

SUPPLY CHAIN FINANCE :

A new way for trade banks to strengthen customer relationships



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Trade banks who seize the Supply Chain Finance opportunity will transform their businesses into ones that align with, and plug into, their customers' quickly evolving supply chain strategies.

Executive Summary

Driven by a range of pressures, organizations must increasingly source and sell globally. Yet moving from regional to global sourcing has had a negative effect on these organizations' Working Capital and supply chain performance. As a result, they are looking to their banks to optimize their financial supply chains, including offering new technologies, bank-assisted Open Account instruments, and new payables and receivables financing approaches.

Although this is new territory for trade banks, it represents a unique opportunity for them to transform from providers that meet only a fraction of their customers' trade needs to full partners that provide solutions across their customers' entire supply chain.

Supply Chain Finance gives trade banks the tools they need to align their offerings with their customers' evolving supply chain needs. This paper provides background on the growing importance of Supply Chain Finance (SCF), delving into the key elements and available options from which these solutions are crafted and implemented.

While the market for SCF is still in the early stages of development, innovative banks already have made heavy investments in it and others will be quick to follow. Those who seize this opportunity will transform their businesses into ones that align with, and plug into, their customers' quickly evolving supply chain strategies.

Background

THE EFFECT OF GLOBALIZATION ON CUSTOMERS' SUPPLY CHAINS

In an increasingly global marketplace, it is more challenging than ever for corporations to keep their competitive edge.

Due to the inability of tracking shipment of orders, buyers cannot accurately predict when shipments will arrive or payments are due.

To compensate, buyers are holding higher levels of inventory to prevent outages and cash to ensure funding is available to meet payment obligations. Yet pressing sellers for longer payment terms has increased prices, eroded relationships with sellers, and decreased the stability of the buyers' supplier base.

The same dynamics make it difficult for sellers to obtain timely payments. Typically, they must wait at least 45 days for payment, and sometimes as long as 90 or 120 days. Due to their geographic location and size, sellers typically lack access to reasonably priced short-term financing. Pressure from buyers to lengthen payment terms only intensifies the situation, which often results in higher prices or an inability to continue as a supplier.

The result is a financially unstable and higher-risk supply base.

DEMAND FOR INCREASED FLEXIBILITY AND MORE CHOICES

Letters of Credit and Documentary Collections are the traditional Trade Finance instruments used by sellers to mitigate buyer's risk and obtain financing. While these payment methods will continue to play a role in Trade Finance, their importance has eroded by about five percent per year over the past five years. Buyers and sellers alike find them complicated, time consuming and expensive to use.

To mitigate the situation, buyers and sellers are moving to another form of trading which is faster, easier and less costly: Open Account. This reduces the need for the risk-mitigating buyer features found in traditional Trade Finance products.

In traditional Open Account trading scenarios, sellers ship their goods and send an invoice to the buyer. In turn, the buyer pays the seller's invoice by check or electronic payment. Unlike Letters of Credit and Documentary Collections, trade banks' involvement in this process has been restricted to processing checks and payments, which provides no insight into their customers' supply chains.

Open Account trading currently represents 85 percent of global trade transactions, reducing the role of traditional Trade Finance to about 15 percent. As a result, banks' participation in their customers' trading is steadily declining-confining banks to an ever smaller slice of their customers' overall trade business.

Faced with the complex requirements of their extended supply chains, corporations are looking for help. An Aberdeen Group study conducted in 2006 found that 90 percent of enterprises addressing their global supply chain technology as “inadequate to provide the corporate finance function with the timely information it requires.”¹ As a result, bank customers are looking for creative new ways to increase responsiveness, visibility, efficiency, cost optimization, liquidity and predictability across their supply chains.

As a result of the long-term trusted role that banks have traditionally played, their customers are looking to them to help optimize their financial supply chains - including offering new technologies, bank-assisted Open Account instruments, and new payables and receivables financing approaches.

Supply Chain Finance

INTRODUCING SUPPLY CHAIN FINANCE (SCF)

Aberdeen Group defines **Supply Chain Finance (SCF)** as “a combination of Trade Financing provided by a financial institution, a third-party vendor, or a corporation itself, and a technology platform that unites trading partners and financial institutions electronically and provides the financing triggers based on the occurrence of one or several supply chain events.”²

The overall goal of SCF is to **optimize Working Capital** throughout the end-to-end supply chain for both buyers and sellers.

