Accelerating supply chain finance

The financial crisis is pushing many corporates towards supply chain finance (SCF) solutions, in order to protect their physical supply chain and optimise their working capital, writes ***Liz Salecka***.

"The recent financial crisis has accelerated the development of financial supply chain solutions," says Jon Richman, managing director and global product head, trade and financial supply chain, global transaction banking at Deutsche Bank.

"We are seeing a fairly broad-based increase in supply chain activity in our European, Americas and Asia regions. This cuts across a variety of industries with a lot of activity seen in the retail, consumer product and technology sectors."

Lack of credit, and the escalating cost of borrowing lies at the root of this trend.

"There is very little money flowing through – to the corporate level in particular. As a result, there has been an unprecedented increase in demand for more structured solutions such as supply chain finance," adds Dominic Broom, head of business development, treasury services at Bank of New York Mellon.

Although a number of financial institutions have pulled out of the provision of supply chain finance altogether in recent times, global players such as Deutsche Bank, HSBC, UniCredit Group and Citigroup, alongside other major, global US banks, recognise it as a valued means of supporting their customers at a time of restricted lending practices.

"The financial crisis has proved very beneficial to supply chain finance. It has really shown to both banks and corporates that they can use their own balance sheets and third parties' balance sheets to provide a third tier of finance," says Stuart Roberts, managing director and head of global supply chain finance at Wachovia, a Wells Fargo company.

And Paul Johnson, vice-president, trade and supply chain product management at Bank of America (BoA), adds: "Supply chain finance has been the wind in our sails over the last 18 months to two years. As the credit crisis escalated, the capital markets were squeezed, and there have been no short-term sources of liquidity such as commercial paper. As a result, we are now seeing increased demand for supply chain finance that is growing geographically and across industry segments."

Focusing on the traditional

Many banks acknowledge that traditional invoice finance buyer-centric programmes have continued to predominate in today's economic and financial climate.

This is the case across Europe, where they currently account for about 80% of the overall supply chain finance.

However, whereas in the past, many corporate buyers established these programmes with the prime goal of extending payment terms with their suppliers, today supply chain finance is being urgently sought by companies that want to ensure the ongoing viability of their supply chains.

"It can be a very big problem if your existing suppliers go bust, and cannot service you," says Wachovia's Roberts. "This is very important now as so many multinationals have placed orders with, and rely on, suppliers in Asia and Eastern Europe."

Jane Guttridge, global head of supply chain sales at Citigroup, adds: "Companies need to ensure that they have an uninterrupted flow of components and materials from their key suppliers. Disruption caused by the failure of one critical supplier can impact a buyer's production momentum and its shipment of goods to distributors."

She agrees that multinationals that have a diverse spread of suppliers in emerging market countries need to guard against this in particular. "Often suppliers in these countries may have little working capital and poor access to bank credit. Therefore, they need quick payment." Michael Quinn, managing director, global trade services at JP Morgan, adds that his bank is actively seeking to meet its corporate customers' demand for financial solutions geared at supporting suppliers.

"Suppliers – whether they are domestic or international – are being squeezed by the lack of liquidity. In particular, non-investment grade suppliers to investment grade buyers are not getting as much access to credit. As buyers are dependent on suppliers for strategic raw materials, they want to make sure that their suppliers have the working capital they need."

He points out that JP Morgan remains firmly focused on the provision of invoice-based programmes to large investment grade buyers (as opposed to other types of supply chain finance) which in 75% of cases have multi-country suppliers.

Supplier-driven demand

However, the current economic climate is generating equally strong demand for structured finance from suppliers themselves, who are finding it much harder to access working capital in today's financial market conditions. Many large investment grade suppliers also want to support their buyers at a time of declining demand and weaker cashflows.

In response to this, some global banks are now providing as much invoice-based finance to corporate suppliers as they do to buyers.

"Large suppliers have a desire to provide liquidity to their buyers to increase their sales. Usually they have a number of key customers that represent a large proportion of their sales," says Roberts.

He explains that Wachovia offers a key accounts purchase facility, which enables suppliers to support their biggest buyers with invoice-based finance, as well as portfolio purchase facilities to suppliers with smaller, and multiple buyers such as distributors.

"With portfolio purchases, we can provide facilities to all of a supplier's distributors in a given region. We directly buy all their invoices and provide them with improved cashflow and credit availability.

Jon Richman, Deutsche Bank

"A number of larger banks are likely to be investing in their own applications to avoid dependency on third-party vendors."

