

# Reinventing Supply Chain Finance

*Unlocking Strategic Value for Procurement,  
Supply Chain, and Finance Professionals*

## Part 1: Holistic Supply Chain Finance



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## The Supply Chain Finance Opportunity— How Much Are You Leaving on the Table?

In most companies, supply chain finance is seen as a narrow and limited tool rather than a strategic enabler of success. As a result, a lot of unrealized value is left on the table. Whether you are in finance, supply chain, or procurement, supply chain finance has the potential to help you provide more strategic value (see sidebar, “*Three Roles, Three Perspectives, Three Potentials*”).

In fact supply chain finance, done right, can generate strategic value throughout the P2P lifecycle, particularly in assuring continuity of supply, reducing COGS,<sup>1</sup> meeting profitability targets, creating more sustainable supply chains, and reducing time-to-market and lead times. Here we explore how taking a holistic approach to supply chain finance, underpinned by a foundational network platform, enables companies to obtain this strategic value.

This paper is organized into two parts:

### Part 1: Holistic Supply Chain Finance:

An explanation of the concept of holistic supply chain finance and network platforms.

### Part 2: Core Capabilities and Benefits:

A description of the core foundational capabilities required of an organization to implement holistic supply chain finance, as well as the benefits that are being achieved by companies taking a more holistic approach to supply chain finance.

### Three Roles, Three Perspectives, Three Potentials

Procurement, supply chain, and finance all have a degree of involvement in most supply chain finance programs, but they each tend to view it from their own limited functional perspective:

- Supply Chain—The supply chain executive often views supply chain finance (SCF) as primarily a financial function. In fact, SCF has the potential for assuring continuity of supply, making the supply chain more agile, and bringing down total costs.
- Finance—The treasurer or financial executive may not fully appreciate the important role SCF can play in cash management.
- Procurement—To many procurement professionals, all the ‘glory’ is in the sourcing phase. Once they’ve found the right supplier and negotiated the right deal, then the rest of it is considered to be just tactical execution. They may not recognize how much SCF can do to help improve suppliers’ performance and financial health.

Because of this mindset, *most manufacturers and retailers miss out on a lot of the value potential of supply chain finance, particularly when it comes to procurement of direct materials.*



<sup>1</sup> COGS = Cost of Goods Sold, of which the cost of input components and materials is often a major or the largest portion.

## Holistic Supply Chain Finance

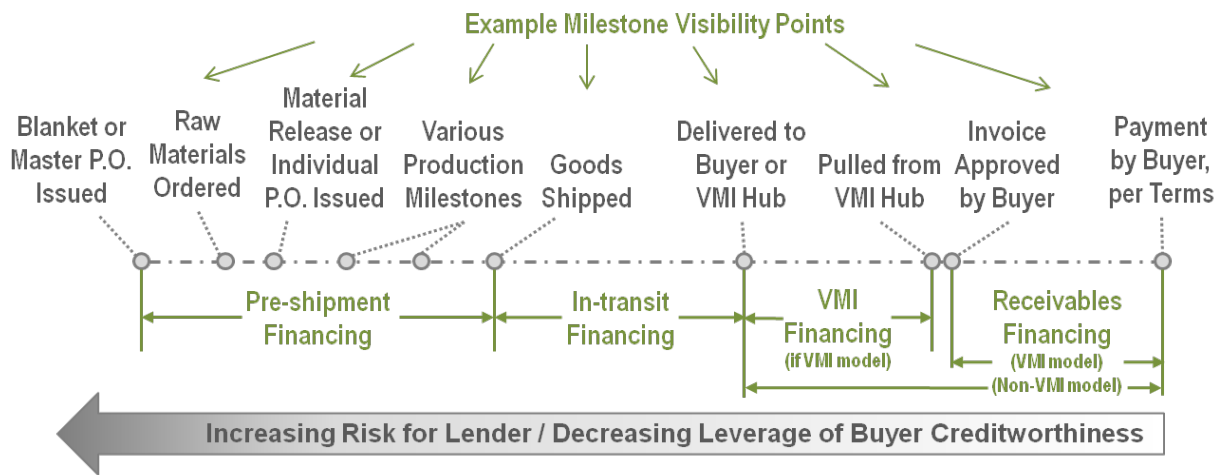
The full value of supply chain finance (SCF) is realized when a broader and more unified holistic approach is taken, comprising:

