Free your suppliers

LEX GREENSILL EXPLAINS HOW SUPPLY CHAIN FINANCE CAN SATISFY TREASURERS' OBJECTIVES OF MAXIMISING WORKING CAPITAL WHILE MITIGATING RISK BY EASING THEIR SUPPLIERS' FINANCIAL CONSTRAINTS.

Supply chain finance (SCF) has come of age since the start of the credit crisis. Previously seen as a source of financing for small and medium-sized enterprises or companies in distress, an increasing number of firms, particularly large multinationals with the strongest credit ratings, have recognised the potential of SCF to help unlock liquidity and increase the robustness of their financial supply chain. In fact, according to Citi research, over 50% of S&P 500 companies now use some form of SCF to support their suppliers and optimise working capital.

Although SCF has emerged during the crisis, it is not a technique just for troubled times. As markets start to ease globally, the value of SCF remains undiminished, and could be even greater in the coming years. Credit will not be as cheap or accessible as in pre-crisis days, and optimising liquidity will remain key to funding future investments: according to a recent EuroFinance survey, 44% of treasurers are seeking to maximise surplus cash to reinvest in the business.

Over the coming months, we are likely to see the "bullwhip effect", which is already apparent in certain markets such as the US. Suppliers that have downsized may find it more difficult to access funding to support additional production materials and staffing than in pre-crisis days. Even a modest increase in customer demand is likely to put significant pressure on these firms. Furthermore, larger companies are also rebuilding their inventory, creating a spike in demand for these suppliers. However, according to the same EuroFinance survey, 30% of companies are paying invoices later, exacerbating suppliers' difficulties and jeopardising their clients' supply chain.

SUPPLY CHAIN FINANCING IN PRACTICE. SCF is often seen as resembling factoring, but this is not the case. Unlike SCF, factoring is seller-driven: the seller is the party seeking financing. The seller's ability to access capital is based on the value of the receivables rather than the credit status of the company, so it is best suited to companies with a lower credit rating. Factoring enables a supplier to receive amounts earlier than waiting for customers to make payment, which may be late and at the least unpredictable, so improving the supplier's ability to forecast cash and manage working capital.

Whereas factoring has no impact on the customer, except in as much as the invoice payee may change, SCF is buyer-driven, with programmes typically established by larger companies with a stronger credit rating than their suppliers. Figure 1 illustrates an SCF programme in practice, but there are some key points to note:

- Buyer, seller and the bank are connected through a central technology platform, which provides process efficiency, control, visibility and auditability for each party.
- While in a factoring programme, the bank has exposure to one seller and a number of buyers, within an SCF programme the bank's risk is concentrated in a single buyer, which is reflected in the way that the risk is priced. This means that if a supplier

chooses to receive early payment of an invoice, the cost of doing so is typically much lower than could otherwise be achieved.

- The buyer pays the invoice amount to the bank on the due date, and therefore its own working capital is unaffected by the supplier receiving early payment.
- In some SCF programmes, such as those supported by Citi, specialist terms such as supplier reserves and holdbacks can be incorporated, so that buyers remain in full control of their supplier payments.

Funding is non-recourse, which differs from more traditional forms of financing such as factoring.

There are few financial structures which can truly be said to create a win/win for both parties, but SCF is undoubtedly advantageous for both buyers and sellers (see Figure 2 overleaf). In addition to the processing and reporting advantages already highlighted, the benefits for the buyer include:

- Their financial supply chain becomes more resilient as key suppliers have greater financial certainty and are therefore in a better position to fulfil orders on time, reducing risk in the buyer's financial supply chain.
- As contracts are renegotiated, companies are in a better position to negotiate payment terms without negatively impacting on suppliers.
- The cost of processing is reduced as the number of supplier queries, in-house payments processing and payment fees are reduced.
- Relationships with suppliers are improved, with the potential for achieving better commercial terms.

For the supplier, the benefits are comparable. Cashflow is predictable, as invoices are settled on time by the buyer's bank. Working capital requirements are therefore reduced and cashflow is less constrained. This also enables the supplier to quote more competitive terms as the cost of late payment does not need to be factored into invoices.

There is the option to seek early payment as a means of financing. This financing is effectively pre-approved and is not subject to the supplier's financial standing. For companies that could not otherwise source financing, or where the cost would be prohibitive, this can be a major benefit. For those with alternative means of financing, credit lines are released for other purposes.

