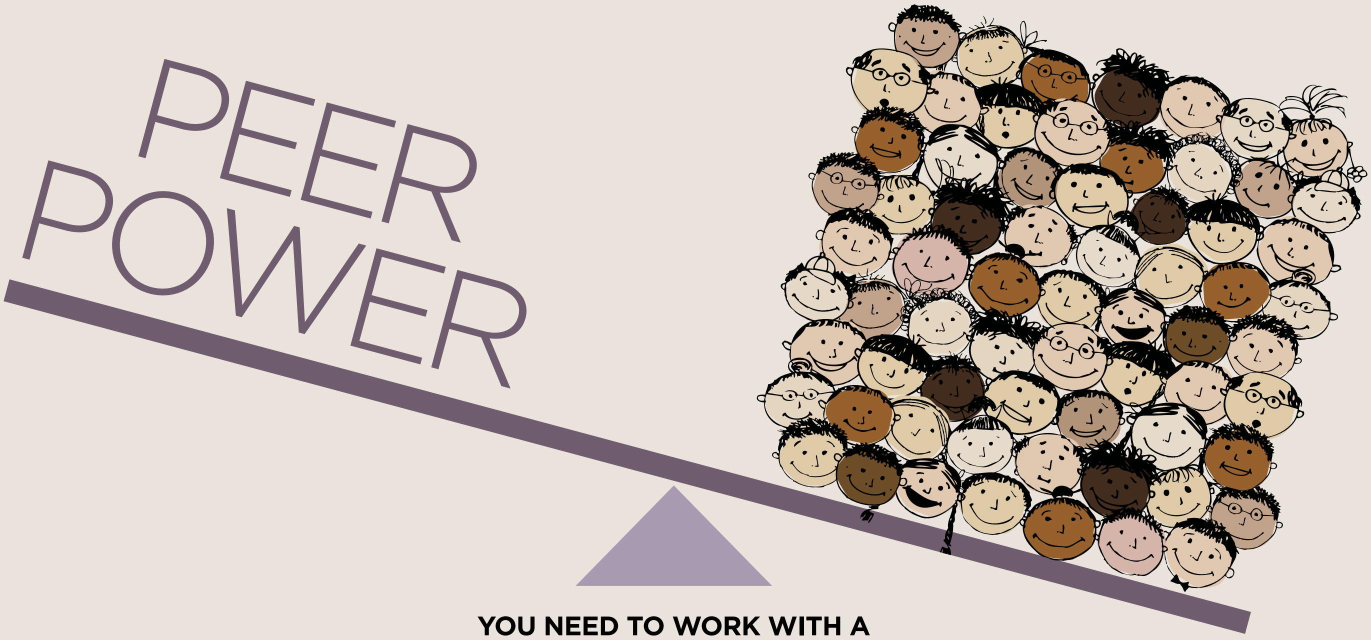
PEER POWER



YOU NEED TO WORK WITH A BANK IF YOU WANT TO SET UP A SUPPLY CHAIN FINANCE PROGRAMME, RIGHT? WRONG, SAYS TONY DUGGAN

Peer-to-peer lending is one of the most exciting trends in financial services right now. You are probably already familiar with the concept, but here is a brief recap: investors pool their resources together to make funding available to individual consumers and businesses in the form of a loan or equity investment. Advances in technology have made peer-to-peer lending viable on a large scale and some of the best-known names in the business include internet platforms Zopa, RateSetter and Funding Circle.

Now there is a new addition to the peer-to-peer club. This is peer-to-peer supply chain finance (SCF), which is an innovative form of working capital finance. With peer-to-peer SCF, a number of different investors join together to make funds available to corporate supply chains. These investors are typically hedge funds and pension funds that are looking for alternative investment opportunities offering attractive returns. Meanwhile, the suppliers within the chain that use peer-to-peer funding benefit from being able to access funding at more favourable rates than if they borrowed from a bank.

Peer-to-peer SCF is a simple concept. The SCF provider enters into a contract with a corporate where it agrees to pay supplier invoices and other payments that have been approved by the corporate earlier than the date on which they fall due. This is on the basis that the corporate will pay the SCF provider for the full amount of the invoices, according to its normal payment terms.

Peer-to-peer SCF is based on the principle that the buyer (the corporate) can capitalise on its strong credit rating to secure cheaper finance for its suppliers, which will usually have lower creditworthiness than the buyer. What happens is that the supplier's invoice is made available to investors through the SCF platform, which will then pay the supplier for that invoice sooner than the buyer would. In exchange, the supplier accepts a 'discount' because, by taking early payment, it is effectively taking out funding.

