Today, treasury performance is frequently measured using working capital metrics. As a result, treasurers and finance managers are far more specific in their working capital objectives than in the past. For example, many treasurers are now seeking alternative forms of liquidity to diversify access to funding and mitigate liquidity risk, and increase the resilience and efficiency of their supply chains. These are in addition to, and often conducted in tandem with, more traditional payment and collection centralization and automation initiatives, but the focus is now more on improving days payable outstanding (DPO) and days sales outstanding (DSO) metrics in addition to cash management efficiency.

We are seeing a particular interest in two categories of working capital solutions among corporate treasurers: supplier financing and distributor financing.

While supplier financing programs have become increasingly popular over the last few years, they are now growing in both size and geographic reach. For example, cross-border, multicurrency programs are becoming more popular, fueled by greater confidence and expertise in design and implementation, and a growing investor base in these types of programs, which is in turn creating further capacity.

Treasurers are also becoming more ambitious in the terms extension they are seeking when establishing or expanding a supplier financing program. While improving DPO remains the
primary consideration, there is growing awareness of the need to create a “win win” for both the corporate and its suppliers, in order to maintain strong supplier relationships and increase supply chain resilience.

Conversely, receivables and distributor financing aim to improve DSO, improve top line growth and enhance the company’s risk profile by offloading credit risk to banks and therefore enabling it to do more business. The growth of these techniques reflects banks’ evolving role as a strategic working capital partner to their customers. For example, banks are becoming vital third parties in the relationship between customers and their often thinly capitalized distributors, allowing them to work more closely together and generate top line growth.

In the past, securitization was often used to achieve the same DSO objectives, but accounts receivable and distributor financing programs are more flexible and easier to implement.

Leveraging Expertise

One of the challenges of early financial supply chain programs was that suppliers and distributors were unfamiliar with these programs, so onboarding suppliers was difficult. Today, however, there is far greater market awareness of the opportunities that these programs offer, and onboarding processes have become more efficient, with a higher proportion of suppliers choosing to participate.

Similarly, better market awareness of the potential complexities of setting up a program, particularly cross-border, means that companies are better prepared. For example, there are often a large number of stakeholders involved across different departments. A supplier finance program might include procurement, treasury, IT, accounts payable, legal and tax, with the number of parties increased significantly where some of these functions are decentralized. As each of these departments needs to be engaged, share objectives and priorities, and allocate the necessary resources, senior management sponsorship is essential in ensuring that objectives are aligned and organizational roadblocks are avoided.

Maximizing Success

A small number of global trade banks have developed significant experience in designing, implementing and supporting financial supply chain programs. The right bank can help to define quantifiable objectives, involve the right people in the organization and categorize suppliers in a structured way, thereby helping to tailor onboarding to target supplier groups and increase adoption.

For example, the first critical step for a financial supply chain project in which Deutsche Bank is engaged is to work with customers to analyze existing working capital metrics, such as DPO and DSO, and compare these with best-in-class and average performance for the relevant industry. Based on these results, we identify the gap and recommend pragmatic improvements. It is very important to outline quantitative and qualitative benefits to senior
management to secure their active support. Therefore, we calculate the value of each day’s reduction in DSO or increase in DPO in terms of cost savings, freed-up working capital and reduced borrowing levels or improved investment returns, providing customers with a clear and compelling senior management proposition.

A Changing Regulatory Landscape

Changes to capital adequacy rules resulting from Basel III will have an impact on financial supply chain programs. However, as a low-risk trade finance solution, these programs will still attract relatively favorable treatment under Basel III compared with balance sheet lending.

Alternative financing solutions, such as supplier financing and accounts receivable or distributor finance, will become more important in the coming years. For corporations, diversifying funding sources brings advantages in managing liquidity and counterparty risk.

A Strategic Partnership

Financial supply chain programs, both for DPO or DSO, are reaching the next stage of maturity, with larger, more geographically extensive programs now emerging, with strong participation by suppliers and distributors. While Basel III will be a factor for both traditional and alternative financing solutions, it will not hold back the market traction and growing success of financial supply chain solutions.

To achieve the degree of value that many programs are now delivering, treasurers and procurement managers need the support of an experienced global bank that offers specialist local knowledge and insights within an established global framework. By selecting a global provider, corporations can maximize the working capital benefit, build closer financial supply chain relationships and deliver demonstrable as well as sustainable value.