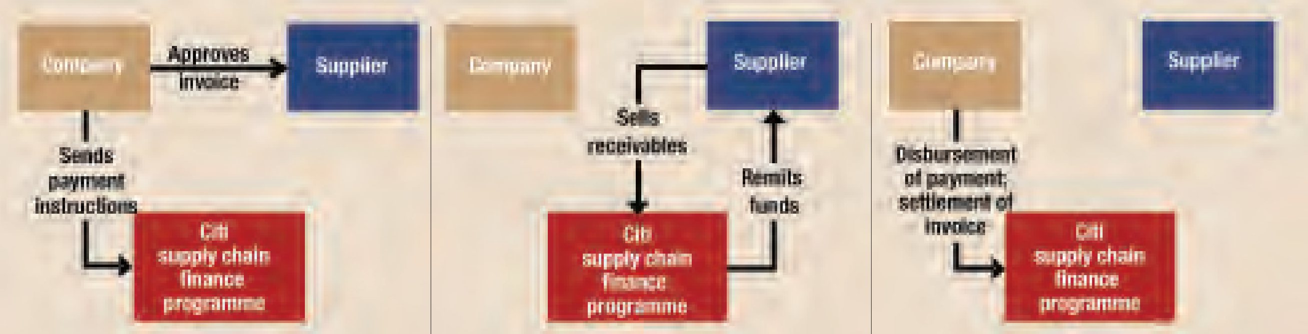
Reconciliation, account posting and management reporting are also enhanced as remittance information is provided in a format that can be integrated with internal systems.

AS MARKETS START TO EASE GLOBALLY, THE VALUE OF SCF REMAINS UNDIMINISHED, AND COULD BE EVEN GREATER IN THE COMING YEARS.

IMPLEMENTING A SUCCESSFUL SUPPLY CHAIN FINANCE PROGRAMME. There are several factors that contribute to the success of a SCF programme and ensure that both buyer and suppliers can leverage the potential advantages. In particular, the right SCF programme partner, with the global reach, expertise, technology platform and streamlined on-boarding process, is critical.

- **Global reach.** The banking partner needs the geographic coverage and global branding to give suppliers the confidence to join the programme. With over 57,000 active suppliers across 36 countries within its buyer programmes, Citi has the track record, reputation and proven capability that buyers and their suppliers require.
- **On-boarding process.** The on-boarding process should be as straightforward and convenient as possible for both buyers and suppliers. Citi has a structured approach to on-boarding, enabling all parties to gain rapid benefit from the programme. For example, once the buyer has introduced a supplier to the programme, Citi provides the supplier with

Figure 1: Supply chain finance in summary



Day 5*
Company approves supplier's invoice and electronically instructs Citi to pay the supplier on a future date. Supplier is notified of a payment from the company, scheduled for a future due date (eg, day 60).

Day 7*
Supplier may immediately and electronically discount the underlying receivables to cash without recourse at a very favourable funding cost. Citi remits funds to the supplier, typically same-day for next-day settlement.

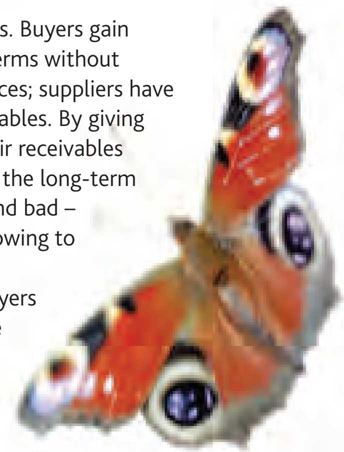
Day 60*
Company funds a disbursement account via normal accounts payable processes at maturity. Citi debits the company's disbursement account for the full amount of the payment on the due date (eg, day 60).

** Actual timing will be depend on company's processes and objectives*

comprehensive online and onsite training and support, a straightforward enrolment process and convenient mechanisms for automatically or manually discounting receivables. We have on-boarding teams in 16 cities globally to support our clients and their suppliers in their local language.

- **Technology platform.** The right technology platform is key to the initial setup, and the ongoing success of an SCF programme. The platform needs to be accessible across the supplier base, and to provide all parties with a secure, easy-to-use solution to support the process from invoice submission all the way through to approval, payment and discounting. The system needs to be integrated easily with internal systems, both buyer's and sellers', in order to optimise the purchase-to-pay process. Citi has developed an extremely successful, proprietary platform which delivers the efficiency, usability, control and management reporting required by our clients and their suppliers.
- **Experience and innovation.** Buyers need to be confident that their SCF provider will be able to deliver their service in a convenient, efficient way, as well as having the financial strength to fund the programme. With over 600 SCF programmes in place, Citi has experience of a diverse array of clients across the world. As banks such as Citi invest further in SCF, we envisage that these programmes will continue to increase in sophistication, convenience and flexibility, such as in risk participation and programme structuring.

THE FUTURE OF SUPPLY CHAIN FINANCE. SCF is not simply a temporary mechanism for supporting buyers and their suppliers during economic difficulties: it is a long-term alternative means of financing for both buyers and sellers. Buyers gain the benefit of extended payment terms without compromising their suppliers' finances; suppliers have the advantage of predictable receivables. By giving suppliers the ability to discount their receivables when required, the programme has the long-term benefit – during both good times and bad – of allowing the overall cost of borrowing to be reduced.



SCF has universal appeal with buyers and their suppliers globally, and the number of buyers seeking SCF programmes is likely to accelerate in the coming years. Companies which are looking for economic ways of funding new investments and positioning themselves for growth should be looking at SCF today as a vital means of increasing their competitive advantage.

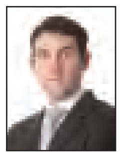


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Figure 2: The economics