Resolving the buyer-supplier tussle

GRAHAM BUCK LOOKS AT HOW THE CORPORATE DESIRE TO COLLECT CASH AS PROMPTLY AS POSSIBLE IS PROMPTING A RENEWED LOOK AT FINANCE TECHNIQUES AIMED AT EASING THE TENSION.

Whatever the size of a company and the sector it operates in, cash is always king. But while suppliers of goods and services want to be paid as quickly as possible, their customers seek to hold onto the cash for longer by extending the period of credit and thus reducing the cost of their working capital.

The key current driver for change in the supply chain is the focus on improved control of working capital, says Tony Pinn, Industry Director for Trade Finance at Barclays. There is, of course, a close link between supply chain and working capital. The benefits of supply chain solutions tend to be business process efficiency with its associated cost reduction, and working capital optimisation with its associated liquidity improvements. For this reason, treasurers have a key role to play in driving forward solutions in the broader supply chain – an area where traditionally only the bravest dares venture.

GLOBALISED SUPPLY CHAINS A report by Demica notes that, over the past five years, globalised supply chains that source from low-cost economies have taken over as the main supply chain management initiative. With much of the potential saving now realised, organisations are looking for further ways to streamline. However, the potential for further process efficiency is limited, and putting further pressure on suppliers could prove self-defeating, particularly where there are few, if any, alternative suppliers.

The conflicting aims of buyer and supplier can prove costly. According to Andrew Walton-Green, Chief Executive of Gresham Computing, more than £76bn of cash is tied up in post-dispute invoice working capital in the UK. The desire by companies to collect debts quickly but delay paying creditors puts a cash squeeze on businesses at the bottom of the supply chain – and many of those in the middle.

One of the techniques now being promoted to resolve this tension is supply chain finance. It is already well established in the US, where it is widely used by the automobile industry. But it has yet to be adopted to any great extent by the UK or the rest of Europe.

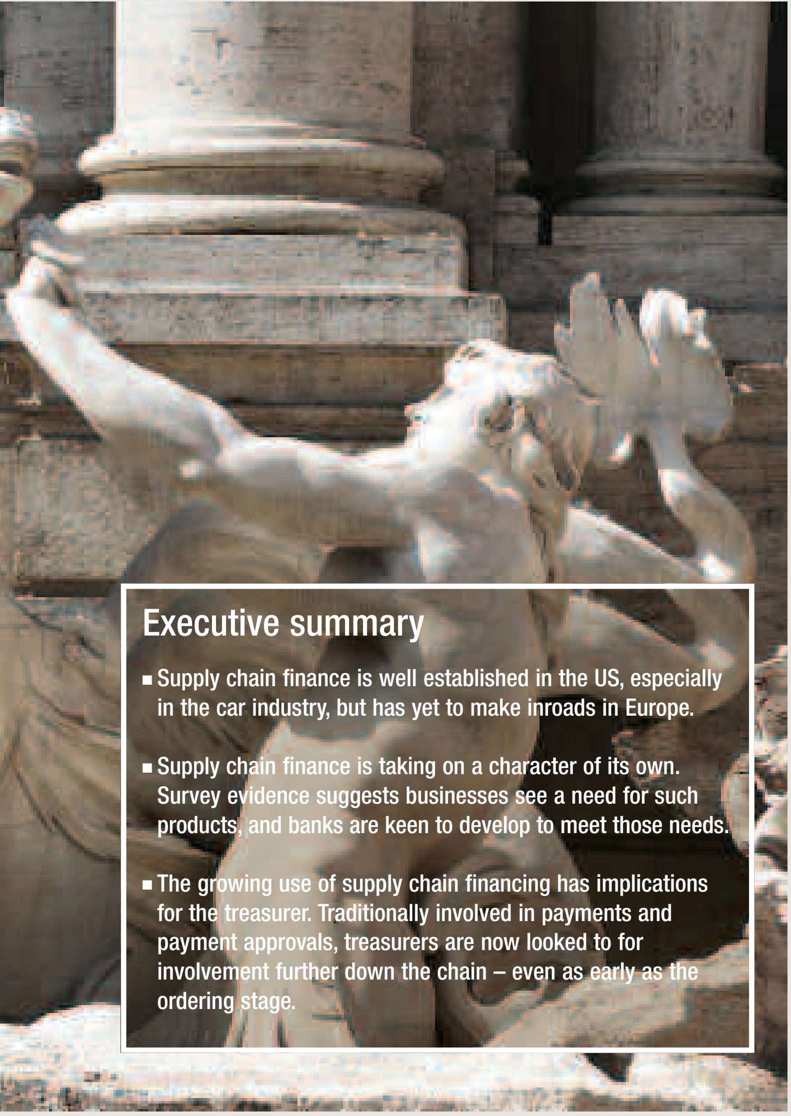
However, Demica's report notes that "supply chain finance is now taking on a distinct persona as a range of products that companies perceive they need, and indeed an area that banks are keen to develop to meet those needs". According to the European banks among the groups surveyed, the automotive industry is experiencing the greatest pressure to extend payment terms with its suppliers, followed by food and drink, retail multiples, high-tech, manufacturing, logistics, heavy plant, electronics and pharmaceuticals.