- A) Full Life-cycle SCF—End-to-end supply chain financing, across the entire P2P order lifecycle includes pre-shipment, post-shipment, and post-invoice financing options for suppliers.
- B) Networked SCF—A unified and connected network of trading partners includes and connects all parties participating in the various transactions and the management and movement of goods, throughout the end-to-end P2P lifecycle. The network should enable interparty collaboration, support automated workflows, and provide tools to help suppliers achieve high levels of compliance in pick, pack, ship, and fulfillment-related data/documentation.

We explore both facets of holistic SCF below.

### Full Lifecycle Supply Chain Finance—Across the Procure-to-Pay Lifecycle

Many people equate supply chain finance only with indirect procurement, and/or only with providing suppliers with early payment programs, or the ability to sell or borrow against their receivables (i.e. factoring or reverse factoring). These are important components, but there are also significant opportunities for improving financing at each stage in direct materials procurement throughout the P2P process, such as pre-shipment and post-shipment financing. Many buyer firms consider earlier financing to be the supplier's headache. As a result, those buyers miss out on the many benefits that can be obtained by helping their suppliers who need cash earlier in the cycle.



Source: ChainLink Research

**Figure 1 – Examples of Potential Visibility Points and Lending Milestones Across the P2P Order Lifecycle**

Of course suppliers may already be able to borrow money at various stages using traditional means ... but often at prohibitive interest rates. In particular, smaller suppliers in emerging markets often have tremendous difficulty accessing affordable capital. This creates all kinds of inefficiencies, delays, and extra costs in the supply chain. However, when lenders can be provided with A) much better visibility into progress on the

ground against actual milestones for each order and B) an agreed system and legal framework that provides them date-certain confidence in getting paid, then it lowers their risk considerably. This dramatic reduction in risk translates into a much lower cost of capital. Injecting affordable capital into the supply chain at these various points in the cycle, when and where it is most needed, can be transformative. It lowers end-to-end costs; enables suppliers' growth and health; helps buyers effectively leverage early payment discount programs; creates more opportunities for lenders to provide financing earlier and longer; and gives suppliers many more choices (from more lenders and hence more competitive rates) for their financing needs. In this paper, we will discuss how these capabilities can be made available to lenders, buyers, and suppliers.

## Networked SCF— Leveraging a Unified/Connected Network of Participating Parties

Many different parties participate in the end-to-end P2P order lifecycle, including the buyer, seller, transportation carriers, brokers and forwarders, customs agencies, private inspection firms, banks and other lender financial institutions, and others. To provide the type of holistic visibility described above in a feasible and cost effective manner, it requires connecting all of these participating parties on an underlying unifying network. This network must provide a real-time single-version-of-the-truth, based on reliable capturing and reporting of actual events on the ground as they happen. It also requires a multi-enterprise workflow capability that drives timely assignment and completion of various tasks, immediate delivery of information, and instant alerts when there are issues that need attention.

