Windesheim

SCF 2.0: Supply Chain Finance Beyond Traditional Ways

From post-shipment to pre-shipment financing

In a globalizing economy, industrial value chains become more complex, spanning more countries and providers than ever before. Goods and information flows in the supply chain are increasingly integrated. The same cannot be said about finance flows. The credit crisis has revealed structural weaknesses. Rising costs of financing make it difficult for suppliers, especially SMEs, to obtain necessary credit. Supply Chain Finance (SCF) addresses these costs and risks of supply chain disruption, with approaches and instruments that optimize transactions, working capital and costs of the extended supply chains.

The most common form of SCF explored and utilized is currently Reversed Factoring. Reversed Factoring is a form of post-shipment financing with a growing market presence. However, liquidity needs of suppliers arise already before shipment of the goods. Therefore, experts are stating that pre-shipment financing is actually more crucial than post-shipment financing. The R&D project dubbed “SCF 2.0” helps suppliers to understand, develop and adopt pre-shipment SCF models. In SCF 2.0 corporates are participating with the aim to realize substantial benefits in the areas of operational enhancement, increased supply chain output, profits, cost reductions and risk mitigation.

SCF solutions reaching deeper in the supply chain

In principle, any type of company in the chain, large or small, robust or weak, can initiate the discussion to start a SCF programme. In many supply chains there is a focal company, quite often a large buyer, which controls and dominates the chain. Other partners in the chain would need the support of that large buyer to implement SCF models. And the large buyer will typically steer the improvement processes in the chain. This dominant buyer has two strong assets that give him the power to manage and control the supply chain: credit worthiness and purchase volume. Big dominant buyers are generally the focal company in the SCF programmes and often the initiator and facilitator of SCF programmes.

Despite dominant buyers having a leading role in SCF, there seems to be a common agreement that successful implementation of SCF solutions is about collaboration. As supply chains have become more complex, the supply chain partner could include any company in or connected to the supply chain. One can distinguish between tier 1 suppliers (direct suppliers), tier 2 suppliers (suppliers of the direct suppliers) and even tier 3 or 4 suppliers. These tier 2, 3 or 4 suppliers are gaining importance for SCF solutions. Examples of Heineken and Philips, both participating in SCF 2.0, show that corporates are not only seeing chances for SCF solutions with tier 1 suppliers, but also with suppliers deeper in the chain.

Heineken: leveraging credit rating further upstream

Heineken is currently enrolling a Supply Chain Finance program with the name “Supplier Finance”. By leveraging Heineken’s strong credit rating, Supplier Finance enables strengthening the supplier base by providing them with liquidity, while simultaneously harmonizing Heineken’s payment term. However, Supplier Finance is only focused on the post-shipment environment. Liquidity needs for suppliers arise earlier than the final delivery of the goods and the corresponding invoice. Therefore, Heineken is now looking at opportunities to leverage their strong credit rating further upstream. Heineken joined the SCF 2.0 research consortium and will produce case studies that are exploring these riskier pre-shipment finance solutions. The first case study which is currently being worked on, is focusing on financing current assets, i.e. inventories that tier 1 suppliers need to maintain. Sharing supply chain information and guaranteeing purchase of the inventories towards an external financier could lower the risk perception of the tier 1 supplier and therefore result in lower total supply chain financing costs.

Philips: extending the focus

Supply Chain Finance with tier 1 suppliers is already successfully implemented by Philips all across the globe, but now the company extends its focus to tier 2 suppliers. By developing a SCF framework for selecting tier 2 suppliers, Philips will be investigating whether working capital benefits can be achieved deeper in the supply chain.

Initial focus is on tier 2 suppliers that have a payable relation with Philips, such as a in Buy-Sell arrangement between the tier 2 supplier, Philips and the tier 1 supplier. The actual purchasing volume is an important criterion in the selection of the tier 2 supplier, both from a financial and operational perspective. With the introduction of a tier 2 SCF program, Philips seeks to reduce costs through, for example, cash-flow improvement, but it could also lead to the mitigation of risk by increasing supplier stability. It is clear that tier 2 SCF is not a program which can be implemented with any second-tier supplier. Further research will be done to determine the requirements for the selection of tier 2 suppliers.

Better financial performance and risk mitigation

SCF 2.0 will give further guidance to and insight in the main reasons for supply chain partners to develop and implement SCF models that are improving financial performance and risk mitigation. Improving financial performance can include lowering transaction costs, financing costs, purchase costs, transport costs, and so on. An important goal of SCF solutions is mitigating supply and delivery risk by dealing with financial stability of the supplier. Supply or delivery risk can be mitigated earlier in the chain by choosing SCF solutions that involve tier 2 suppliers. SCF 2.0 is set up to prove through experimentation and analysis that pre-shipment financing beyond tier 1 suppliers has the potential to increase stability of suppliers, allow for growth, increase loyalty and provide safety cushions against disruption.

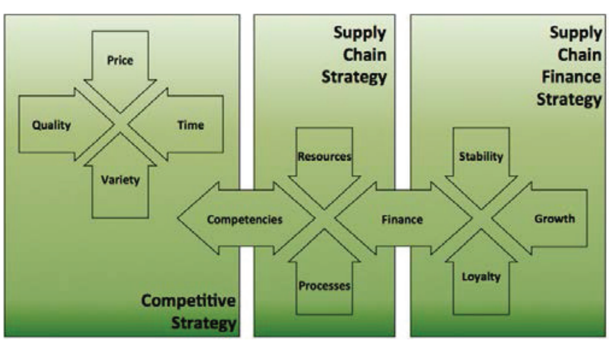

Figure 1: The potential of Supply Chain Finance strategy

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About the author: Michiel Steeman was recently selected as the inaugural holder of the Supply Chain Finance Professorship at the Windesheim University of Applied Sciences in the Netherlands.

He is also the founder and chairman of the Supply Chain Finance Community. His working experience includes a variety of roles for Deutsche, NIB Capital, NMB-Heller and ING.

At Windesheim Michiel Steeman leads the R&D project SCF 2.0.

About Windesheim: Windesheim is one of the largest universities of applied sciences in the Netherlands and has recognized Supply Chain Finance as a new interdisciplinary field of research in between supply chain management and finance.

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