"Although, we are seeing a lot of demand from suppliers, we are still basing the risk on the buyers. With the portfolio concept, the risk is placed on the whole pool of buyers."

Matthias Krönung, head of global trade management, UniCredit Group, adds: "Large suppliers are asking for this type of financing solution because by helping local buyers to get the necessary credit facilities, they can increase their purchasing volumes.

"Generally, we only provide this type of finance to suppliers that are very large. In these structures, the risk can be shared between the supplier and the bank."

Bank of America, meanwhile, has witnessed growing demand from investment grade suppliers seeking to protect themselves against buyers defaulting on payments due as a result of weaker demand and cashflows – and even bankruptcy.

"Even though the cost of discounting the receivables is higher, it is better than just leaving them outstanding," says BoA's Johnson. "This is unsecured lending from a bank's perspective as we do not take a charge on the underlying asset, but the risk is lower because it is short-term, and you are lending against a trade transaction.

"The biggest risk here is that of double receivables financing. It is very important for banks to conduct due diligence and do their homework to make sure there is no prior lien against the assets."

Inventory finance demand

As suppliers across the globe struggle to find the working capital they need to maintain their operations at pre-credit crisis levels, demand for financial solutions further up the supply chain – such as inventory finance and pre-shipment finance – is also escalating.

However, while many global banks are now also responding to this need, US Federal regulations continue to make this a challenging area for many US banks.

"Inventory finance is more problematic

Will proprietary platforms survive?

Despite the recent crunch and its impact on banks' IT spending, a number of global banks still rely on their own in-house developed, proprietary platforms for their supply chain finance activities.

"We have our own platform, which is well regarded in the market, and we also private label it to some institutions," says JP Morgan's Quinn.

Roberts adds: "At Wachovia, we don't use a standard third-party technology services company's platform because it offers no differentiation in the marketplace. We use a platform which is unique to us."

Deutsche Bank's Richman believes that larger banks, who see supply chain finance as core and strategic to their businesses, are likely to remain committed to developing their own applications.

"A number of larger banks are likely to be investing in their own applications to avoid dependency on third-party vendors where they may have limited control over the strategic direction of the product's roadmap, or where concerns over counterparty risk may preclude entering into a contract," he says.

However, the extent to which global banks can continue using proprietary solutions, and ensure they are at the forefront of technological advancement, is questioned.

"In terms of implementing new technologies, there are always upfront costs. Banks can purchase the most basic trade finance platforms and engines but even this can represent significant cost and there are also the maintenance costs to consider," says Bank of New York Mellon's Broom.

And here Steve Starace, vice-president of banking and investment at CGI Technology and Solutions, points out that the use of outdated SCF technology can present not only a supply chain risk – but also a major business risk.

"In supply chain finance, banks now require more and more capabilities in areas such as pre-shipment finance and inventory finance as well as traditional invoiced-based finance," he says, claiming that CGI's Proponix360 offers all these capabilities.

"Our solution, which is offered as a managed service, represents a value proposition because we are continually enhancing it – meaning that banks don't have to invest in major upgrade projects. There are no implementation issues either and once banks have deployed the capability, they can use it straight away."

This is reiterated by Murray Freeman, marketing manager at Surecomp, which offers three different back-office supply chain software products to meet banks' varying needs.

"Many banks are choosing to go it alone when setting up platforms, and have large IT departments who believe that they can do it all themselves. What we ask them is why they should invest their money and time in this when they can buy a solution off-the-shelf, which can then be customised for them," he says.

Carmen Crutchfield, vice-president, pre-sales and marketing at S1 Enterprise, adds that large banks can minimise the costs of enhancing their existing platforms, by investing in software components from third-party technology providers.

"Many banks realise that their proprietary systems have got them a long way, but a lot of them are now looking for ways to cut costs and realise they can't rely solely on the old system in place," she says, pointing out that by simply investing in additional software components, banks can provide their corporate customers with the increased visibility they now need, as well as addressing their needs for convergence between trade finance and cash management.

The growing role of third-party technology companies is also noted by UniCredit Group, which itself is rolling it out a new web-based technology, called Trade Purchase, across all the countries in which it operates to offer centralised processing and local coverage.

"A couple of major banks have already made a big investment in supply chain finance technology, but to ensure innovation, the perception of a more global perspective as well as tighter budgets, I am sure that the role of third-party technology suppliers will steadily increase," says Krönung.