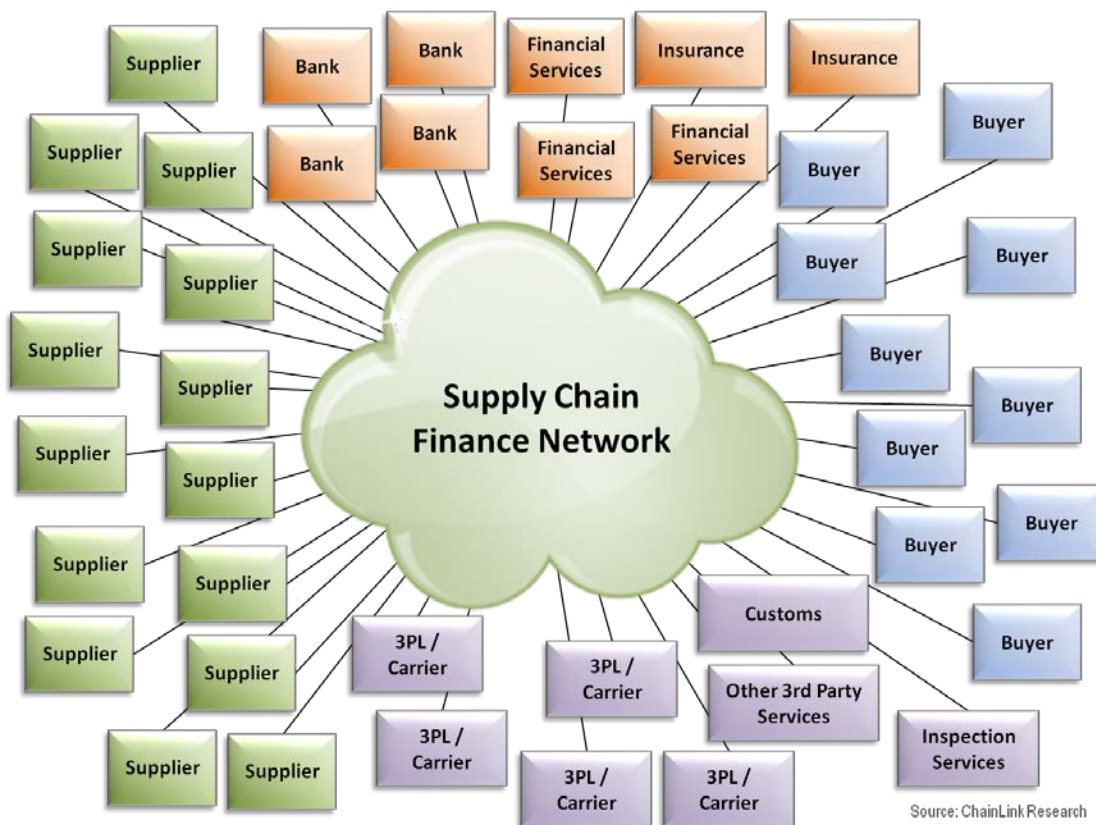


Figure 2 – Unifying Network of Participating Parties



Once this type of holistic, end-to-end network is in place, a wide array of dramatic improvements to supply chain finance (and operational performance in general) become possible.

## Increasing Margins—Lowering Risk, Cost of Capital, and COGS

Profitability is top of mind for most senior executives, being one of the key metrics of success for the firm, and one that the leadership team is often personally measured on.<sup>2</sup> Procurement and supply chain professionals in particular have accountability in the cost-reduction side of the profitability equation. They are tasked with finding ways to reduce the cost of materials and operations. However, they often miss significant opportunities from the cost savings that are made possible by reducing the cost of capital for their suppliers. The supplier's cost of capital is often ultimately passed along to the buyer. Holistic supply chain finance provides a number of ways to reduce the cost of capital.

Traditionally if a supplier needs pre-shipment financing, they have to approach their bank or other lenders within their own country. The loans are based on the supplier's credit rating and the going rates in their country. For small or medium sized suppliers in emerging economies, these rates can be exorbitant. Radically lower interest rates occur when a holistic supply chain finance approach is used. The underlying unifying network platform, connecting all of the participating parties, provides a number of ways to lower risk for lenders and dramatically lower the cost of capital for suppliers:

- **Milestone progress visibility**—Lenders can get timely, high-confidence visibility into progress against milestones such as when the PO is issued, amendments issued, raw materials ordered, production milestones occurred, order shipped, inspection completed, order received, and invoices approved. This reliable direct visibility makes it much simpler for lenders to tie payment to achieving certain milestones.