A BRIDGE IN THE PROCESS Commercial early settlement discounts provide a remunerative investment opportunity for buyers and a beneficial working capital and liquidity solution for suppliers, says Pinn. Efficient processes in the supply chain will enable these arrangements to be increasingly leveraged and, equally importantly, monitored. The buyer is choosing to reduce days payable outstanding (DPO) on the basis that the cost is balanced or outweighed by the implied return provided by the discount. Where corporates are unable or unwilling to fund the supply chain in this way, third parties can provide liquidity. The reasons for such unwillingness will vary but where there is a focus on balance sheet structure rather than return on capital employed, the use of capital in this way may be unattractive, and a third-party solution that is at least balance sheet-neutral for the buyer will offer an attractive alternative.

The bank will take into account the requirements of the sector in which the buyer operates, says Fritz Philipps, Director of Global Transaction Banking at Deutsche Bank. However, he says company size is usually less relevant than the "actual setup of physical and financial supply chains, the 'power play' between the business partners, and the degree of technical sophistication".

A major importer of goods, with a strong credit rating, will be able to access credit more cheaply and easily than most of its suppliers. It must factor in the working capital of all those companies involved at various stages down the supply chain line, which, typically, will collectively exceed its own. If the bank provides a bridge, this cost should be lessened.

The company may also source products from more boutique-type suppliers that cannot afford a 90-day wait and require payment in as little as 14. These smaller suppliers are likely to lend



Executive summary

- Supply chain finance is well established in the US, especially in the car industry, but has yet to make inroads in Europe.
- Supply chain finance is taking on a character of its own. Survey evidence suggests businesses see a need for such products, and banks are keen to develop to meet those needs.
- The growing use of supply chain financing has implications for the treasurer. Traditionally involved in payments and payment approvals, treasurers are now looked to for involvement further down the chain – even as early as the ordering stage.

their support to a supply chain financing scheme if it can ensure prompt payment and also enable them to approach banks for funding, backed with evidence that they have money coming in from a reputable source.

Conversely, suppliers that are major multinationals are likely to be bigger than their customers and to enjoy a better cost of funding. While they may be happy to enjoy the benefit of early payment, they may be less willing to participate in a customer's supply chain financing scheme.

If the project is a significant one, you need to choose the right banking partner at the outset so you don't have to swap a year or two later down the line. If the bank subsequently decides to pull out, or its price goes up, the implications are considerable.

A good scheme offers a win-win situation for all the business partners involved, says Philipps. The benefits include balance sheet optimisation, improved risk management and cost reduction, plus a host of qualitative benefits such as higher visibility of funds.

