New routes, new efficiencies

AXEL-PETER OHSE LOOKS AT HOW THE MEANING OF FINANCIAL SUPPLY CHAIN MANAGEMENT IS EVOLVING.

Executive summary

Financial supply chain management offers companies the potential for significant cost savings, but the task also presents corporates and their banks with some formidable challenges.

Financial Supply Chain Management (FSCM), with its key components Supply Chain Finance (SCF) and Supply Chain Services (SCS), has been perceived by a growing number of companies in recent years as a means of squeezing out further cost efficiencies and improving their cashflow.

Much of the interest stems from the fact that the majority of companies have by now extracted most potential savings from their logistical operations. Having taken measures to reduce the cost of their global supply chains, such as outsourcing to low-cost economies, there is only restricted scope for further reductions.

As a result, the financial side of the supply chain is the focus for a new round of cost cutbacks and companies are looking to their banks to provide services through which they can achieve fresh savings.

With interest in FSCM steadily growing, the term has assumed a range of different connotations. For Deutsche Bank, our FSCM service proposition falls into three main areas of application:

- **SCF – Supplier Finance** as a programme to fund suppliers for multiple transactions on an ongoing basis under a revolving contract providing considerable benefits, not only to the buyer in the programme but also to the suppliers. It is supported by a "state of the art" electronic platform and is based on the extension of payment terms within the underlying commercial contract between buyer and seller.
- **SCF – Transaction-based Finance**, which allows the specific financing of single supply chain transactions before and/or after shipping. It could be combined with traditional documentary transactions and/or supply chain events based on purchase order or invoice basis and usually is chosen where full-blown electronic platforms would not be economical.
- **SCS – Supply Chain Services**, which offer tools to efficiently facilitate the processing steps and provision of formatted data to clients. They can be used to insource various processing steps, provide Global Sourcing services, offer trade-related risk analysis and hedging solutions and give client and transaction data for exception management, dispute management, reconciliation and others.

PARTNERS IN THE SUPPLY CHAIN How can cost savings be secured through FSCM? As an example, consider the following scenario:

A car parts manufacturer sources from 50 suppliers, which in turn also source from a wide variety of pre-suppliers. Each of these partners to the final product has its own bank relationship(s) providing credit on the strength of those banks' discretionary credit assessments. The partners in this supply

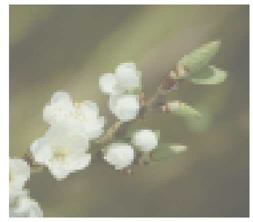


Figure 1: Supply chain and disproportionate commercial lending

Supply chain	Pre-supplier	Supplier	OEM	
Value of delivery	100	150	200	
Financing requirement	100	150	200	450
Available bank lending	60	120	250	430
Supply chain risk	100	50	50	200

Exemplified view
- bank lending does not match requirements
- bank lending not aligned to where it is needed
- bank lending aggregates rather than relating to underlying supply chain risk

Source: Deutsche Bank

SUPPLIER FINANCE IS ONE OF THE MOST CRUCIAL SERVICES IN IMPLEMENTING A FINANCIAL SUPPLY CHAIN STRATEGY, AND ONE THAT CAN ENHANCE THE PROFITABILITY OF ALL THREE PARTICIPANTS IN THE CHAIN.

chain do enjoy different credit ratings and not everybody in those various supply chain levels receives the credit which is necessary to finance the specific part in the supply chain. The challenges in this set-up are the absence of assessing the whole supply chain by most banks, credit pricing being insulated on each supplier/pre-supplier, the aggregation of credit process cost, missing visibility and transparency and the fact that bank credit is unlikely to be fully available at the right time with each partner in the supply chain. That in turn invites substantial cost by looking for funding outside the banking industry or by rebating to invite faster payment.

It is probably safe to say that most of the above inefficiencies end up as "cost of goods sold" for the car parts manufacturer.

Deutsche Bank has reviewed its own service offerings and the supporting technology to develop effective solutions. This is an ongoing exercise, with the aim – over time – of offering further enhancements, additional services and intelligent interfaces with the corporate world.

SUPPLIER FINANCE Supplier finance is one of the most crucial services in implementing a financial supply chain strategy, and one that can enhance the profitability of all three participants in the chain – the supplier, the buyer and the bank.

