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Customer financing program enhances sales

The latest innovative play in supply chain finance is motivated by a desire to support sales. The new strategy is exemplified by a customer financing program that RBS developed for a major U.S.-based multinational manufacturer and distributor.

Last year, the multinational firm was facing two serious challenges to sales. First, in a market where 30- and 60-day open account terms were the norm, with companies occasionally offering 90-day terms to some international buyers, the multinational's competitors began offering terms of up to 180 days.

Second, in the midst of the global liquidity crisis, customers wanting to buy the company's products were having trouble getting local financing at a reasonable cost. "Their banks were either canceling or contracting their credit lines, or drastically increasing the price of financing," says Rob Long, Director, RBS Global Trade Finance.

To help protect and grow the company's market share, RBS developed a program designed to provide competitive financing to the firm’s key customers around the world.

Addressing cost, balance sheet concerns

Under normal circumstances, meeting competitors' 180-day terms would hit the company hard in two ways. Carrying receivables an extra 90, 120 or 150 days would impose a significant financial burden. Furthermore, the added weight of those receivables for a longer period would negatively impact the firm's balance sheet.

RBS responded with a customer financing program that meets the financing needs of the company's customers — and thus promotes sales — without impacting the firm's days sales outstanding (DSO) or weighing down its balance sheet with inflated receivables.

The program enables the multinational to offer terms of up to 180 days but still be paid within its standard terms of 30 or 60 days. RBS takes ownership of the receivables at that time and finances the buyer's purchase for the difference between the original and extended tenors (typically 120 or 150 days).

Not only do the buyers receive the financing they need to purchase the company's products, but they receive it at "a very favorable rate compared to what they could get in the local market," Long says.

The company isn't required to carry the receivables on its balance sheet beyond the standard 30 or 60 days. After RBS purchases the receivables, they are carried as a contingent liability in the footnotes of the firm's financial statements. "This form of financing does not qualify for a true sale opinion under existing accounting standards, but it does move the receivables off the balance sheet and into the notes," Long explains.

Role of corporate guarantee

At the heart of the program is the company's payment guarantee. Understanding that no bank would be able to undertake the credit risk of each of the company's customers worldwide — especially smaller, thinly capitalized customers that may not meet minimum bank lending standards — the company has provided to RBS a corporate guarantee of its buyers' obligations.

The multinational only selects for this financing program key distributors that meet its credit standards, as well as RBS' minimum threshold for participants of $2 million in annual revenues.

Buyers in the program sign a financing agreement with RBS. The bank and the company have developed a mutually agreeable arrangement for follow-up on late payments, including when the exercise of any drawing under the guarantee may occur. Late interest is billed to the buyers but is ultimately the company's responsibility.

RBS and its multinational client don't have to disclose the company's payment guarantee to buyers. "It introduces more discipline into the payment process when the buyer must pay a bank on time as opposed to one of its suppliers," Long says.

Results and future goals

The company initiated the program last year with five U.S. customers and has since expanded it to include another 10 global customers, including buyers in Latin America, Western Europe and Asia. The program currently operates in U.S. dollars and euro.

"The company has been pleased with the good will the program has engendered with its customers," Long says. "Over the next several years, they expect substantial increases in sales to these individual buyers."

The company would like to have $65 million in outstanding accounts receivable being financed by its buyers through RBS by mid 2010, and wants to increase that to $100 million by early 2011, he says.

"We regard this as a win-win proposition," Long says. "The company carries the receivables at their standard tenors with no impact to the firm's cash flow or cost structure, while the buyers benefit from increased availability of financing at very attractive rates for their product purchases from the company."