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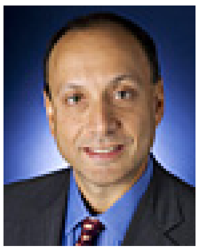
Demand Grows for Financial Supply Chain Solutions



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The continuing trend toward globalization and companies using offshore production has lengthened supply chains. As a result, they are potentially subject to higher levels of risk. This dynamic has driven the rapid take-up of financial supply chain (FSC) programs, as corporates look for ways to mitigate physical and financial risks. The effects of 2008's global liquidity crisis accelerated this trend, with ongoing constraints in the capital markets and a diminished number of financial players fueling corporates' focus on optimizing working capital management.

Working capital is crucial to the sustainability of cross-border supply chains but is complicated and compromised by restricted access to bank-supplied credit lines — even for corporates that are essentially financially sound — and by ongoing financial market instability. As a result, unblocking and maximizing working capital is now a key strategy for many corporates that are increasingly focused on overcoming supply chain complexity and vulnerability.

A Crisis Is Never Far Away

Given that all it takes is one weak link to have serious (even catastrophic) effects on the entire supply chain, a supply chain disaster is — at least in theory — never far away. This was demonstrated when the credit crisis struck. The drying up of market liquidity created conflict between buyers and suppliers, with the former calling for relaxed credit terms and the latter desiring earlier payment. These opposing forces threatened to obstruct — and in some cases break — supply chains, highlighting the need for alternative sources of financing for the long-term health of trade flows.

Financial supply chain solutions and programs — which are designed to optimize cash flow management, reduce risk and increase the transparency and flow of transaction data and information between trade counterparties — can ease supply chain tension and help overcome hurdles to keep cross-border trade flowing.

Unlocking Trapped Capital

The benefits of FSC solutions as a stable and reliable source of finance are increasingly recognized as companies across the globe experience an ongoing reduction in capital availability and a resulting pressure to improve cash flow. In addition, FSC solutions are now providing document/data management, including automated interaction, matching, and reconciliation and warehousing, in order to further improve supply chain efficiency.

FSC solutions are becoming much more than a crucial component of working capital management. Unlike other sources of funding — such as credit from capital markets — FSC solutions are flexible and an incremental source of credit in the sense that they add to, rather than consume, existing cash flow. Operational benefits associated with automation and processing scale also add value and reduce costs. As a result, FSC solutions can unlock trapped working capital and — as working capital metrics are increasingly regarded as a measure for management effectiveness and operational efficiency — have a positive effect on how trade entities are viewed by the market.

The advantages of FSC solutions are many for buyers and suppliers alike. For larger buyers, they present the opportunity to extend — and more importantly standardize — trade payment terms. In the early days of FSC solutions, the emphasis was very much on shifting trade instruments from letters of credit to open account which, although less secure, was more cost-effective for buyers and far more efficient and accurate from a processing perspective.

Focusing on Working Capital Management

This move has now evolved into a focus on working capital management, with the emphasis on extending payment terms to increase days payable outstanding (DPO) and reduce days sales outstanding (DSO), and operational efficiency.

For example, a buyer may attempt to improve working capital by imposing a period of 60 days in which to pay suppliers, instead of 45 days. While the retail sector may perhaps be best known for such renegotiation of terms, the practice is becoming increasingly common across the board.

Larger buyers also stand to gain from the financial arbitrage opportunities that FSC solutions present.

While the advantages here may appear to be weighted heavily in the smaller suppliers' favor — as they allow a smaller supplier to leverage the creditworthiness of its larger trading partner to access greater and more flexible funding than it could alone — the larger "anchor" corporate can benefit from the increased financial stability of its partner(s). Indeed, this improves buyer-supplier relationships, and the greater financial stability of individual trade entities improves the overall strength and security of supply chains.

The increased risk mitigation element of such solutions is also recognized and appreciated. At several points during the delivery cycle, from the order of goods to the receipt of payment, there is the potential for the trade process to be disrupted, and to result in financial loss for one or both parties.

FSC solutions can minimize opportunities for errors by increasing the connectivity, automation, efficiency and — crucially — the visibility of end-to-end transaction and process flows for all players.

This enhanced visibility decreases the payment risk for suppliers, as they can be sure of when and exactly how much they are to be paid, and it also helps both buyers and suppliers to better manage their working capital through concrete payment dates and more efficient operations.