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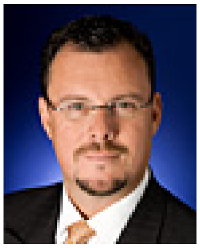
Bringing Suppliers on Board



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Traditionally, the main marketing focus of a financial supply chain (FSC) initiative has been to highlight the benefits for the buyer. However, in order for an FSC program to achieve success, a detailed value proposition for suppliers must be put forward to encourage their buy-in. The buyer's messaging to the supply chain needs to clearly articulate the benefits associated with improved working capital and risk mitigation on the supplier side.

Take, for example, the situation for many small and medium-sized enterprises (SMEs): Before the financial crisis, they benefited from a system flush with low cost liquidity. After the crisis, their financing costs rocketed while collateral requirements increased and loan limits decreased. Even if they had access to credit, that capacity was likely to be significantly more expensive, and many quickly found themselves fully pledged and with their borrowing lines fully utilized.

The proposition of a well-positioned anchor entity — offering access to credit capacity at a competitive rate to enable the supplier to sell the receivable with no contingent risk, collateral requirement, borrowings or pledging — becomes increasingly compelling.

However, some buyers make the mistake of indiscriminately launching massive FSC programs. In today's environment, credit remains a scarce and valuable resource. A company should therefore focus that capacity principally on its strategic suppliers, because if a buyer loses those suppliers its own production capability may suffer. Also, if a buyer puts too much financial pressure on its key suppliers, it runs the risk of impairing their profitability and triggering a reduction in quality, which will have negative downstream effects on the business.

Different Core Value Propositions

Corporates also need to distinguish between the core value propositions of different FSC programs.

If a company presents a value proposition based on payment automation, such as moving from paper to electronic invoices, then it will promote a different strategy for supplier adoption than if it is pushing a program where the fundamental driver is optimizing working capital through utilizing its credit capacity. For the latter, a company needs to stress that it has this scarce resource it wants to allocate to the benefit of targeted suppliers, thereby improving the buyer/supplier relationship.

Supplier Onboarding Challenges

Sometimes a larger corporate's demand for credit to support a program, such as a confirmed payables program, will exceed the capacity of any one bank or even a few big banks put together. In many cases, large corporates look to a few banks to put together FSC programs because they want an assurance of capacity to support their business.

Banks are often willing to work collaboratively because the market opportunity is so great. In most cases, the client enters into multiple agreements with its banks, and suppliers are onboarded by one or another bank, not multiple banks. One bank may onboard a set of suppliers for a given client and the next bank onboards a different set. That diversification in the bank group reduces volatility, which benefits both the corporate and the supplier. The bank's focus will be to ensure that the customer understands how to target its suppliers so that everyone gets maximum value out of an FSC initiative.

For this to work smoothly, the onboarding process must be as easy and streamlined as possible. In confirmed payables, the value flows from being able to onboard suppliers — if a company builds the program but doesn't make it easy for suppliers to participate, or doesn't deliver the value proposition message properly, suppliers will not join and the FSC program will not get off the ground.

If the corporate and bank work in partnership to collectively determine the tone of the message and plan the approach, then adoption rates skyrocket and client satisfaction with the process is significantly higher. As the adoption rate improves, it becomes easier for the buyer to leverage the liquidity it is providing through the system to achieve other objectives, such as extending payment terms or gaining pricing advantages.

Ultimately, whether a supplier participates in an FSC program or not is principally driven by four factors:

1. How focused they are on raising liquidity: What is the alternative cost of borrowing?
2. Is the rate attractive?
3. Timing.
4. Risk.

For example, a well-performing company may look at its receivables and realize it has concentration risk with one particular buyer. To hedge the risk, the supplier may insure the receivables by paying a premium on top of the cost of carry, but then it doesn't gain liquidity or reduce its Days Sales Outstanding (DSO). Alternatively, through an FSC confirmed payables structure, it could sell those receivables outright, achieving a reduction in DSO and de-risking the receivables portfolio at a cost competitive rate.

Conclusion

As global economies continue to squeeze suppliers and their access to liquidity, their risk profile may deteriorate significantly. Corporates should be increasingly proactive in looking at the risks associated with their supply chain and consider strategies to help mitigate some of those risks.

FSC programs may be a great way to provide strategic suppliers a liquidity "lifeline" that can be leveraged to enhance the relationship or to achieve other benefits such as extending payment terms or negotiating price reductions. Understanding the value proposition of an FSC program and communicating it to your strategic suppliers is essential to driving adoption.