As an example, in some supplier financing schemes involving the sales of receivables to a financial institution, both buyer and supplier can achieve working capital benefits. The buyer improves its DPO figure through an extension of terms, while the supplier reduces its days sales outstanding (DSO) by using a low-cost alternative to traditional factoring for offloading its receivables.

Asked whether it is a good ideal to outsource supply chain financing solutions to a bank, Paul Turner, Group Financial Controller at fruit juice packaging company Gerber Emig, says: "Business survival necessitates positioning as a lowest cost provider. To achieve that, we would always be looking for simplicity and lowest costs. When looking at optimising global liquidity, we didn't seek solutions that tied resources excessively in administration. Therefore we outlined requirements for well-structured systems creating simplicity through optimising modern platforms. Such optimisation may entail outsourcing to a bank to take on associated issues. If the contract is controlled and the right structure is there, then this might be optimal. However, there is always an array of factors to give appropriate consideration to."

IMPLICATIONS FOR THE TREASURER The growing use of supply chain financing has implications for the treasurer. Traditionally involved in payments and payment approvals, he or she is now looked to for involvement further down the chain – even as early as the ordering stage – to improve cashflow forecasting.

Fortunately, this trend has been coupled with a greater willingness on the part of both customers and their suppliers to exchange information on invoices and payment dates. In the past, it was common for a supplier to receive money from a customer without knowing what order the payment was for. Greater co-operation between the two parties, assisted by automation and innovation, has made it possible to track cashflow far more accurately.

The aim of ensuring that better information accompanies each payment has provided a wonderful opportunity for software providers in helping processing and reconciliation. The potential administration savings from these efficiencies can be considerable.

Thanks to this greater openness, suppliers can now ascertain whether their customers have approved individual invoices and, if so, the date by which payment can be expected.

But there are also potential problems, among them the difficulty of assessing the financial benefits of a supply chain financing scheme.

The cash benefit to working capital is a one-off for the first year, then rolls into subsequent years to benefit profit and loss. As it will not recur in subsequent years, it must also be tangible and demonstrable to the organisation's financial director.

Not that the treasurer should be a standalone project manager, adds Philipps. Managing supply chain finance schemes is a cross-functional activity. Purchasing departments will typically take the lead in implementing supplier financing, with strategic sales directors heavily involved in distribution financing schemes.

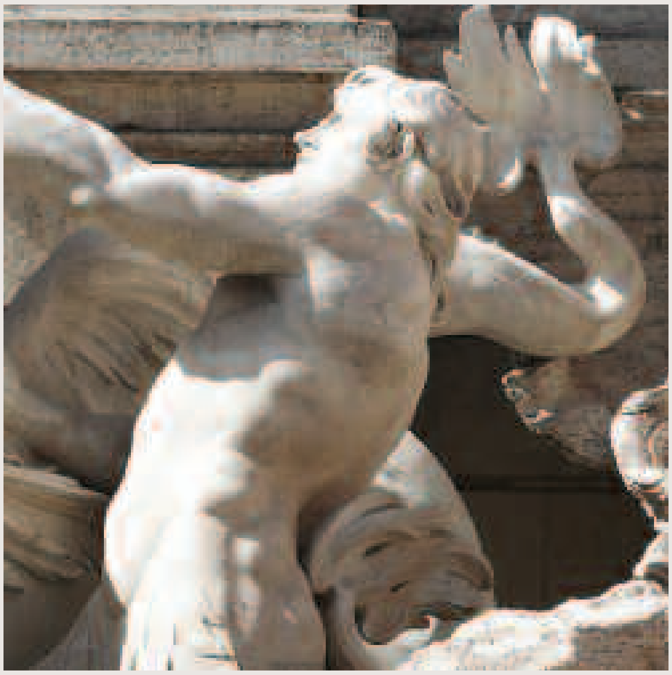
Treasurers can lend assistance to colleagues in both departments, especially if they find it difficult to convince some business partners of the financial merits of the scheme, although it is best not to engage directly in dialogue with suppliers and distributors.

