SUPPLY CHAIN FINANCE

PHD VIKTOR ELLIOT AND JÖRGEN HOLMGREN
Inför the Cool Connection

• Ta med egen dator men lånedator finns om någon behöver
• För de som inte kan medverka kommer det att komma en ”krävande” kompletteringsuppgift på fredag eftermiddag
• Samtliga stundeter medverkar under hela den schemalagda tiden.
• Om ni har några frågor inför kan ni mejla mig: viktor.elliot@gu.se
PhD Viktor Elliot
Director Bitlab

Focus area:
Management Accounting and Performance
Management in Banks and other financial firms.

Current research:
Performance Management and Regulations in Banks; Implications of Indebtedness;
Digitalization, Risk Management and the Digital Ecosystem; Supply Chain Finance

Extensive executive training
Training boards and executive teams from 2013-2019

Selected publications:
Learning outcomes

• Basic understanding of the financial flows of the supply chain
• Basic understanding of the various product solutions included in SCF
Why Supply Chain Finance; all about the flows

• "The ultimate objective [of SCF] is to align financial flows with product and informational flows within the supply chain, improving cash flow management from a supply chain perspective" - Wuttke et al (2013)

• We can depart from practical perspective:
  • The financial crisis and liquidity shortages among firms
  • The link between the different flows in the supply chain
    ▪ Visibility: how do we make the flows visible?
    ▪ E-documents, tracking etc. blockchain
  • Supply chain efficiency; “win-win-win”
  • Who are the SCF-actors tomorrow?
  • The role of the LSP, the bank and other SCF parties

• But we can also have a more academic perspective:
  • Who gains from SCF and who gets the cake?
  • How can we reduce information asymmetry; risk and uncertainty?
  • To what extent can these solutions facilitate or disrupt trust?
Three Supply Chains

**INTERACTING FLOWS**

- Physical:
- Information:
- Financial:

RM Supplier  Component Supplier  Focal Company  Finished product  Retailer

RAW MATERIALS

FINISHING

FINANCIAL

INFORMATION

PHYSICAL

SCHOOL OF BUSINESS, ECONOMICS AND LAW
PHD VIKTOR ELLIOT
The missing element for flow

\[ \Delta \text{Visibility} \rightarrow \Delta \text{Variability} \rightarrow \Delta \text{Flow} \rightarrow \Delta \text{Cash Velocity} \rightarrow \Delta \left( \frac{\text{Net Profit}}{\text{Investment}} \right) \rightarrow \Delta \text{ROI} \]

**Variability** is defined as the summation of the difference between our plan and what happens. \( \text{Variability} \downarrow = \text{Flow} \uparrow \)

**Visibility** is defined as relevant information for decision making. \( \text{Visibility} \uparrow = \text{Variability} \downarrow \)
Definitions and a conceptual model

Three different definitions

- Everything that has to do with Finance in Supply Chains (1)
- All instruments that make the financial flow in the supply chain more efficient (2)
- One specific instrument: Reverse Factoring (3)

Figure 1: Overview of FSCM research streams.
Based on Liebl et al., 2016, p. 395.
Skillnaden mellan SCF, TF och TC

- Trade credit (TC): När leverantören ”lånar ut” pengar genom att fakturan inte ska betalas direkt (open account)
- Trade finance (TF): traditionella bankprodukter så som garantier och ramburser
- Det viktiga är egentligen inte skillnaden utan när de kan vara till nytta → informationsassymmetri
What kind of instruments?