However, he also points out: "I do not believe that any one bank or provider has yet built a top-end solution that provides true end-to-end supply chain finance capabilities that include pre-shipment, inventory finance and traditional invoice-based finance in one. Such platforms also need to provide treasury and cash management capabilities too now given the ongoing convergence of trade finance and treasury functions. The ingredients are all there – now we are finalising the recipe."

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for US banks to offer than western banks because of US Federal regulations that bar US banks from owning inventory on behalf of other parties," explains Roberts.

"We can lend against inventory but this takes the form of debt and remains held on suppliers' balance sheets. Many companies prefer, where they can, to take inventory off their balance sheets altogether."

UniCredit, however, is taking full advantage of new opportunities here, and identifies itself as one of only three banks that has the dedicated structures and instruments needed to provide inventory finance.

"In several cases, buyers are asking their suppliers to keep a certain level of inventory or stock to secure the supply chain," says Krönung, pointing out that this trend is typical in today's automotive industry. "This stock needs to be financed and a huge amount of capital is bound.

"In the past, a few banks did offer these types of solutions, but given the nature of banking business, they were not willing to account for inventory on their balance sheets."

Demand for pre-shipment finance is also escalating – particularly from the many Asian and Eastern European suppliers whose businesses expanded rapidly on the back of large orders from western companies that sought to outsource their manufacturing and production to lower-cost countries.

Olivier Berthier, Misys

As these western companies now bear the brunt of a global downturn in demand for their products, they are reducing their order sizes and seeking extended payment terms with their suppliers.

Germany's Commerzbank, which focuses on the provision of tailored supply chain finance solutions to its customer base of German mid-tier companies, which are both exporters and importers, notes an increased interest in solutions that optimise financial supply chain processes.

Angela Koll, assistant manager, trade finance and transaction services, at Commerzbank says: "Our approach of supporting corporate customers with which we already have a strong relationship is growing, whereas the financing of suppliers abroad, based on the German corporate's good rating, is rather difficult in today's climate."

However, Standard Chartered Bank, from its base in Asia, is keen to offer solutions to locally-based suppliers in desperate need of working capital.

"For many suppliers today, the need is not just to receive funds due after the goods have been shipped through traditional invoice-based financing, but to receive funds before shipment so that they can get on with their production processes," says Tan Kah Chye, global head, trade finance at Standard Chartered Bank, who is based in Singapore.

He adds that his bank's close local relationships with Asian corporates have enabled it to play a key role in the provision of pre-shipment finance to many of these companies.

"In pre-shipment finance, 100% of the risk is on the suppliers. There is no obligation at that stage on the buyers. However, this risk can be minimised if there is a long-term relationship between the buyer and supplier."

He explains that Standard Chartered Bank is becoming increasingly involved in the provision of structured finance further up the supply chain, particularly for industries such as agriculture, where it supports farmers' entire supply chains through to storage, shipment and beyond.

"Supply chain finance involves having a relationship with all the parties in a supply chain on an ongoing basis. It involves working right across the supply chain – up and down it. With the current state of world trade and the banking crisis, it is important that providers step up the chain and bridge the financing gap," he says.

Wachovia is also very active in the provision of pre-shipment finance to suppliers across Asia, Latin America and Europe, working in conjunction with its large network of correspondent banks worldwide.

"We provide the visibility our local correspondent banking partners need using one platform. We provide payment guarantees for major Western European or US buyers and sometimes also provide the actual payments," says Roberts. "Our locally-based correspondent banks have relationships with suppliers in these countries and they provide the finance needed by and large."

UniCredit Group, which is also involved in pre-shipment finance, stresses the importance of having a large footprint, and relationships with suppliers at local level, when offering this type of structured finance.

"It is very important to have relationships at local levels with suppliers when providing pre-shipment finance. A major part of the risk is on the supplier – that the goods are produced and delivered in the right quantities and quality," explains Krönung.

"When offering this type of finance, we look for existing long-standing relationships between the buyer and the suppliers. We usually start with a classic buyer-centric model, and then extend the programme to a pre-shipment and in-transit model.

"Ultimately, we want to provide complete end-to-end supply chain finance programmes. There are only a few global banks that can provide this type of complete end-to-end solution by themselves."

End-to-end capabilities

For banks that have global footprints, and relationships in local markets, the opportunity to offer true end-to-end solutions, is certainly there.

"Banks have the ability to offer financing solutions across the entire production

> "These clients have enhanced their relationships with major corporate clients and have also established a competitive advantage."