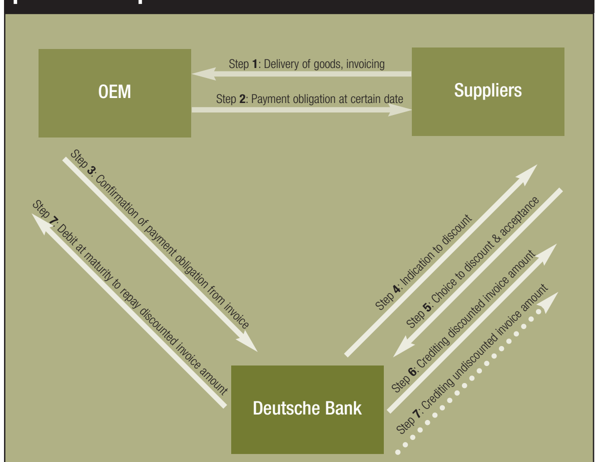
Yet only quite recently has its potential been realised. It has been helped by the fact that the application of supplier finance now extends across a company's entire financial structure, offering balance sheet optimisation, better risk management and overall cost reductions. In addition, more companies are recognising the qualitative benefits, such as improved efficiency and higher visibility of funds. At the same time, the mechanics of the supply chain have changed enough for supplier finance to become a more practical proposition.

How does it work? An effective supplier finance offering will provide financing at three distinct stages along the supply chain: pre-shipment financing, post-shipment financing and post-acceptance financing. Simultaneously the process of presenting necessary information and financing is managed on an electronic platform which links the key partners: sponsor, suppliers and bank.

In the first phase, the buyer informs the bank of a purchase by supplying purchase-order information, so that selected suppliers can be offered pre- and post-shipment financing to cover financing starting with the production phase. Upon shipment of the goods, suppliers provide the bank with invoice information so that the loan can be converted into post-shipment financing – also enabling a higher proportion of the transaction value to be financed in the supply chain. These programmes are sponsored by the buyer, who acts as "programme principal"; the bank's individual credit decisions will be based principally on the trading relationships between the buyer and his suppliers.

Post-acceptance financing – also known as payables-based supplier financing – covers the period between the creation of a payment obligation by the buyer and the maturity of the payment. Typically buyers suffer from paying too much due

Figure 2: Concept of payables financing in partnership



Source: Deutsche Bank

to inefficiencies of provision of funding and broken processes in the supply chain, whereas suppliers find it often enough difficult to access sufficient bank funding at attractive interest rates. These challenges can be addressed simultaneously by enabling buyer and sellers to swap comparative advantages.

Suppliers can access favourable funding thanks to the buyer's superior financial standing and simultaneously reduce total assets by selling receivables to the bank. The buyer can optimise its payment terms and streamline existing processes, additionally the buyer gains opportunities to positively influence the liability side of his balance sheet.

Employing a collaborative electronic platform, either the supplier provides invoice information or the buyer payables information into the system, eventually leading to a financing trigger and thus minimising dilution risk. It would be up to the supplier to initiate a discounting process.

For our example of the above car part manufacturer this would result in substantially lowering its cost of goods sold besides providing visibility and process improvements.

THE ADVANTAGES, SUCH AS ATTRACTIVE FINANCING RATES, CREDIT AT THE RIGHT TIME ON THE RIGHT SUPPLY CHAIN LEVEL AND CONTINUOUS AVAILABILITY OF CREDIT FOR SIMILAR COMMERCIAL TRANSACTIONS IS BALANCED BY THE NECESSITY TO PROVIDE THE BANK WITH THE NECESSARY INFORMATION ON AN ONGOING BASIS.

TRANSACTION-BASED FINANCE A fully fledged electronic platform to link a buyer with its suppliers might not be possible or economical for some supply chains, be it that process inefficiencies do not play a big role or be it that the buyer does not have the clout over suppliers to introduce such a platform. Here Transaction-based Finance (TXF) products help which enable either buyer or supplier to generate direct cash funding for specific commercial transactions, undertaken in day-to-day business operations and based on their proven operational performance.

Where transactional performance can be tracked down by companies providing data from their financial and/or physical supply chain, those transactions become traceable, transparent and visible to the bank be it on the basis of classical trade documents or simple purchase order and invoice basis. Such an approach helps to reduce the credit risk since it helps to factor in and evaluate performance risk in the supply chain.

In that respect TXF essentially focuses on isolating the operational performance element in commercial transactions. The value of the financing bank's potential access to the assets being funded is also relevant, but less important.

