PROCUREMENT
LEADERS

Supply chain finance as a tool for delivering on strategic aspirations

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EXECUTIVE SUMMARY

- Procurement organisations can struggle to persuade suppliers to engage with their broader strategic agendas – environmental, social and governance, for instance, supply chain resilience or assurance of supply.
- But procurement professionals, who often have a lower cost of capital than their suppliers, can unlock economic value because of this credit arbitrage, which can support working capital and other strategic objectives.
- A lower cost of capital and a lower credit risk translate into an opportunity for supply chain finance, which can be highly attractive to suppliers with stretched working capital resources.
- Technology advances render deploying a supply chain finance programme easier than ever.

Struggling for traction

Today's buyers want more than just a good commercial deal. They need suppliers to support their organisation's strategic aspirations, too

Procurement organisations' agendas have never been broader. Strategic imperatives such as supplier responsiveness, environmental, social and governance (ESG) concerns, innovation, supply chain resilience and assurance of supply are now important aspects of buyer-supplier negotiations.

And a growing focus on the total cost of acquisition – as opposed to purely on purchase price – further adds to the agenda, notes Soroosh Saghiri, senior lecturer at Cranfield School of Management's Centre for Strategic Procurement and Supply Chain Management.

"Instead of pushing suppliers solely on price, a more productive strategy can be to push them on issues that contribute to costs in different ways – working capital, inventory-holding costs, inspection and quality costs, and the cost of supplier management," he says.

MUTUAL BENEFITS

The challenge? It is not always easy for procurement organisations to identify suppliers' cost of funds and propose an option that is mutually beneficial.

Supply chain finance is often overlooked as a source of such leverage, says Jorge Tapia,

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> **Soroosh Saghiri, Cranfield School of Management**

who is responsible for working capital and commercial solutions for Europe, Middle East and Africa at global financial institution Citi.

"From procurement's perspective, supply chain finance – sometimes known as reverse factoring – has often been seen as something driven by the finance or treasury functions, and focused solely on improving working capital," he points out. "In fact, supply chain finance is more of a multi-function tool that can be utilised for many purposes. Yes, it reduces working capital – even while extending payment terms – but it also enables the procurement organisation to move forward on many other fronts."

EYES ON THE PRIZE

SCF incentivises suppliers by paying them more quickly – paying them immediately, if desired. In certain cases, payment can be made ahead of the delivery of the goods or services being bought from the supplier. Tapia insists this is not a fanciful suggestion, pointing to examples where precisely this occurs. And this can happen without adversely impacting the buying organisation's own working capital or cost base.

"It's all about credit arbitrage," he says. "In any situation in which suppliers have a higher cost of finance – and more restricted access to finance – than their customers, then there's an opportunity for supply chain finance to unlock economic value. And once unlocked, suppliers can then leverage that value in diverse ways, to enhance their own competitive position. The buyer gains and so does the supplier. By offering supply chain finance, the buyer helps to cement their position as a preferred customer."

The bottom line? The traditional view of supply chain finance – as a tool for reducing working capital – leaves a lot of strategic value on the table, concludes Tapia.

"There's a bigger prize on offer – a much, much bigger prize. And supply chain finance is the key to unlocking it."

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> **Jorge Tapia, Citi**

Now you're talking

Rapid payment delivers suppliers that are ready to engage – and thanks to supply chain finance, prompt payment can also deliver a working capital boost

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Among large companies, lengthy payment terms have become the norm, suggests Dale Rogers, supply chain finance expert and professor of logistics and supply chain management at Arizona State University's WP Carey School of Business. Payment terms of 45 days have been extended to 60 days, and then 90 days. Now, he notes, in some industries it seems that 120 days is becoming the norm.

Consequently, as suppliers' working capital positions have come under pressure, supply chain finance solutions have become more attractive.

"At payment terms of 30 days, there might not be much call for supply chain finance. But as 30 days becomes 45 days and then 60 days, and then 90 or 120 days, the appeal increases. And buyers aren't going to roll back these extended payment terms, no matter what," explains Rogers.

Given suppliers' growing appetite for working capital, it makes sense for procurement organisations to capitalise on that appetite to further their own objectives, says Charles Findlay, a former partner at consulting firm Accenture, a cofounder of the Supply Chain Finance Community, and a coauthor of *Financing the End to End Supply Chain*.

UNTAPPED OPPORTUNITY

SCF, he points out, typically costs suppliers less than conventional invoice factoring as it leverages the buyer's credit risk and cost of finance, as opposed to the supplier's. Being granted access to a buyer's supply chain finance programme is generally seen by suppliers as a positive development, as it demonstrates an element of long-term commitment.

"To some extent, it's an untapped opportunity. Undertaken in appropriate circumstances, it can add another dimension to a buyer-supplier relationship, signalling the importance of a supplier

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> **Charles Findlay, Supply Chain Finance Community**

IT'S IN THE BANK: FINTECH DELIVERS VIRTUAL CARD PAYMENTS THAT LOOK LIKE BANK PAYMENTS

London-headquartered NSC Global supplies IT networking infrastructure solutions in more than 100 countries. However, it became aware that its strict control over working capital and payment terms was calling into question the viability of some of its smaller suppliers, resulting in them being reluctant to deal with NSC.