The flexibility and cost-effectiveness of peer-to-peer SCF is one of the reasons why it is attractive to corporates that want to finance their supply chains in the developing world. Small businesses in many emerging markets find it hard to access finance and, if they are successful, they may end up having to pay an exorbitant price for it. By contrast, they can get funding at more attractive rates through peer-to-peer SCF. This is a good way for corporates to support their suppliers in less developed parts of the world and to further secure their supply chains.

SUPPLY CHAIN FINANCE SPECIAL

Putting peer-to-peer SCF into practice

If your business is considering using peer-to-peer SCF, the best place to start is with a segmentation of your supplier base. Build a profile of your supply chain and broadly segment your suppliers into three groups – those that are comfortable, those that are struggling a little for cash and those that have serious cash-flow issues. It is the latter group that you will want to focus on since peer-to-peer SCF may be the marginal difference between survival and collapse.

Once suitable suppliers have been identified, the corporate introduces them to

BENEFITS OF PEER-TO-PEER SUPPLY CHAIN FINANCE FOR CORPORATES

- **Peer-to-peer SCF is a good way for corporates to support their supply chain by helping key suppliers that may often have significant cash-flow issues. This assures them of better security in the supply chain since some suppliers will provide components that may not be easily sourced elsewhere. Also, maintaining a healthy mix of suppliers means the corporate is less likely to suffer from price inflation when buying goods and services.**
- **With peer-to-peer SCF, investors are pooling together to offer funding. So this means that the corporate is not reliant on a sole funding provider, such as a bank, which could withdraw credit support for SCF programmes.**
- **Where suppliers use banks, factors or other finance suppliers, they are often required to sign over their whole debtor books. But with peer-to-peer SCF, there is generally no requirement to provide security of this sort. Finance may be taken on a regular or an ad hoc basis. For example, if they want, suppliers can finance just a single invoice through the platform in order to raise cash at a difficult time – for example, to pay the staff wages bill at the end of a quarter.**
- **Suppliers that are struggling for cash flow may be tempted to diminish the quality of goods and services they supply. The introduction of an effective and flexible SCF solution will help corporates to ensure they avoid this occurring within their supply chains.**
- **Unlike other peer-to-peer platforms, peer-to-peer SCF is not auction-based. This is a significant plus point since corporates would not want to introduce uncertainty into their supply chains through the process of auctioning invoices.**
- **Peer-to-peer SCF is easy to set up and can be scaled up and down depending on the needs of the corporate and its suppliers.**

the peer-to-peer SCF provider and encourages them to use it to address their working capital issues. The corporate uploads approved payment commitments to the SCF provider's platform. Then the platform will make an offer of finance, based on an algorithm that takes into account the credit ratings of the buyer and supplier, how many investors want to invest, and the rates at which those individual investors are prepared to lend. Once an offer is made, the supplier can decide if it is happy with the rate and accept or decline it accordingly. Unlike other peer-to-peer lending platforms, peer-to-peer SCF is not a public auction process. Instead, investors will identify in advance the profiles of companies whose invoices they are willing to finance by considering factors such as their credit rating.

Generally, a corporate would not make all its invoices available for financing through a peer-to-peer SCF platform; it would focus on using the platform to support suppliers that are particularly struggling with their cash flow and unable to secure funding from their banks. By using peer-to-peer SCF, the corporate is able to ensure that its supplier – which may be absolutely critical to the functioning of its business – is able to access working capital as and when it needs it. (See box above.) Suppliers can log on to the system each day and choose which invoices they want to borrow against, if any. They may receive cash into their bank account as soon as the day after they've accepted an offer.

Technology plays an important role in peer-to-peer SCF. Suppliers submit invoices and other payment requests onto a cloud-based transaction-processing platform. From then, the transaction flow of invoice processing and approval by the buyer, payment to the supplier and settlement to the investors, is all managed using automation. As well as algorithms, behavioural data is used to predict demand for finance, allocate funds, calculate returns and manage risk.

While peer-to-peer SCF is not regulated in the same way as the banking sector, it still adheres to the same high operational standards as the rest of the financial services industry. For example, an SCF provider will have a robust credit compliance team in place to access the risks and it will carry out thorough due diligence on both the corporate customer and its suppliers. It will also need to abide by data protection and anti-money-laundering regulation.

The development of the internet and the cloud, together with the changing landscape of the financial services sector, is driving innovation in funding and payments. If your company is looking for a flexible way to support its supply chain, and gain an advantage over its competitors in the process, then peer-to-peer SCF is an option that you need to consider. If you're wondering about the depth of the peer-to-peer SCF market, it may reassure you to know that it can already support billions of pounds' worth of corporate purchases.

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Tony Duggan is CEO at Crossflow Payments. For more information on peer-to-peer SCF, see www.crossflowpayments.co.uk

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