In relation to our above example, TXF can be used to supplement a potential Supplier Finance programme whereby various supplier levels can also help financing specific transactions over a TXF product concept. The advantages – such as attractive financing rates, credit at the right time on the right supply chain level and continuous availability of credit for similar commercial transactions – are balanced by the necessity to provide the bank with the necessary information on an ongoing basis.

As regards timing and phasing, Deutsche Bank offers TXF products to exporters/sellers starting with their acceptance of a commercial purchase order; i.e. for financing production cost on a "pre-shipment" basis and/or for financing their payment terms on a "post-shipment" basis where agreed in the commercial contract between seller and buyer.

For importers/buyers TXF products include financing of post-import periods, when corporates hold imported goods on their balance sheets on an inventory basis for onward selling, which is specifically of interest to trading companies. TXF products

perfectly link to the bank's related supply chain services, since the information made available through the process can be used straight through for value-adding services.

SUPPLY CHAIN SERVICES Global supply chain uncertainties include delayed or incomplete shipments, freight expediting expenses, unexpected customs fees or fines, foreign currency fluctuations, and unanticipated customer claims. Additionally companies try to move from Letters of Credit (LC) based payments to Open-Account payments to save on bank induced processing fees and save on human resources with expertise in LC handling, processing and legal knowledge and the associated continuing training need required to keep up-to-date. But all that creates new layers of operational and payment risk which can affect shareholder value or erode competitiveness. In response, Supply Chain Services could offer relief on various levels.

Assume in our introductory example that the accounts payable vouchering process takes as long as 30 days. If the company pays in 45 days, it gains over two weeks' visibility into the cash requirement. By contrast, under a letter of credit the company is usually required to fund its account no later than the next business day after presentment of documents. Besides the different payment risk, the problem with moving cross-border payments to open account is that the accounts payable vouchering process becomes far more complex. Paper-based cross-border trade documents still prevail in the majority of documentary trade business. Nearly 60% of original purchase orders are exchanged paper-based and for the price/quantity matching of incoming invoices 60% still involve a manual process. Although financial settlement terms have been standardised over the years, the underlying documentation chain still consists of multiple datasets and is derived from various data sources. These practices mean that information from many different sources must be integrated in order to provide the necessary visibility to make payment.

This is where SWIFT's Trade Services Utility (TSU) plays a role with its aim of offering a common data platform. The TSU provides a common standard for a simplified trade data set and a messaging service for matching this data for banks. This makes the exchange of trade data highly efficient, both between banks and also between corporates and banks. There is a parallel with the web-enablement already achieved by individual banks, which has assisted "traditional" documentary credits such as letters of credit and their underlying datasets. TSU goes further than individual bank solutions however, by offering a multi-bank, multi-country data standard and matching service.

Deutsche Bank's product development focuses on TSU-compatible services that encompass financing propositions, risk management and value-added service offerings such as enhanced transaction tracking capabilities. Additionally the bank offers insourcing services which help exporters to still employ Letters of Credit where counterparties insist on it and/or where it is not economical to employ specialised staff. In these circumstances the bank takes over responsibility for Letters of Credit-congruent documents.

FINANCIAL SUPPLY CHAIN MANAGEMENT SOLUTIONS CAN BE DEPLOYED BEST WHERE BUYERS AND SELLERS WORK TOGETHER IN PARTNERSHIP AND ARE PREPARED TO REVIEW THEIR OWN PROCESSES AND BE PREPARED TO MAKE NECESSARY ADJUSTMENTS.

Deutsche Bank provides for collaborative reporting tools and platforms, such as db-Infotr@ck which allow for an increased visibility and traceability of financial supply chain events and data and hereby perfectly links into the bank's SCF offerings.

WORKING TOGETHER Financial supply chain management solutions can be deployed best where buyers and sellers work together in partnership and are prepared to review their own processes and be prepared to make necessary adjustments. Such co-operation between partners is in many cases already successfully implemented on the physical side of the supply chain, so the next step will be to apply the same partnership approach to the financial side of the supply chain. The question is who would be the right partner and the right platform? It is clear that there is some desire for bank independent platforms and standards – but the key questions to answer here are about medium-term sustainability, new levels of operational risk, seamless linkage into SWIFT and payment platforms of banks. In particular it is necessary to understand who has the capacity to absorb financial losses for operational lapses. Banks collectively have heavily invested in stable and integrated payment standards and platforms and some banks have made additional investments to complement those by integrated value-adding services and applications, all with the target to seamlessly operate in their global network.

While this issue of FSCM is not completely settled, it is clear that much progress is being made.

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