Finance on tap

IAN ARMSTRONG EXPLORES HOW SUPPLIER PAYMENTS CAN BE A REAL WINNER.

As credit remains a scarce resource, companies are beginning to think outside the box to access the funding they require. Increasingly, Santander Corporate Banking is seeing its clients take advantage of supplier payments, a flexible solution which they can adapt to their own circumstances and which is particularly useful at a time of business volatility and uncertainty.

We have seen situations where successful companies with full order books have been caught in a pincer movement between a lack of finance from traditional sources and new working capital demands from their customers. While Santander has been expanding its presence in the corporate sector in the UK, others have been leaving the market, causing their clients to seek alternatives urgently. This market change may happen either as a general retrenchment from particular sectors or sizes of business, or because of concerns (often unfounded) over the future creditworthiness of a business. These concerns can lead to companies seeking to take out credit insurance, which not only increases costs but also sends out a wrong and unnecessary signal.

At the same time many companies have been reviewing working capital management practices and those (often large) companies that are in a position to do so have extended payment terms (for instance, from 60 to 75 days) for suppliers just when suppliers could have done with quicker payments.

Smaller suppliers will usually have the highest finance cost in the supply chain, so it makes no sense for the credit requirement to be sitting at that particular point in the chain.

Supplier payments can break this vicious circle. The solution uses the financial strength of the buyer to provide finance to the supplier at a lower cost than they could obtain elsewhere. When the goods are received and are matched to purchase orders and invoices, then the buying company tells the bank that the invoices have been approved for payment. The bank then offers early payment to the supplier in advance of the negotiated trade terms.

In terms of finance cost for the supplier it is hard to find a cheaper source: the supplier payments option is considerably cheaper than loans and overdrafts. At a cost of around 40-70 basis points it represents good value, and it alleviates the need to incur other costs such as credit insurance.

And while it represents a good opportunity for the supplier, it also works for the buyer. By reducing the risk of the supplier ceasing to trade, it lowers the risk of interruption to the buyer's supply chain. And perhaps more importantly, the company holds onto its cash, using the bank's balance sheet instead to help its supplier.

At pubs and restaurants group Mitchells & Butlers, purchasing director Susan Martindale says that after an initially low take-up until an open model was introduced, the supplier payments option has become a key tool in M&B's supplier relationship and support. Its main strength for the group is that it is administratively straightforward and simple to implement.

"For our suppliers, there are several benefits," she says. "It offers them certainty of settlement, as all approved invoices can be viewed on Santander's website. They have clarity as to which invoices have been passed for payment.

"There is flexibility of settlement timing and, in an environment of increasing credit terms, they can manage and maintain their cashflow and working capital while reducing their reliance on credit insurance. In all, it provides a source of early non-recourse payment, at a lower cost of finance with reduced risk. In fact the hardest part of the process has been convincing suppliers that all of these advantages don't come with strings attached!"

Those suppliers that do not require discounted early settlement can opt to receive full settlement on the due date.

While the supplier payments model is making its way in the UK it is well established in other parts of the world, with Santander having 275,000 buyers and suppliers using the scheme. One of the great attractions for suppliers is the flexibility offered. The terms and conditions offered to all suppliers can be standardised, which is of enormous benefit to the treasury and finance department in terms of efficient management of the ledger, and in terms of cashflow planning is very forecast friendly. And while all suppliers can be enrolled on supplier payments, the choice is theirs if and when they take advantage. Some will draw down the funds regularly; others will do so only at particular times in the year when cashflow is under particular pressure.

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