TRANSITION FROM PRODUCT-CENTRIC THINKING TO COLLABORATIVE PARTNERSHIPS

Today, banks' customers already are working to optimize responsiveness, visibility, efficiency, costs and flexibility across their supply chains.

As a first step in achieving this goal, they are establishing strong partnerships with suppliers and other parties in their supply chains. Together with their partners, they're working to invest in technologies that allow people to share data and work with each other collaboratively.

These organizations are looking to their banks to assist them in this process. However, for banks to help, they must adapt to a new business reality.

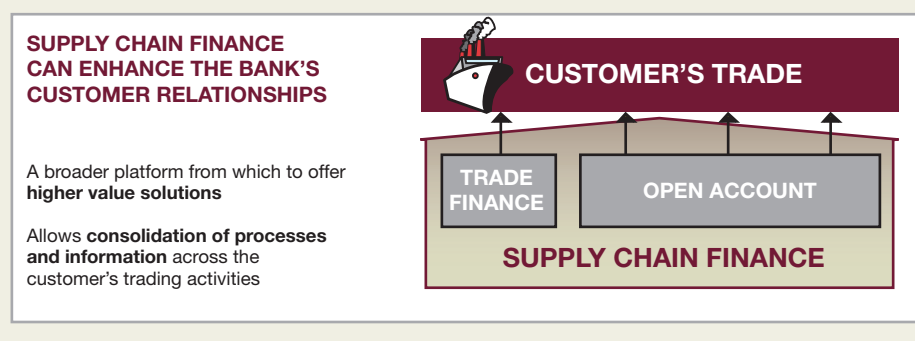
In the past, banks had customarily taken a product-centric approach to Trade Finance. However, this traditional approach must give way to a new one: that of value-added collaborator. To successfully adopt supply chain finance solutions that truly benefit their customers, banks must work in partnership with their customers, understand the value that the bank can provide to the customer's supply chain, and orient their offerings to fit that specific need.

The features and benefits of Supply Chain Finance include:

- Helping the buyer optimize the supply chain by offering bank-assisted Open Account processing, buyer-backed and direct seller financing, Purchase Order and Invoice Data Management, and data matching across Open Account, bank-assisted Open Account and Letters of Credit
- Meeting the seller's export finance needs for pre-shipment, shipment and post-shipment financing from the seller's bank for Export Letters of Credit and Outward Collections, and from the buyer's bank for bank-assisted Open Account and Import Letters of Credit
- Providing liquidity to sellers through receivables financing

Armed with these capabilities, banks can offer SCF solutions that enable their customers to lower costs and create financial stability in their end-to-end supply chain-and create deeper and broader customer relationships in the process.

impact on bank's customer trade relationships



KEY ELEMENTS OF SUPPLY CHAIN FINANCE SOLUTIONS

Key elements of SCF include Purchase Order / Invoice Data Management, bank-assisted Open Account, Open Account Payment, Export / Seller Finance and buyer-side finance.

Purchase Order / Invoice Data Management

Global trade transactions revolve around Purchase Orders, Invoices and other non-bank documents. Letters of Credit, Documentary Collections and bank-assisted Open Account instruments simply provide added benefits.

Incorporating Purchase Order and Invoice data into traditional Trade Finance and creating new Open Account solutions around them allows banks to provide strong offerings that align with corporations' view of the Supply Chain Finance.

The first step is to work with the customer to obtain access to Purchase Order and Invoice Data. This can be accomplished through portal uploads or back-office integration.

Key Elements of Supply Chain

Finance Solutions:

- *Purchase Order / Invoice Data Management*
- *Bank-Assisted Open Accounts – Approval-to-Pay*
- *Open Account Payment*
- *Export / Seller Finance*

Once the data is available, banks can offer a range of services, including:

- **Purchase Orders / Invoices linking Open Account and Trade Finance instruments.**
Banks can link Purchase Orders and Invoices to their Open Account and Trade Finance instruments, with the objective to integrate Purchase Order terms to the instrument and/or to provide the underlying basis for financing.
- **Invoice Matching Service.**
Banks also can match Invoice Data against Purchase Orders to identify mismatches. Mismatches are then handled as appropriate for the type of instrument to which the Purchase Order is linked. Matching can be done at a high level, matching key data only, or can be executed in more depth. For example, Swift recently introduced their Trade Services Utility (TSU) to provide its member banks with a deep matching service they can embed within their trade applications.
- **Purchase Order Tracking.**
As a result of invoice matching, the bank can track the status of Purchase Orders and their remaining balances on behalf of the customer. This information can be provided back to the customer via various channels, such as front-end systems and back-office integration.

