

## Supply Chain Finance: Flexibility and Ease of Implementation

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### The Challenge

As corporations seek to improve financial performance through enhanced working capital management, many are pursuing supply chain financing — an innovative financial solution with diverse benefits that appeal to both buyers and sellers. Interest is quickly growing, with more than two thirds of companies reporting that they are investigating or establishing supply chain management programs to lower end-to-end costs (*Aberdeen Group, Supply Chain Finance Benchmark Report, Sept. 2006*).

The reasons are clear. Hackett-REL, the Total Working Capital Practice of the Hackett Group, says days working capital for the average company shrank by 5.6 percent in 2005, compared to a decline of 3.6 percent in 2004. They also indicate the nation's 1,000 largest firms still have about \$450 billion tied up in working capital in the form of overdue receivables, invoices that were paid too early and excess inventory. And, according to Killen Associates — a leading market researcher — the typical billion-dollar company unnecessarily spends about \$27 million annually for working capital and inefficient processing.

The emergence of robust financial supply chain solutions signals the start of the next corporate paradigm, bringing financial and operational benefits to the heart of businesses today. According to the Aberdeen Group's study, on average, best-in-class buyers enjoy 13.6 days greater days payable outstanding (DPO) than their peers, and obtain trade financing at an annualized rate 2.86 percentage points lower. And, suppliers enjoy better metrics too.

The information presented in this article will help you understand how this solution works and how it might benefit your organization.

### The Supply Chain Finance Solution

Unique in terms of its flexibility and ease of implementation, the Supply Chain Finance solution often supplements existing accounts receivable / payable programs to support a company's working capital and corporate goals. Its low implementation costs and minimal impacts on technical infrastructure add to its appeal.

To get started, supply chain finance providers generally collaborate with the financial and procurement executives

from the Buyer's organization to identify the types of Suppliers who would benefit from a Supply Chain Finance solution. Together, they customize the approach to accommodate each participant's working capital and cash flow needs.

### How it works.

In a typical scenario, a Supplier sells goods to a Buyer and requires payment according to trade terms, such as net 30 days. In the traditional business model, the Supplier would then wait a minimum of 30 days to receive its money. Occasionally, the Buyer might unilaterally extend its payment terms. During this time, the Supplier might finance its receivables via mechanisms such as receivables securitization, asset-based loans, factoring or various other methods. Often, there is a fairly significant cost for this financing.

Trade payables finance can help both the Buyer and the Supplier avoid this common situation with a few simple steps. The process looks like this:

- The Buyer purchases an item from the Supplier.
- The Supplier invoices the Buyer with terms of net 30 – 90 days.
- The Buyer signals its intent to pay the Supplier.
- The Supply Chain Finance provider may fund the Supplier at a discount in as early as 2 business days.
- When the original payables liability is due, the Buyer funds the Supply Chain Finance company.

### Why Suppliers like it.

Supply Chain Financing gives Suppliers a low-cost source of financing as opposed to the traditional sources of financing listed above. Suppliers know with certainty when they will be paid, which is a significant benefit to their cash forecasting capability. They can also:

- Accelerate cash flow to decrease the amount of working capital required.
- Reduce Days Sales Outstanding from 30 to 90 days to only 2 or 3 so that they can pay their own debts faster, cut interest payments and accelerate the cash-to-order cycle.

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- Gain visibility into approved invoices.
- Deter situations where problem invoices may go undetected, thus tying up money that the seller could use to run its business.
- Virtually eliminate credit risk.
- Improve their own credit ratings.
- Decrease administrative expenses for invoice reconciliation.
- Increase purchasing power, while supporting production and sales.

Some Suppliers use Supply Chain Finance to augment the lines of credit they offer to select Buyers, while also limiting their risk exposure. In doing so, they may increase the amount of business they do with their clients without violating credit limits or trade credit insurance thresholds.

## But what about Buyers?

While the benefits aren't as apparent, Buyers who participate in a Supply Chain Finance arrangement stand to gain as much as sellers...if not more.

Supply Chain Financing provides Buyers with extended payment terms, enabling them to increase Days Payable Outstanding and free up working capital. ***By establishing a more predictable and economical payment process for their Suppliers — using significantly lower cost financing alternatives — Buyers gain a financially stronger supply chain.***

In addition to optimizing DPO by extending or standardizing terms, Buyers also stand to benefit from:

- Unilaterally adjusting payment terms without negative effects on the supply chain.
- Reducing costs for products / services.
- Converting traditional paper payments to cheaper electronic funds transfers.
- Lowering working capital requirements.
- Improving supplier relationships.
- Obtaining an unsecured credit line since they can extend their procure-to-payment cycle.
- Increasing cash flow to reduce debt and avoid future borrowing under secured lines of credit and, therein, reduce interest payments.

## Who provides Supply Chain Finance services?

You will find that some banks, technology companies, and specialty financial services firms provide Supply Chain Finance solutions. If you are looking, seek a provider with an in-depth understanding of working capital management. To find the “right” fit, you should carefully consider the numerous aspects of the solution you seek to implement. Ask potential providers about their:

- Technology solution.
- Sources of financing.
- Implementation process and the amount of work the Buyer has to do.
- Willingness to customize solutions.

## Who uses Supply Chain Finance solutions?

Supply Chain Finance solutions are largely used by companies in the manufacturing, distribution, and retail industries. Companies that need extended payment terms or desire additional credit find the option especially appealing.

## The bottom line.

Supply Chain Finance solutions will likely become increasingly popular as CFOs and treasurers seek solutions that integrate cash management, trade settlement and finance and logistics management to improve their working capital efficiency.

If you are thinking about implementing a solution, I invite you to contact Dan Reiff, SourceNet's senior vice president of Business Development, at (979) 691-7800. Dan will further explain how both Buyers and Suppliers of goods and services can benefit from a supply chain finance solution that provides a low-cost, secure method of settling commercial trade transactions.



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