UNLOCKING THE VALUE

HOW ARE LEADING EUROPEAN CORPORATES LEVERAGING SUPPLY CHAIN FINANCE SOLUTIONS TO MINIMISE PROCUREMENT COSTS AND OPTIMISE WORKING CAPITAL? LUCAS ARANGUENA EXPLAINS

Supply chains are becoming increasingly interdependent, global and complex. Despite such sophistication, European corporates have $1 trillion of working capital unnecessarily trapped in the system.

The cost of carrying working capital is often pushed down the supply chain towards smaller suppliers, which tend to have higher costs of funding and less access to credit than the large buyers they serve. As a result, the supply chain is wracked with expensive inefficiencies and financial risks. Hence, value is being locked up – to the detriment of all the players within the chain.

The recent financial crisis was a difficult period for many. Throughout the supply chain some hard lessons were learned about the importance of supporting the supply chain and controlling working capital. So perhaps it is not surprising that, as we emerge from this period, we are seeing a greater number of top European companies take a more holistic approach to the way they manage their supply chains. Primarily, they want to use their strong credit to support their suppliers who typically have lower creditworthiness than they do. So the question for those companies is: how can they effectively leverage their stronger credit to support their suppliers without having to shoulder the burden in terms of working capital or liquidity?

One effective solution can be found in supply chain finance (SCF), which is why adoption of SCF is on the rise across Europe.

Win-win approach

The concept behind SCF is simple; a buyer gives its suppliers the option to be paid early for its invoices. This is done by the supplier selling its invoice to the buyer's bank and accepting a 'discount' in exchange for early payment. Alternatively, the supplier can wait until the invoice falls due, in which case it receives the full amount owed.

Strategic and financial objectives typically vary throughout the supply chain. But the beauty of SCF is that it is a 'win-win' approach for both buyers and suppliers.

Suppliers win because they can sell their receivables to the bank for an immediate cash injection and get on with growing their business. This represents an opportunity for the supplier to access cheaper funding without stretching its own banking lines, since credit risk is assessed according to who the buyer is. Suppliers may also save more money because their buyer's commercial risk passes to the bank, making credit insurance redundant. The buyer will pay their invoices as usual – only their trade creditor is now the bank and not their supplier.

Buyers win because they will secure their supply chain at no cost or detriment to their own working capital position and, in addition, it may put them in a position to agree more favourable payment terms or to negotiate a lower cost for goods in future. More strategically, SCF is often used as a way to minimise sourcing risks and strengthen relationships with key suppliers.

Both buyers and suppliers benefit from the greater transparency that accompanies the invoice-approval process under SCF, as well as reduced administrative costs.

SUPPLY CHAIN FINANCE SPECIAL

Although SCF is already well established in some European countries, such as Spain, adoption has been slower in some others, such as the UK. One reason for this may be that corporates are put off by the implementation process because they perceive it as resource-intensive or because they see peers that have implemented a programme, but have not extracted all the benefits.

Getting started

There is a misconception that implementing an SCF programme is difficult. Certainly, careful planning is needed to set up the programme, but once this has been done, the system and process changes are minimal, and for the majority only minor IT development is required. Implementing an SCF programme typically takes between four and eight weeks in total. Once implemented, however, it requires minimal human intervention, even reducing the operating burden on each side of the value chain.

To establish a successful programme, it is important to follow the steps below:

◆ **Set clear objectives at the outset.** When SCF programmes fail, it is usually because the corporate's objectives have not been clearly defined and communicated throughout the organisation. Know what you want to achieve with your programme and how you will set about doing it.

◆ **Put a multidisciplinary team in place to manage the implementation.** Swift implementation requires

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buy-in from many parts of the company including representatives from the IT, legal, procurement and treasury functions. Securing senior-level sponsorship is a powerful way of ensuring alignment throughout the organisation.

◆ **Choose the right partner** (see box below) and agree key deliverables with them.

◆ **Plan supplier on-boarding carefully with your SCF partner.** If you don't on-board your suppliers into the programme correctly, you won't reap all the benefits that you should. Make sure you communicate effectively with suppliers about the objectives of the programme and emphasise how it will help them to gain access to cheaper funding and greater control over their cash flow and liquidity. Don't treat all your suppliers the same way. Make sure you segment them according to their creditworthiness, current trade terms and the relevance of the existing trade relationship for both you and them.

◆ **Review the programme quarterly.** Review the contribution of the programme against the objectives that were outlined at the outset and plan a new course of action if necessary. Ensure that your SCF partner has strong management information system capabilities since this will prove a very powerful tool throughout the life of the programme.

Taking it to the next level

Putting an SCF programme in place is not the end of the journey; it is just the start. So those corporates that already use SCF have some exciting options in terms of taking it to the next level and extracting more value.

With the support of their SCF partner, corporates can look at integrating additional functionality so that suppliers can choose the currency in which they wish to discount their invoices. They can offer e-invoicing solutions to further reduce the operational burden and increase controls on both buyer and supplier. Corporates may even be able to extend payment terms for their biggest and strongest suppliers, while avoiding difficult negotiations by using their bank to intermediate the trade flows. Another way of taking SCF to the next level would be to extend the benefits to a wider spectrum of suppliers, maybe further down in the supply chain, so that the company's direct suppliers can further benefit.

Conclusion

While SCF is not yet mainstream, its popularity is growing rapidly. Most multinationals already have an SCF programme in place and we expect that SCF will become as commonplace as letters of credit or factoring over the next decade. Since no supply chain is ever isolated – your company's suppliers will provide goods and services to your competitors – your company could soon find that it is at a competitive disadvantage if it does not adopt SCF. SCF may only be in its infancy today in some markets, but it is set to be a powerful payment model in future.

HOW TO CHOOSE THE RIGHT SUPPLY CHAIN FINANCE PARTNER

Below are some considerations to bear in mind when choosing an SCF partner:

◆ ***Financial stability.*** Your business is making a significant investment by establishing an SCF programme, so it will want a partner that can stay the course.

◆ ***Safe and user-friendly IT systems.*** Choose a partner that has a solid IT infrastructure so that the SCF programme runs smoothly. Make sure the systems are user-friendly for both buyers and suppliers, and adaptable to the needs of each business.

◆ ***Experience.*** Use a partner that has extensive experience of running SCF programmes. An experienced partner will have a lot of insight, which will enable them to minimise implementation issues and advise on matters such as how to segment your suppliers and how to market the programme to them. Also, make sure that your partner can offer more sophisticated solutions down the road, to ensure that the programme can be taken to the next level, if necessary.

◆ ***Dedicated on-boarding resources.*** Check that your partner has a dedicated team to on-board suppliers. This will ensure that on-boarding proceeds smoothly and relationships with suppliers stay strong.

◆ ***International presence/geographical footprint.*** If your business operates internationally now, or is likely to do so in the future, you will need a partner that has the capability to on-board suppliers from around the world and communicate the benefits of the programme in the suppliers' local languages.

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