Bank-Assisted Open Accounts – Approval-to-Pay

Approval-to-Pay is a new bank-assisted Open Account product that eliminates bank exposure fees that a customer would pay under Letters of Credit, while providing many benefits similar to that of Letters of Credit. Approval-to-Pay is based on Purchase Orders and issued like Letters of Credit, with the buyer's conditional payment terms specified but without a bank guarantee.

The Approval-to-Pay instrument provides a structured framework from which Open Account trading services such as document checking, Purchase Order / Invoice matching and tracking, Purchase Order or Invoice financing, seller payment, or buyer-side financing can be offered.

Open Account Payment

An Open Account payment provides the ability to make straight trade payments for due invoices.

Export / Seller Finance

The typical Order-to-Pay trade cycle places the financial burden on sellers. They must prepare and ship their orders, followed by a rather long wait for payment. This results in a growing need for export financing.

However, the role of Export Finance varies widely. The mix that a bank might provide depends on the risk profile of the bank, which role the bank is playing in the transaction, and type of programs that it may support. As described below, Export / Seller Finance can be extended in a wide range of contexts and situations.

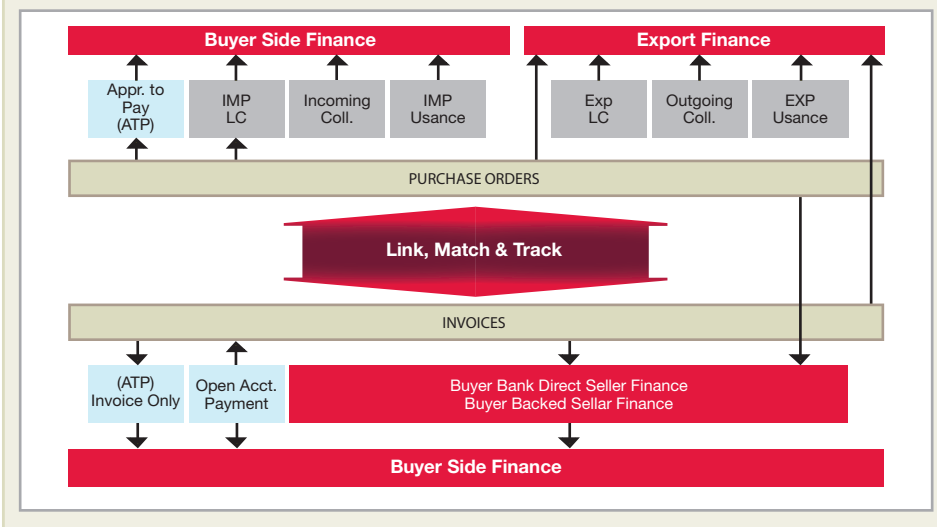
- **Export Trade Finance – Export Finance**

To provide financing at various points within the Order-to-Pay lifecycle, the export bank for an Export Letter of Credit or Outgoing Collection can provide pre-shipment, shipment or post-shipment financing.

- **Pre-shipment finance:** The bank finances the manufacture or purchase of goods to be shipped. Although traditionally based on the seller having a Letter of Credit that covers payment of goods, Purchase Orders are gaining acceptance as the basis for this type of finance.
- **Shipment finance:** The bank provides financing from the time Letter of Credit documents are presented or that Outward Collection instructions are received from the exporter until payment is received.
- **Post-shipment finance:** If the Letter of Credit or Collection specifies time payment by Banker's Acceptance (BA), Deferred Payment (D/P) or trade acceptance, the bank can extend financing until the maturity date of these instruments is reached.

Although these types of financing are not new, the ability to link Purchase Order and Invoice Data to an Export Finance instrument provides a stronger basis for extending finance for a higher percentage of the Invoice value or at a better rate of interest.

the elements of supply chain finance



- **Open Account / Import Trade Finance-Direct Seller Export Finance**

The buyer's bank can directly finance the seller with Pre-shipment, Shipment or Post-shipment export financing, creating both country and party exposure. Many banks without an existing presence in the seller's country will not find Direct Export Finance attractive. However, banks that do have a presence can offer financing on the Purchase Orders or Invoices that have been downloaded and linked to bank-assisted Open Account and Import Letters of Credit instruments.

By extending their reach to cover their customers' end-to-end supply chain, trade banks improve their bottom line and strengthen ties with their customers.