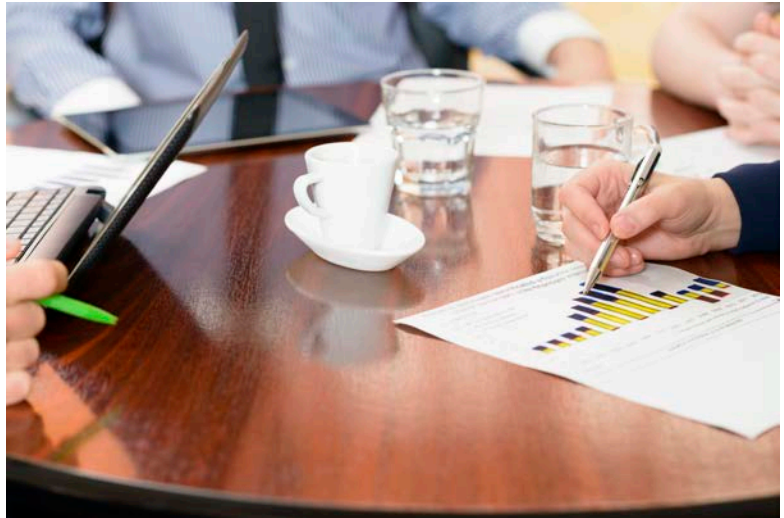
- Lower Lending Risk
- Increased Lending Competition
- Lower Lending Rates
- Lower Cost of Capital
- Lower COGS

Source: ChainLink Research

**Figure 3 – Holistic SCF Capabilities Lower the Cost of Capital**

<sup>2</sup> In particular for public companies, their stock valuation is often highly influenced by earnings, the P/E ratio being one of the most widely used metrics. Stock often accounts for the majority of compensation for top executives, so the value of the stock means a lot to them. Further, they are answerable to shareholders and the board who have the power to remove underperforming executives.

- Past performance visibility—The lender can see exactly how the supplier has performed in the past, including metrics such as on-time delivery rates, inspection failure rates, and so forth. This is particularly critical for pre-shipment financing. The legal framework described below removes the supplier's credit risk from the equation. The primary risk left for the financial institute is supplier non-performance. Consistently performing suppliers can thereby obtain much lower interest rates, since lenders will see by the past performance data that the risk is low.
- Legal framework/Automated payment—This is critical for lowering risk for the lender, who no longer has to rely on the supplier to pay them back the loan. Instead, the buyer has committed to pay according to the agreed terms and the money is automatically transferred on the due date, independent of any commercial disputes the buyer may have with the seller. The lender gets date-certain payment and, with visibility into the supplier's past performance, knows the probability of non-performance. Disputes between buyer and seller are much less likely, since everyone is working off of the same data and single-version-of-the-truth, with the network platform acting as the agreed system of record between trading partners. This results in far fewer disagreements on what was ordered, what was shipped, and what was received, when, and in what condition.
- Competitive lending marketplace—Instead of relying exclusively on their local bank or a small handful of in-country lenders, the supplier gets access to an international marketplace of potential lending institutions. A much broader pool of lenders are competing for the supplier's business, hence the supplier gains access to competitive rates around the globe.
- Accurate and timely data/documents—In a highly secure electronic network, data from the original PO flows automatically to create shipping documents which are used to create the invoice. This virtually eliminates the numerous errors that occur when each company rekeys all the data as documents flow between the different entities involved. Status is updated electronically, much closer to real-time, without the cost and delay of sending physical documents all over the world via courier.



As a result of all these factors, suppliers gain access to cash not previously available to them, at considerably higher advance rates, and lower discount rates than typically available in their local markets using traditional methods. The impact is truly significant.