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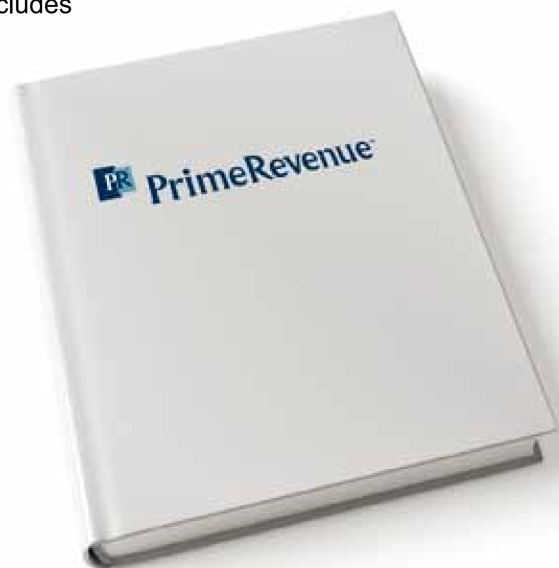

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Tan Kah Chye, Standard Chartered Bank

Vivek Ramachandran, head of cash and trade at Barclays Commercial, adds: "Today the trend is for buyers' or suppliers' relationship banks to extend financing options further across the supply chain. This can result in a single bank financing the complete trade transaction within the supply chain.

"Banks providing an end-to-end supply chain solution will get closer to the complete transaction, and develop a better understanding of the risks. Therefore, there is potential to reduce operating costs."

Working in collaboration

Many major banks recognise the importance of entering partnerships with third party providers, such as logistics companies and local banks, to offer financing solutions right across corporates' supply chains on a global basis.

"By working with other financial service partners, such as export credit agencies, development and multilateral finance institutions and transaction services banks on a collaborative basis to support corporates and their supply chains, banks can provide the additional capacity needed to fuel this market and further reduce programme costs," says Guttridge.

Ramachandran adds: "Third-party providers, such as freight forwarders, are gradually increasing their areas of influence across the supply chain. "Some freight forwarders provide direct links to insurance companies, pre-shipment services and finance options. Having physical possession of the goods places the carrier in a stronger position of control and provides visibility on repeat trade flows and the potential for value added services.

"We are continually seeking opportunities to work with third parties across the end-to-end supply chain."

Moving in on the game

However, the role of third-party technology services providers – as solution providers, enablers and true partners – in major supply chain finance programmes is becoming equally, if not more, important. Indeed, many technology solutions and services providers now look set to play a leading part in setting up programmes for large corporate customers themselves – particularly in light of the current movement towards multi-bank programmes.

"We have seen that certain corporates are less willing to place operations and funding with a single institution – both to spread their funding sources and reduce risks given the current shake-up among financial institutions," explains Betts.

"As demand for the proposition increases and proposed facility sizes increase, the ability of a single institution to take on range – from pre-export/pre-shipment finance, based on confirmed purchase orders, through to post-shipment solutions, based on buyer risk," says Andrew Betts, global head, trade finance and supply chain, global transaction services at RBS.

> "With the current state of world trade, it is important that providers step up the chain and bridge the financing gap."

Collaborating on supply chain finance

The growing popularity of multi-bank platforms is highlighted by the rise of TradeCard's supply chain collaboration platform which connects several financial institutions with multiple buyers and suppliers, enabling them to conduct automated supply chain finance transactions.

The hosted platform, which has attracted 4,300 suppliers and buyers as members, is being used by 25 financial institutions, which benefit from increased visibility into the physical and financial aspects of corporate members' supply chains, according to TradeCard.

Corporates that join the platform, meanwhile, benefit from a choice of financial providers, and can compare the rates offered for solutions that range from invoice discounting to pre and post-export financing. Suppliers can also purchase credit insurance from a range of financial institutions via the hosted platform.

"We are now handling many more international transactions via the platform," says Esther Lutz, vice-president of business development at TradeCard, pointing out that there has been a 65% increase in suppliers buying credit insurance since the financial crisis began.

"How buyers and sellers use the platform depends on their needs – their liquidity situation and risk structure. They may just need additional liquidity, or they may want to lend or borrow against only 50% of their invoices or receivables rather than 100%."

She adds that financial institutions can reach a large number of buyers and sellers via the platform and that where any one corporate has a particularly good credit rating, they will compete for this business.

