Supply chain evolution

Globalisation has fragmented supply chains and made them more challenging to manage. However, a number of solutions are emerging.

By Julia Henriques, Director, Supply Chain & Structured Trade Finance, BMO Capital Markets

Advances in global supply chain management have created a new business reality. Companies that once oversaw a discrete number of customer-supplier relationships now find themselves managing a complex matrix of third parties to make, store and distribute their products.

Supply chains have become fragmented, with companies operating in different legal jurisdictions, with their own unique business environments and banking practices. These complicated networks of relationships have led to increasing supply-chain finance inefficiencies that are only now starting to be addressed.

"Some estimates suggest that logistics account for at least 4% of the cost of goods sold," says Philippa Fitzsimons, Director with Canada's BMO Capital Markets. "And companies have become very good at minimising that cost. They are now starting to address the realisation that built-in financing costs account for an additional 4% of the cost of goods."

Importers using just-in-time processes may benefit from carrying a reduced inventory by transferring the cost of carrying that inventory to suppliers, she says. However, suppliers' working capital financing cost may well be at a higher rate than the importer's rate. Savvy buyers/importers realise that at the end of the day, these higher financing costs are simply added back into the cost of goods. By way of an example, companies that offer a discount of 2% off the sales price if the invoice is paid within 10 days may actually build that 'financing cost' into the face cost of goods at a rate of 24% or even 36%.

But there are solutions to this challenge emerging. For example, supply chain finance enables a supplier to obtain financing rates on receivables owed to it by large corporates at rates better than the supplier could obtain on its own working capital loans. In return, the buyer can typically negotiate better terms with its own suppliers in the form of better pricing or extended terms, thus improving its own working capital position. When suppliers sell the receivables to the buyer's financial institution, they receive cash sooner, improving their own working capital position. This technique provides significant benefits for both the buyer and seller in a unique win-win scenario.

Holistic approach

According to a recent report from technology analysts Aberdeen Group, "Supply chain finance leaders are creating a lower cost and more financially stable end-to-end supply chain, resulting in a strategic advantage."

Crucially, they note, innovators are examining inventory and supply chain finance more holistically and evaluating them not only in the context of their individual company, but from a supply-chain-wide perspective. These leaders are finding that in the process, they are able to reduce days inventory outstanding and, thus, are able to reduce their working-capital requirements to levels never before achieved.

In other words, companies are finding that opportunity lies less in reducing the cost of finance within the buying organisation and more in reducing the cost of finance across the supply chain for all players, particularly those that lack ready sources of capital.

"Take a strategic look at working capital optimisation and identify financial improvement opportunities," in these key areas, the Aberdeen report suggests:

- Estimate the impact of current inventory practices on the cash conversion cycle and the return on capital;
- Improve the transparency and predictability of cash flows and

the accuracy of operational budgets; and,

- Plan your days sales outstanding (DSO) and days payable outstanding (DPO) improvement initiatives in the context of the broader working capital management strategy – consider the impact of the current payment terms with customers and suppliers on the supply chain metrics. (ie. The ability/ need to carry more inventory and the viability of the supplier's production processes.).

"The key to success is building financial strategies on the basis of sound supply-chain processes, which ensures that both physical and financial supply chain management are optimised," concludes the report.

Vendors are responding

The trend towards integrated supply chain management has not gone unnoticed at international banks, which are leveraging internet technology and various financial instruments to deliver technology solutions to link buyers, suppliers and financing providers, optimising the visibility, financing cost and delivery of cash.

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> PHILIPPA FITZSIMONS, DIRECTOR, SUPPLY CHAIN & TRADE SOLUTIONS.

"A supply chain finance solution is a combination of trade financing by a financial institution, a third-party vendor or an enterprise itself, and a technology platform that unites the trading partners and the financing institution electronically, providing the financing triggers based on the occurrence of one or several supply chain events," wrote the researchers.

Supply chain finance platforms facilitate the process of exchanging purchase orders, invoices, payments and related documents, and help integrate this information between buyers, sellers and financial institutions. They provide secure channels to exchange financial information.

Canada's BMO Capital Markets is a case in point. The bank's trade finance department has long offered the traditional tools of global finance – documentary letters of credit (LCs), stand-by LCs and guarantees, and documentary collections – and several years ago enhanced those offerings with a leading internet-based platform, called Tradevenue Direct™. "Tradevenue Direct™ enabled seamless integration of the various components of clients' traditional trade products," says Fitzsimons.

BMO Capital Markets has also offered receivables or payables financing – the precursors to supply chain finance – on a manual basis for many years. Last year, it partnered with PrimeRevenue, the leading technology provider in SCF, to provide state-of-the-art infrastructure for payables financing.

It is further expanding its traditional trade platform through the Proponix integrated trade-finance platform to enable the processing of other open account (OA) financing products. Tradevenue Direct™ will soon be expanded to provide comprehensive reporting of the traditional products, such as documentary letters of credit, standby letters of credit, and collections, and also newer OA products such as supply chain finance, receivables financing and bank-assisted open account (a hybrid of an LC and OA payment).

With all this information at hand, clients will be able to use the system's flexible reporting tools to analyse their performance and fine-tune their strategy. Tradevenue Direct™ also includes powerful data mining tools to help build focused, customised reports. Its open architecture enables users to export data from these reports to other popular software applications for further analysis.

When banks receive purchase order information early in the process direct from buyers, and also manage the flow of related documents and payments, other forms of supply chain finance may be possible. Financing triggers in the supply chain can include the presentation of shipping documents by the supplier for 'in-transit financing'.

During the pre-shipment period, purchase order or raw materials financing may be possible. Partnering with a logistics company can facilitate warehouse financing and in-transit financing. Each buyer and their suppliers will have a unique combination of needs. Banks wishing to provide meaningful supply chain finance solutions to their clients need flexible technologies and partnerships to meet those needs.

"We strongly believe that effective supply chain finance can provide our clients an advantage in the marketplace," says Fitzsimons. "Companies have become extremely adept at managing their manufacturing and logistics to save money. We now find that leading-edge companies have turned their focus to minimising the financing costs of the entire supply chain. Through our various strategic partnerships and leading technologies, BMO Capital Markets is prepared to assist our clients in this evolving world." ❑