## Early Payment Discount Programs— Interest Rate Arbitrage Opportunities

Connecting through a common network-platform creates a convenient mechanism for suppliers to receive accelerated payments and for buyers to receive discounts for those early payments. Buyers that have available cash can fund the program themselves. Alternatively, these programs can be funded by financial institutions. Suppliers can opt-in to be automatically paid early at a discounted rate. These can include dynamic discounting, where the discount rate depends on how early the payment is made.

Early payment is a win-win for both parties. These days corporate treasury managers struggle to get even 0.5% interest for the cash they have on hand. On the other hand, their overseas suppliers are often paying 10% or more for short term loans to provide cash for their operations. By splitting the difference, the supplier gets early funding at rates that can be less than half of what they are currently paying, while corporate treasurers get 5X or even 10X their current rates for cash on hand. Furthermore, with an automated electronic platform, the procure-to-pay process is streamlined, and payment approvals are made much more quickly (often weeks earlier). For example, the platform can approve invoice payment based on e-POD (electronic proof-of-delivery) from a third party logistics provider scanning and verifying the goods delivered right there at the receiving dock, instead of waiting for a goods receipt document to be issued by the buyer's systems. This acceleration of invoice approval enables longer discount windows and hence higher returns for the buyer, and earlier access to cash for the supplier.

### Columbia Sportswear's Early Payment Program

Columbia Sportswear is a \$1.6B outerwear and sportswear manufacturer. They have been using the supply chain finance capabilities available on the GT Nexus platform to offer early payments to their suppliers at a discount. About 25%-30% of their vendor base is taking advantage of this program. Columbia discounts at the equivalent of about 4% per annum, which is win-win for both Columbia and the supplier. Most payments are auto-approved, so the supplier gets paid the next day and Columbia gets the maximum discount rates. Columbia runs about \$800M of payables through the platform. The automation of the network platform has also streamlined accounts payable operations—Columbia only has 1.5 FTEs in their AP department.

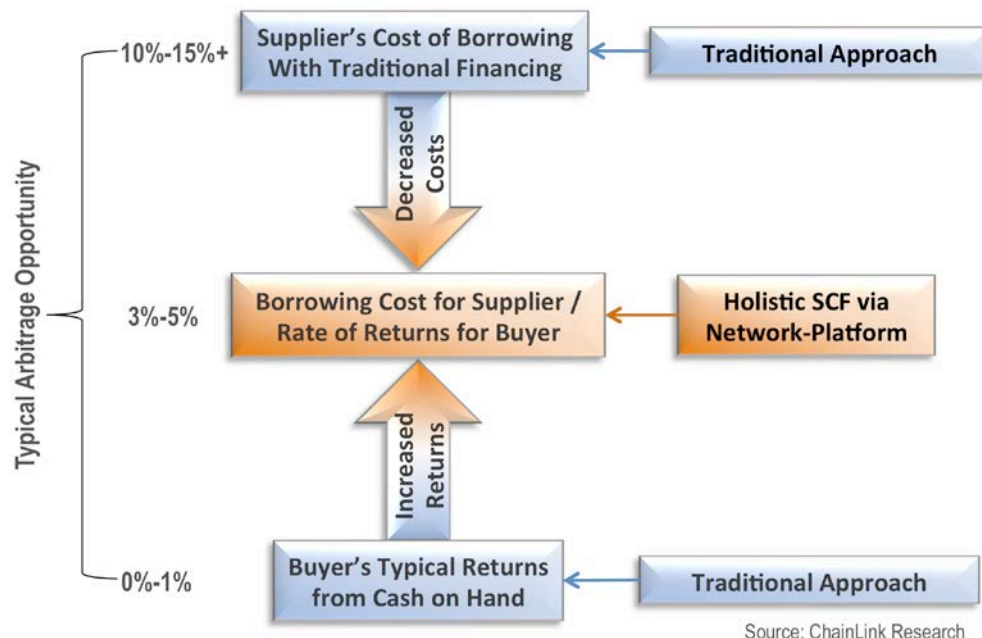


Figure 4 – Arbitrage Opportunity: Delta Between Buyers' Returns from Cash and Suppliers' Borrowing Costs



Even if the buyer does not have or want to use their cash this way, suppliers can turn to a financial institution connected to the network. Because of the legal framework explained earlier, the risk to the lender is significantly reduced. Because it is an open and competitive marketplace, lenders will provide very competitive rates, especially compared to those provided by traditional factors that purchase receivables (usually at a very steep discount).

