stock the boutique with 150 designer brands, such as Armani and Hugo Boss, but life can be challenging for suppliers in the fashion world, Cochrane explains. "It's tough getting paid in the fashion industry; it's a very fickle business. We asked our suppliers, 'Do you want to get paid in 48 hours?' They were over the moon."

Cochrane set up a payment scheme whereby his bank pays each supplier within 48 hours. Psyche then settles with the bank within 90 days, or even longer, and receives an early settlement discount from the supplier.

Psyche has signed up 26 suppliers to the programme, with its smaller ones showing the most interest, and hopes to add more. The programme didn't kick off overnight, though. Cochrane first approached suppliers in August last year, but only started onboarding them to the programme this spring.

Overall, the benefits have outweighed the 'slow process', says Cochrane. Psyche has improved its relationship with its suppliers, even elevating its status to a preferred retailer with some of them. The improvement to suppliers' working capital has also had a positive knock-on effect on Psyche's own business.

"If we get a run on something or sell out of a particular pair of jeans or a shirt, we can order it [from the supplier] straightaway. And we get extra things out of them like hangers, shop fits and signs," says Cochrane.

Cochrane is 100% sold on the benefits of Psyche's SCF programme, but ironically, his biggest challenge is selling it to those that benefit from it the most – his suppliers. The first hurdle is explaining the concept, and then convincing them that early payment is actually possible, he notes. "I didn't expect it to be so challenging to get brands to understand it. [That] caught me off guard. Some of them don't want to be paid by a third party… and a lot of them think it's too good to be true."

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