- **Receivables Financing**

Accounts Receivable Financing allows the bank to provide liquidity to the seller by financing its invoices prior to payment by the buyer.

- **Open Account – Buyer-Backed Seller Export Finance**

Innovative buyers are moving away from traditional payment-delaying tactics toward programs that optimize the costs of their supply chains in more creative and collaborative ways. One of these solutions is Buyer-Backed Seller Finance, which creates a win-win situation for the buyer, seller and even the bank.

A typical program enables a buyer to instruct its bank to pay invoices on their due date with extended payment terms. The bank then provides early payment to the seller by purchasing its invoices on terms based on the buyer's credit worthiness-typically a significant savings for the seller. As part of the arrangement, the buyer usually negotiates better pricing.

This type of program provides the buyer with longer payment terms and lower prices; the seller with cheaper, reliable and on-demand financing and the bank with brand-new revenues for lending and activity fees.

- **Buyer-Side Finance**

Whenever the buyer has an obligation to pay under an Open Account, Import Trade Finance or other Import finance instrument, the buyer's bank can extend buyer-side financing to the buyer, with its proceeds covering the obligation.

Benefits across the Board

Supply Chain Finance creates a unique situation where everyone – buyer, seller and bank – benefits. While buyers enjoy lower prices for goods purchased, improved visibility of their cash flow, and an increasingly reliable supply base, sellers can leverage the buyer's credit to reduce the cost of capital, obtain lower cost financing and create more predictable cash flow.

Meanwhile, trade banks stand to dramatically increase the amount of business they conduct with their customers. By extending their reach to cover their customers' end-to-end supply chain, they improve their bottom line and strengthen ties with their customers.

Innovative organizations already are enjoying the benefits of Supply Chain Finance. According to a study conducted by Aberdeen Group in 2007, “Best in class companies are six times more likely to have gained significant competitive advantage due to implementing SCF technology.”³

BENEFITS ACROSS THE SUPPLY CHAIN

BUYER	SELLER	BANK
<ul style="list-style-type: none"> • Reduce the cost of goods purchased 	<ul style="list-style-type: none"> • Reduce the cost of capital through improved Days Sales Outstanding (DSO) and lower finance costs 	<ul style="list-style-type: none"> • Build stronger, collaborative relationships with customers
<ul style="list-style-type: none"> • Reduce working capital requirements through improved Days Payable Outstanding (DPO) 	<ul style="list-style-type: none"> • Generate flexible, predictable cash flow 	<ul style="list-style-type: none"> • Enhance customer retention
<ul style="list-style-type: none"> • Enjoy a more stable supply base 	<ul style="list-style-type: none"> • Gain access to low-cost finance rates 	<ul style="list-style-type: none"> • Increase bottom line by supporting customers' entire supply chain from end-to-end
<ul style="list-style-type: none"> • Improve relationships with sellers 	<ul style="list-style-type: none"> • Acquire more secure source of Working Capital 	<ul style="list-style-type: none"> • Increase reach of Trade Finance organization
<ul style="list-style-type: none"> • Improve visibility across the financial supply chain 	<ul style="list-style-type: none"> • Gain visibility into the payment process 	<ul style="list-style-type: none"> • Expand profile of Trade Finance organization

Getting Started

SOURCING OPTIONS: BUILD, BUY, OR OUTSOURCE

When implementing a solution for Supply Chain Finance, banks have three options: develop their own software from scratch; purchase a software license; or outsource via a Managed Service Provider or Business Process Outsourcing (BPO) arrangement.

- Develop from Scratch**
 Developing software internally allows a bank to enjoy a higher level of control than licensing software or outsourcing. However, going it alone is not only prohibitively expensive for most, it is also risky. Custom-built systems rarely have the flexibility and robust capability that commercially-available systems possess—and in today's accelerating marketplace, systems must evolve at a rapid pace. This requires significant ongoing investment at a time when funding is difficult to obtain and internal resources are scarce.
- Purchase a Software License**
 Relative to internal development, licensing software initially provides banks with a quicker and easier method to obtain software to meet their needs. However, once the costs of customization and implementation, routine maintenance, release upgrades to obtain needed new functionality, disaster recovery and operations are factored into the equation, the price tag and resource requirements can be very high.

 Time to market for new improvements also is affected by the need to justify an upgrade project, find the financial and human resources, conduct the upgrade project and deploy. This can delay the bank's ability to meet the market demand by months or years

Banks can transform themselves from providers who meet a fraction of their customers' trade needs to a full partner that provides products and services across their customers' entire supply chain.

