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The Rationale of Payables Financing

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The recent interest in financial supply chain (FSC) solutions has its roots in shifting patterns of global trade and the inexorable movement towards trading on open account. It has also been driven by concerns regarding liquidity and counterparty risk, which have been accentuated by the recent turmoil in global credit markets. A key component of this type of approach is often a confirmed payables financing solution. This allows a bank to leverage a buyer's strong credit rating to deliver benefits to both parties in a trading relationship — something that has often been considered a zero-sum game.

Confirmed payables financing solutions normally follow a relatively simple process that is assisted by the use of intuitive web-based technology. Data relating to payables is presented to suppliers via an online platform with information on the price at which they can be financed — often considerably less than the supplier's usual funding costs. When a supplier accepts an offer of funding, it immediately receives a payment equivalent to the total payable minus the bank's discount rate, while the buyer still pays the full amount to the bank at maturity. Such solutions can be set up as fully automated, semi-automated or processed manually.

With these systems, trading partners can now find a way out of the traditional issue where a buyer constantly seeks to extend payment terms to the detriment of its suppliers — where the result would often be suppliers forced to artificially inflate selling prices to compensate. Instead of costs being shifted from one side of the supply chain to another, confirmed payables financing allows the underlying systematic issues to be dealt with by harnessing the arbitrage opportunity that exists between the perceived creditworthiness of each trading party.

Benefits to Buyers

Buying corporates establishing such systems are often in a position to extend payment terms through offering the compensation of cheaper credit to their key suppliers. Indeed, careful calculation can determine a fair increase in the payment terms offered. In this respect, from the buyer's perspective, working capital can be freed up for other activities and balance sheets can be made more attractive to investors, lenders and analysts.

Also, profitability can be increased by using this additional liquidity to reduce other (bank) loans and financing costs or to promote growth.

Another strong motivation for buyers is the ability of such programmes to protect supply chains. This type of financial safety net dramatically reduces the risk of a key supplier suddenly being unable to meet its obligation due to liquidity shortages. The fact that buyers provide indirectly early liquidity to their suppliers can be used to realise rebates on pricing.

Benefits to Sellers

From a supplier's perspective, there are also multiple benefits. Aside from a source of dependable short-term liquidity, the sale of trade receivables also completely eliminates the risk of non-payment — something that can represent a considerable economic hazard when a supplier's turnover is concentrated with only a few buyers. At the same time, payables financing also supports sellers supplying a wide portfolio of buyers. By reducing their receivables exposure in foreign currency, suppliers can mitigate their foreign exchange risk. Additionally, in cases of invoicing in foreign currencies, suppliers based in countries with high interest rates can benefit from financing based on low interest rate currencies.

Such a powerful risk management tool may even allow the supplier to do more business with certain clients without exceeding any customer credit limits they have in place, thereby promoting growth and profitability. Additionally, electronic portal-based solutions provide advantages to the supplier such as detailed cash forecasting, on-time payments and automated reconciliation, bringing increased transparency to the supplier's order-to-cash process.

Conclusion

Each implementation of a confirmed payables financing programme is a unique project shaped around the supply chain dynamics of individual trading relationships that have likely developed over some time. It can afford both parties the opportunity to remodel their purchasing or selling strategies to better suit current needs and, most crucially, can deliver benefits at both ends of the chain — often a liberating experience compared to the old supply chain logic where a zero-sum game prevailed.