A card-based supply chain finance programme was established to ease those pressures – but it turned out that many of the suppliers in question had no mechanism for accepting payment cards. So, with only 5% of suppliers being paid through the supply chain finance programme, something else was required, recalls Alexander Hooper, deputy chief financial officer.

Citi worked with a fintech company to seamlessly interpose a bank-based supplier-facing payment solution, with payments triggered by NSC's payments facilitators charging the appropriate amount to a centrally held virtual card, billed by Citi on its normal payment terms, plus a 30-day billing cycle.

The result? Happier, more viable suppliers receiving near-immediate payment, and a 20% improvement in NSC's working capital position. As an incentive to join the programme, says Hooper, suppliers are assigned their own payment facilitator, who proactively manages their payments.

"Suppliers tell us that they like dealing with NSC, because they don't have to call us up to get paid: we act as if we were their own internal credit control department, but working inside our organisation – not theirs. Where once there were complaints about slow payment, we're now a preferred customer."

to a buyer's strategic goals and ambitions, such as ESG, or resilience. And likewise, the supplier's earlier access to payment can render the buyer as a 'preferred customer' – a customer requiring a lower investment in working capital," says Findlay.

Again, says Jorge Tapia, responsible for working capital and commercial solutions for Europe, Middle East and Africa at global Citi, benefits accrue to both parties in the relationship. The buyer can harness its suppliers to the fulfilment of its own strategic goals and objectives, and those suppliers benefit from earlier payment translating into what is effectively a lower cost of capital – which, appropriately leveraged, can improve those suppliers' competitive positions in their own marketplaces.

But supply chain finance is not appropriate in all circumstances, notes Steven van der Hooft, chief executive of Netherlands-based Capital Chains, a specialist supply chain finance training and consultancy firm.

"There's little point setting up a supply chain finance programme for a supplier that a buyer only buys from intermittently – but for suppliers where there's a constant flow of goods or services, a supply chain finance programme can make a lot of sense."

And advances in technology have transformed the ease with which a supply chain finance programme can be rolled out, says Ritesh Jain, B2B product head for Citi Commercial Cards within Europe, the Middle East and Africa.

VIRTUAL CARDS

One development, for instance, combines the global reach of credit and debit card payment networks with traditional supply chain finance working capital funding to create 'virtual' payment cards – a 'one time only', invoice-specific means of payment that can be accepted by millions of suppliers worldwide. What's more, Jain points out, that payment automatically comes with the payment protection facility built into every card transaction in the event of faulty goods or services, or customer dissatisfaction.

"A bank payment to a supplier is irrevocable. But, with virtual payment cards, there's an inherent dispute resolution capability on offer – even without the physical form factor of a 'real' card," he says.

Not every supplier can accept card payments, but that is not a problem, says Jain. A fintech intermediary, working in conjunction with Citi, can interpose a conventional direct bank transfer mechanism between the buyer's in-house accounts payable systems and the same virtual card capability. The buyer sees minimal change in their accounts payable systems, and the supplier is paid by bank transfer, as usual – but now a supply chain finance programme sits between them.

Either way, says Jain, the outcome is the same: suppliers gain early access to invoice payments and the buyer receives a monthly total invoice, payable at some point in the future. For both buyer and seller, the result is a cost-effective improvement in their working capital position – plus, for the buyer, a supplier that is incentivised to deliver on the buyer's strategic aspirations.

"Traditionally, when buyers have sat down to negotiate with suppliers, the choice of payment method hasn't really been a consideration," he says. "But in our view, that's a missed opportunity. Especially now, when suppliers are likely to be experiencing working capital pressures, a solution that bridges the liquidity needs of buyers and suppliers in an economically efficient way can unlock better value, foster resilience in the supply chain and be a source of competitive advantage for corporations. Plus, technology is making the entire process of deploying and operating such working capital solutions extremely straightforward for both buyers and suppliers. It's a new frontier for forward-thinking procurement professionals."

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IMMEDIATE PAYMENT AND SLICK PROCESSES TRANSFORM ROYAL DSM INTO A PREFERRED CUSTOMER

Large-scale events and conferences are integral to Netherlands-headquartered Royal DSM's business, bringing together customers, scientists, management teams, and multinational sales forces in the 23,000-employee company's health, nutrition and bioscience operations.

But a core characteristic of the events marketplace is that rapid payments are required to secure both venues and the teams of event firms that provide services such as lighting and sound services. A growing worry for Royal DSM was that, by the time a potential supplier had been onboarded and a deposit payment approved, those venues and providers might instead have been contracted by other parties.

Royal DSM turned to Citi's virtual payment card capability as an extension of its existing supply chain finance programme, seamlessly building it into its event management platform.

"On a line-item level, individual pieces of event-specific expenditure aren't huge – but aggregate them up over our entire global events activity, and it becomes very significant," says Nick Pupa, a Royal DSM indirect procurement category manager. "The supplier is paid immediately, but we pay Citi in a significantly longer timeframe, at a scale that turns event management into a significant source of gross free cash flow, increasing our working capital."

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"And in the process, the ease with which all this happens serves to transform us into a much more attractive customer to venues and providers – it's totally seamless, with significantly less friction."

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