## Adding Sustainability into the Mix

The IFC has a program which pre-qualifies the supplier for early payment discount programs, to certify that the supplier is socially and environmentally responsible. The lending rates for these programs are extremely low – as little as 3.5% at today's rates.

## Lowering COGS

When suppliers' borrowing costs are reduced substantially (up to 50% or more in some cases), those lower rates can translate directly into lower prices for the buyer. How much the cost of goods to the buyer is actually reduced depends on many factors, such as the competitive landscape and price elasticity for those particular goods, the nature of the relationship between buyer and seller, the type of commodity<sup>3</sup> or item being sold, and more. In any case, it takes cost out of the supply chain, which can be used to increase supplier health, reduce the buyers' COGS, or both.



<sup>3</sup> The price of fungible commodities is typically tied to market pricing, independent of the financial condition of any particular supplier.

## Assuring Continuity of Supply—Healthier Suppliers

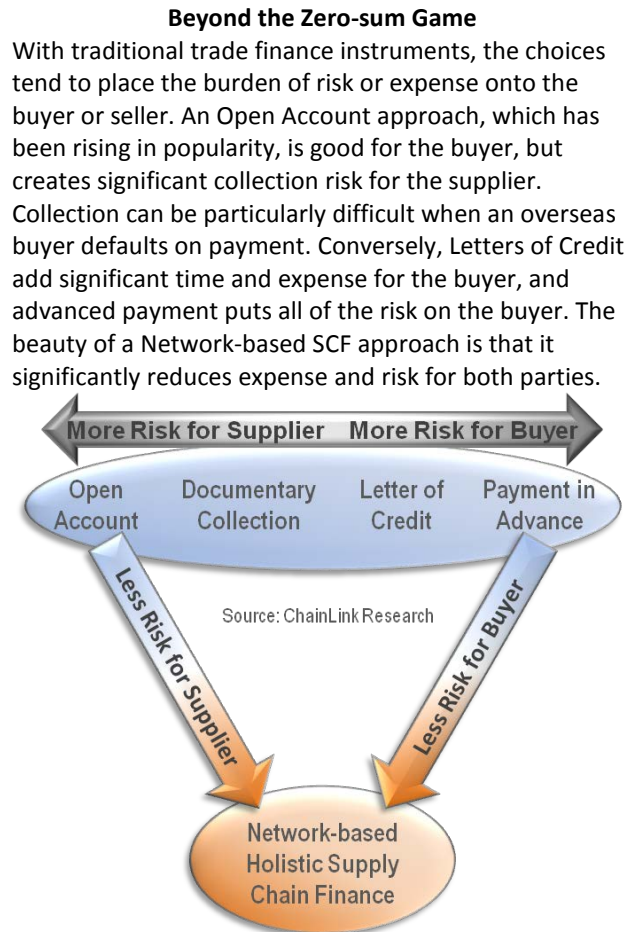
A key component of supplier risk management for many companies is monitoring the supplier’s financial health and viability to try and obtain early warning of potential supplier issues that could impact the continuity of supply. However, by itself, supplier monitoring misses opportunities to actually bolster and improve the supplier’s financial health, which is particularly important for those suppliers that are highly leveraged and/or have cash flow challenges. Holistic supply chain finance can make it easier for those suppliers to obtain financing, earlier in the process, and at a lower cost of capital. For suppliers that are in a cash crunch, this lifeline could make the difference between insolvency vs. survival. From the buyer’s perspective, this can be especially critical for one-of-a-kind suppliers that are difficult or nearly impossible to replace. And it is accomplished without the buyer having to inject their own funds to bail out the supplier. Instead, holistic SCF creates a healthier supplier, rather than providing temporary ‘life support’ to an ailing supplier at a cost to the buyer.