- **Outsource – Managed Service Provider**

The managed service provider model is the best choice for banks that have skill workers but require better technology to meet the changing needs of their customers.

In this approach, the provider is responsible for keeping the software up to date, providing ongoing technical support and hosting operations, including hardware, software, security, disaster recovery, and availability. As costs are shared across all of the service provider's clients, the result is significant cost savings for each bank, and therefore, a lower total cost of ownership.

This model dramatically reduces product cycle, the time to develop and deliver new capabilities to production. Since the provider delivers the improvements directly into production, there is no need for costly and time-consuming release upgrade projects for the bank. This is a significant factor in a swiftly changing marketplace, where having needed solutions months or years earlier can offer a huge competitive advantage.

- **Outsource – Business Process Outsourcing**

The BPO model is attractive to banks that lack the resources to internally maintain a team of skilled trade services workers and, frequently, the technology to support increasingly sophisticated trade offerings. In this model, a third party (typically another bank) operates the outsourced bank's trade operations. Most often, the third party's workers use their own technology, although they also may use the outsourced bank's technology. The BPO approach enables the outsourced bank to increase focus on its core businesses.

Developing the capabilities to keep up with the industry's transition to Supply Chain Finance will require banks to make significant investments. Increasingly, outsourcing is seen as providing quick access to SCF and other evolving supply chain solutions, which increasingly are seen as a cost-effective strategic enabler to compete.

CONCLUSION: AN OPPORTUNITY FOR COMPETITIVE ADVANTAGE

The market for Supply Chain Finance is at a critical stage of development. In a survey conducted by Aberdeen Group in 2006, more than two-thirds of companies report that they are “investigating or putting in place SCF programs to lower end-to-end costs.”⁴

Trade banks are in a unique position to turn that demand into a profitable business. The same forces that have driven bank customers to transform their operations from local to global are giving banks the opportunity to apply their Trade Financing expertise in creative new ways. Innovative banks already have begun the process, and others will be quick to follow. To avoid being left behind, banks must act now.

Today, like no other time since the creation of the Letters of Credit, trade banks have the opportunity to dramatically transform the relationship they have with their customers. By offering SCF solutions that meet their customers' continually evolving needs, trade banks can help their customers decrease costs and optimize working capital throughout their end-to-end supply chain. In the process, they can evolve into an integral and valued partner.

ABOUT THE AUTHOR

Kitt Carswell is the Product Manager and Executive Consultant within CGI's Trade Services Group. Previously, Kitt was managing partner of TradeEvolution, a trade banking consultancy, and a founder of the Trade Finance Group at American Management Systems, where he held numerous senior roles over a 20 year period.

About CGI And Its Proponix Solution For Supply Chain Finance

Founded in 1976, CGI is a leading IT and business process services provider with approximately 25,500 professionals operating in 100+ offices worldwide. For the banking industry, CGI has helped 9 of the top 10 U.S. banks and 7 of the top 20 banks worldwide transform their operations to adapt to market needs and to better meet their customers' expectations.

CGI's trade portfolio includes Proponix™, a hosted, web-based Trade Finance platform that provides access to global trade technology as a service, enabling reduced costs, enhanced customer service and accelerated time-to-market for market-driven innovations.

Proponix's integrated Trade Finance Platform enables banks and their customers to use Proponix's suite of Trade Finance systems to perform both front and back-office transaction processing. This service includes a Trade Portal, workflow and imaging, a back-office trade processing system and a reporting system.

CGI is quickly evolving the Proponix platform to enhance its Supply Chain Finance capabilities, including Purchase Order / Invoice Data Management, bank-assisted Open Account, Open Account payment, Export / Seller Finance and buyer-side finance.

These solutions provide trade banks with the ability to employ SCF strategies that both improve the performance of their customers' financial supply chain and enhance their relationships with key bank customers.

Footnotes:

- (1) Aberdeen Group, "Get Ahead with Supply Chain Finance: How to Leverage New Solutions for End-to-End Financial Improvement", July 21, 2006.
- (2) Aberdeen Group, "Get Ahead with Supply Chain Finance: How to Leverage New Solutions for End-to-End Financial Improvement," July 21, 2006.
- (3) Aberdeen Group, "Technology Platforms for Supply Chain Finance," March 2007.
- (4) Aberdeen Group, "Supply Chain Finance Benchmark Report", September 2006.