NEW INTERMEDIARIES IN THE MARKET The banks have been joined as supply chain financing service providers by internet-based firms such as Prime Revenue and Orbian, which act as an intermediary between the supplier and customer.

Provided that both parties agree to the arrangement, the customer downloads internal records on invoices received, the progress of approved payments and payment due dates onto the intermediary's website.

The supplier, provided with secure access to this information, can check on the status of the invoice, verify that payment has been agreed and establish the scheduled date on which it will be made. Any queries or problems threatening to delay a payment can be investigated and swiftly resolved. This information, in turn, can be used as backing for any borrowings made by the supplier. Suppliers can also offer their customers a discount in return for bringing their payment commitment forward to an earlier date.

Achieving such as a system, which offers benefits to all participants, requires a degree of standardisation, particularly on the issue of electronic invoicing. Initiatives in this area, such as the financial sector's ongoing Single Euro Payments Area (SEPA) initiative,



will help both the acceptance and savings potential of supply chain financing schemes, while acceptance of electronic invoicing schemes is now picking up in many countries.

When such solutions were first developed they were generally seller-promoted models, says Pinn, and offered little incentive for adoption by buyers. Even now, take-up is relatively low, except in isolated markets such as the Nordic countries.

More recently, the focus has been on buyer-promoted models. Here, supplier adoption rates tend to be higher since they are incentivised by more reliable and timely settlement. In addition to seeing the potential of these applications to enhance their supply chain financing offerings, banks can bring their experience to bear in the field. Swift's TSU initiative and the European Commission's current e-invoicing work linked to SEPA will undoubtedly spawn further interaction by banks in this space.

Matthew Burns of Gresham Computing says that a number of companies have adopted online payment and information services in Australasia, but that the UK and Europe have been slower to embrace the concept. Gresham's Clareti cash reporting service, which employs the term 'receivables purchasing' as much as it does 'supply chain financing', signed up its first UK client in March, telecommunications group Cable & Wireless.

"Companies have to be convinced that the system doesn't involve risk being taken by the buyer, and we focus on companies with a good credit rating," says Burns. He expects more UK and European businesses to follow once the benefits of supply chain finance tools become evident.

A major attraction is that, in addition to providing the supplier with early payment, the buyer can gain a revenue stream. In addition to retaining capital for longer by extending the credit period, the buyer is also allocated part of the fee paid by the supplier for receiving payment ahead of schedule, with the remainder shared by the funding agent and the service provider.

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Executive summary

- Corporates have set up the US-based International Bank Compensation Group to standardise the bank billing process.
- The group's aim is to promote the introduction of a standard electronic billing statement which all banks offering cash management services will recognise and use.
- The experience of US corporates suggests they can work with banks on the value of bank services, eliminating those that are not cost-justified and increasing the value-add.

In the constant battle to maximise profit and shareholder return there are not many questions that a blue chip's finance and treasury team at the top of their game cannot answer. Best way to pool overnight long balances? Got that covered. Reducing foreign exchange settlement risk? All over that. Monthly cost and breakdown of your international banking transaction charges? Errrrr…

It's a question that surprisingly few corporates have confidence in answering. A combination of potentially hundreds of accounts, multiple banking relationships spread across many countries and currencies, and vague product descriptions all conspire to make the budgeting and reconciliation of charges almost a lost cause.

And yet bank charges represent a meaningful cost line in the finance team's annual expenditure. No wonder then that the distant rumblings of many years to bring greater visibility and standardisation to the bank billing process have become a central issue in the bank services conversation, led largely by a new industry group, the International Bank Compensation Group (IBC).

SINGLE AMBITION IBC numbers multinationals such as General Electric, EDS, Honeywell, Hewlett-Packard and Volkswagen among its participants and has come together with a single ambition in mind: to establish and promote the introduction of a standard electronic billing statement which all banks offering cash management services will recognise and utilise.