"Many banks now have a strategy of not placing all their eggs in one basket. Using a bank-neutral platform reduces risks," she says. "A lot of smaller banks also don't have the infrastructure or resourcing in place to offer top-notch supply chain finance solutions. A solution like this enables them to compete with larger banks in this area."

100% of a facility onto their balance sheets has decreased so multi-bank solutions need to become more prominent."

Robert Kramer, vice-president of working capital solutions at PrimeRevenue, adds: "Many financial institutions are finding that they do not have sufficient capacity for very large buyers, and as a result more banks are getting involved in each buyer's programme. Many banks don't have the liquidity capacity to fund £3-4mn programmes and they are also concerned about country and jurisdiction risks."

This bodes well for technology services providers, which claim that by going directly to them, and investing in their supply chain platforms in the first instance, corporates can benefit from flexible, bank-neutral SCF platforms – through which they can access finance from as few or as many banks as they choose.

"Many corporates like the implications of having their own supply chain finance platforms," says Phillip Kerle, CEO of Demica, which offers an application services provider-based solution to both banks and corporates.

"When you use one particular bank's platform, you cannot change banks. Companies need the flexibility of being able to work on supply chain finance programmes with different banks.

"We enter a partnership approach with our corporate customers and then approach suppliers with them to explain the benefits of the programme to them."

By licensing software in this way, corporates can also get their programmes up and running quickly.

Kramer adds: "Third party technology providers are becoming increasingly necessary because buyers want all their suppliers to deal with the one single technology platform and have the same interface. This definitely places an emphasis on having a third-party provider, which can provide a single global platform.

"These things are all being driven by customer demand. They realise that they need multiple banks for big supply chain finance programmes."

A number of banks themselves also recognise the important role of third-party technology providers, and that flexibility on their part can mean more business. This is illustrated by the bank buy-in achieved by Misys for its trade portal for multi-banking solution.

"The collaboration and buy-in of KBC and ING Wholesale Bank were key factors in bringing this solution to market," says Olivier Berthier, solutions director, transaction banking at Misys.

The established front-end Misys trade portal solution offers online payment, foreign exchange hedging and pre and post-shipment finance services.

"In turn, these clients have enhanced their relationships with major corporate clients and have also established a competitive advantage."

He adds that Misys trade portal for multi-bank' software has recently been licensed by an international agribusiness and food company seeking to manage multiple banking relationships via a single portal.

RBS's Betts acknowledges that "where third-party providers have been able to facilitate supply chain finance solutions, they have made inroads".

"We have a strategy of remaining as flexible as possible to support our clients across whichever supply chain finance platform they choose – bank proprietary, third-party or client-owned."

Stuart Roberts, Wachovia

> "What these programmes need is not technology-driven syndicates, but banks that have the credit capacity."

He adds that one of RBS' most recent supply chain finance deals involved partnering up with PrimeRevenue, whose platform was installed at Sainsbury's in 2007, to provide the retailer's suppliers with online access to invoice-based finance. The bank is now fully supporting all of Sainsbury's registered suppliers, who can opt to receive early cash settlement of their invoices by selling them to RBS, via the PrimeRevenue platform.

Standard Chartered Bank, which has its own in-house developed, standardised platform, known as Straight-to-Bank, is also keen to support corporate customers that invest in third party solutions.

Tan Kay Chye says: "We will go with what the customer wants and believe that there is not any one system that will dominate the world.... However, we do prefer it if customers use our own platform."

JP Morgan Chase and Wachovia are two banks that remain committed to managing supply chain finance programmes on their own – and using their own platforms.

They both point out that, where they do not have the capacity or appetite for a single buyer's programme, they approach other financial institutions.

"We sell our deals on to other banks who want to invest in them because we can generate more capacity in this way. There is only a certain amount of credit available for any one customer under this type of programme," says JP Morgan's Quinn.

"We have had conversations with technology suppliers, but have found that in some cases they are servicing common customers. They are really looking for our balance sheets to support their programmes."

Wachovia's Roberts adds: "We are working on SCF programmes that require in excess of US$6-7bn in capacity. We are well-placed to build capacity in the primary and secondary markets, as we can access additional credit capacity if need be through the commercial paper market or private placements with our correspondent banks.

"What these programmes need is not technology-driven syndicates, but banks that have the credit capacity. Major global wholesale banks around the world can provide this liquidity and also the scalability now required.

"Technology is just a means to an end – this is a credit business and involves mobilising large scale credit." **GTR**