It is not just about lower interest rates, but also the ease of access to capital. A holistic SCF network-platform approach is not traditional supplier financing. There are no lines of credit, covenants, or pledging of assets needed in this environment for a supplier to gain access to capital. It is a much simpler process for them, built right into the supplier’s sale-to-cash process. And it complements rather than replaces the supplier’s existing bank relationship.

For anyone responsible for managing supplier relationships, supply chain risk, and continuity of supply, the use of a holistic supply chain finance strategy should be one of the key tools used to keep their suppliers financially healthy.

## Compressing Time-to-Market

One of the fundamental responsibilities of supply chain managers is reducing cycle times throughout the business and its supply chain. As the pace of competition continually accelerates, it becomes increasingly critical to reduce the time-to-market for introduction of new products. Very few people associate supply chain finance with the ability to compress lead times and bring products to market faster, but it actually can be an important tool in the arsenal of supply chain managers.



**Figure 5 – Moving Beyond the Traditional Risk Tradeoff**

If a supplier has cash flow challenges and difficulty obtaining further financing (as many smaller ones and some larger ones do), then they are forced to wait until they get paid before they are able to order raw materials. Labor is their highest component of cost (especially for the types of labor-intensive, hard-to-automate manufacturing that has moved to low-cost labor countries), so when push comes to shove and the supplier has limited cash, they must pay their workers and will virtually always delay purchasing raw materials if they don't have the funds for both. These delays cascade forward, causing delays in production and shipment.

Affordable access to pre-shipment financing enables earlier procurement of raw materials and thereby earlier shipment of the supplier's products to the buyer. In particular, when that supplier is a contract manufacturer or provider of a key long lead time component, then this acceleration can make a material difference in the time-to-launch of a new product for the buyer. With today's ultra-short product lifecycles, that can make a real difference in competitiveness.

## **Postponement of Differentiation**

Supply chain managers will often seek 'postponement' or 'differed-differentiation' strategies, so that they can postpone certain decisions until they have greater clarity about actual demand in the market. For certain types of products (apparel is a good example), it is very common for the buyer, early in the cycle, to have pretty high confidence in the overall quantities they are going to sell into a category, but not know the specifics of which style, size, color mix they will sell until considerably later, usually when they actually start selling. In a traditional setting, with lack of visibility, the buyer is forced to make a one-time buy of the entire quantities, and take their best shot at style, size, color mix ... often with very painful results (big shortages of the hot items and big markdowns on the dogs).

When buyers have the visibility of the network-platform, and their supplier has the confidence of a firm order for the overall quantities, then the supplier can buy the raw materials earlier in the process. With precise visibility into the supplier's production status, the buyer knows exactly when the dyeing will start and knows when they need to make their color decisions. They can see when the cutting will start and when they need to make their style and size decisions. They can even instruct the manufacturer to postpone production of a certain portion of the raw materials until they see which styles, sizes, and colors will be hot sellers and then instruct the supplier to produce more of those. The added cost of somewhat smaller production runs is more than offset by a potentially dramatic increase in sales of the hot items and reductions in markdowns. This concept can even extend to postponement of shipment destination decisions until the items arrive at the deconsolidation point.

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In part two of this report, we take a look at the foundational core capabilities that each organization needs to implement holistic supply chain finance.



#### About ChainLink Research

ChainLink Research, Inc. is a Supply Chain research organization dedicated to helping executives improve business performance and competitiveness through an understanding of real-world implications, obstacles and results for supply-chain policies, practices, processes, and technologies. The ChainLink 3Pe Model is the basis for our research; a unique, multidimensional framework for managing and improving the links between supply chain partners.

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