The new standard, known as Bank Services Billing, has been created by a working party made up of large corporates, a small number of specialist vendors and major international cash management banks. Bank Services Billing, or BSB to formally initiate it within the three-letter-acronym hall of fame, is the product of starting from a blank piece of paper. Consideration had been given to modifying the Ansi 822 standard, which has been the North American bank billing standard since the 1990s, but the combination of a having to accommodate cross-border tax regimes and foreign currencies outside the US led to a ground-up approach.

While the standard is all new, it does set out to deliver the major features and benefits that have become familiar to corporates

Standard billing

maintaining accounts in the US thanks to the existence of Ansi 822. These are:

- A common transaction name or code for each of the major cash management transaction products and variants offered by international banks, which eases the comparison of service charges between one supplier and another; and
- Standard message structure for billing information, which allows automatic reconciliation and exception management of billing data.

For solid evidence of the financial value of such standardisation, look no further than General Electric's experience. The company now has full knowledge of what has been paid away in bank charges and what is being accrued within the current billing period – which is extremely valuable within the context of complying with the needs of the US Sarbanes-Oxley law on financial controls. This cost transparency has enabled General Electric to focus with its banks on the value of bank services, eliminating services that are not cost-justified and increasing the value-added services.

WIDESPREAD USE After close to 15 years in service, the Ansi 822 standard is now in widespread use in the US. More than 90 North American banks produce 822 files and hundreds of corporates make use of them. The proliferation of BSB throughout Europe and beyond is expected to outpace the adoption of Ansi 822 and those that have seen the US standard mature cite two simple reasons for this:

- The benefits are proven and large corporates will insist on the BSB being a standard component of their banking service. We know that reference to BSB provision is already appearing in requests for proposals (RFPs), requests for information (RFIs), and so on, being issued by corporates as part of their regular cash management services review process.

- The corporates are tacking the issue in a concerted manner, not only through IBC but also through the Twist organisation. The corporate standards body has identified BSB as one of the initiatives it is supporting for industry-wide adoption.

Paul Burstein, Managing Director for Operations Services Corporate Treasury at General Electric, says: "The existence of BSB represents a defining moment for a bank. Adopt it, and a bank sends a clear signal that it intends to be at the forefront of the provision of cash management services. Pass up the opportunity and, well, that sends an equally clear signal."

LACK OF ATTENTION Steve Weiland, Chairman of the Weiland Financial Group, is the IBC's technical liaison and subject matter expert. He was a contributor to the Ansi 822 format and co-author of the BSB standard.

Weiland spoke at February's ACT Cash Management Conference and was surprised at how little attention European corporates had historically paid to the area of bank billing despite the benefits of cost control, enhanced investment opportunities and the needs of new compliance guidelines. He says: "From the experience of our solution user groups in the US, I'd predict the BSB will be a catalyst for a whole new raft of control and analytic possibilities within the European arena. With the banks producing standard billing statements, corporates, using the software solutions on offer, will be able to quickly reconcile charges, prioritising items that are way out of line with expectations.

"Even at the simplest level you'll probably see that the BSB standard will encourage corporates, perhaps for the first time, to create a database of comparative bank charges. Before the 'standardisation' of banking products across the market this was extremely difficult and open to subjective interpretation. 'What-if' scenarios, either to plan for an increase in transaction volume or the effect of concentrating business on a fewer number of suppliers, also becomes much easier once there is a common base of product names and the software is in place to exploit such data."

There is a fast-growing interest among banks and corporates, with discussions taking place on both the sell- and buy-side of the cash management services equation. It is not surprising that banks want to take a first-mover position on the topic as those customers that are demanding the service are typically their most prestigious – and dare one say – most profitable.

The most up-to-date BSB requirements document and XML schema can be downloaded from the Twist organisation's website at http://www.twiststandards.org/twiststandards/tiki-index.php?page=BBS_Q3

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