Strategic
Vertical integration

Tactical
Capex

Operational Opex

R. de Boer, M. van Bergen, M. Steeman (2015), *Supply Chain Finance, its Practical Relevance and Strategic Value*
A supply chain is not a dyadic setting!
Reverse Factoring in detail

- Invoice is submitted from supplier to buyer
- The buyer electronically approves the invoice
1. When delivery is confirmed supplier can chose to be paid or wait
2. The factor (typically a bank) extends payment, withholding a pre-agreed discount, typically 100-200 bps over a period of 30 or 60 days
3. When the payment term expires the buyer pays the factor
Benefits for the buyer

1. Improves financial performance (by extending payment terms)
2. Reduces disruption and delay risk in supply chain
3. Reduces transaction costs

Drawbacks for buyer

1. Buyer needs to invest in P2P process to quickly approve invoices
2. Implementation costs
**Benefits for the supplier**

1. Room for (long term) investments
2. Reduces receivables risk
3. Reduces transaction costs

**Drawbacks for supplier**

1. Supplier often has to agree to payment term extension or discount to buyers to qualify for RF
2. There can be unforeseen costs (e.g. legal costs, regulatory costs)
Benefits for the financier/bank

1. Opportunity to get new clients
2. Low risk, because of creditworthy buyer
3. Receives a fee

Drawbacks for financier/bank

1. Possible cannibalization of existing business models of banks
2. Investment needed in technological platforms
3. Increases transaction costs
Implementation Costs

- IT maintenance costs
- Accounting and Legal assistance costs
- Training costs of internal staff
- **Supplier on-boarding costs**
- Procurement project management costs
- Monitoring costs
Obstacles to spreading out RF

- Lack of collaboration buyer-supplier
- Lack of knowledge
- Inefficient O2C and/or P2P processes
- Lack of internal cohesion

→ These are also obstacles for implementation of most other SCF instruments!
“Implementation costs” can still be high, that’s why buyers look at:

- **Strategic Relevance** of supplier
- **Purchasing spend.** Most buyers have threshold values for suppliers from 100,000 – 5,000,000 euros

**Trust** between buyer and supplier
Buyer-supplier relationship

Most big buyers have a supply base with a 80:20 structure.

SCF/RF programs will initially focus on the 20% suppliers that represent the biggest purchasing volume.

Most suppliers who are SMEs are in the 'lowest' 80%, and therefore are not the first candidates to include in SCF/RF programs.
Lack of knowledge

Reverse Factoring and other SCF instruments are relatively new:

- Most companies don’t know about possibilities and preconditions
- Lack of personnel with SCF experience
- External financial advisors and accountants often also don’t know
Inefficiencies in the O2C Process

- Lack of standardization in exchange of invoices
- Fragmentation of sales responsibilities
- Many different types of invoices
- No segmentation in types of clients
- Mistakes in invoices
- Disputes
  - Lack of standardization in handling disputes

Inefficiencies in O2C process
Lack of internal cohesion
Lack of internal cohesion

Supply Chain Finance is where multiple company departments that often do not speak each other’s language come together

- Supply Chain
- Finance
- Sales
- Purchasing

Salespersons are responsible for closing the deal, but not for following up on invoices
Andra risker och nackdelar

• Kan introducera systemrisk (vad händer om en stor köpare går omkull)?

• Har också i viss utsträckning används för regelarbitrage och för att förbättra nyckeltal för enskilda individer (belöning/incitament)

• Kan göra företaget beroende av en leverantör (bank eller Fintech)

• Kan innebära väldigt många system för leverantörerna
Dynamic Discounting

How does it work?

- Early payment for supplier
- Small percentage of the invoice goes to the buyer
- This discount is calculated as a function of time between payment date and actual due date, based on a sliding scale
Static versus dynamic discounting
Buyer: benefits and drawbacks

- Buyers can use it to reduce payment terms to suppliers in exchange for price discounts: this can increase gross margins.

- Relatively **high rates of return** compared to other investment alternatives.

- Dynamic Discounting **does not contribute to working capital objectives**: buyers use their own cash, no bank involved.
Supplier: benefits and drawbacks

- Supplier **reduces DSO** and **lowers working capital needs**

- **Decreased profit margins** on sales

→ So, Dynamic Discounting will be beneficial for supplier if the discount can still offset the costs for arranging financing by itself
## Reverse Factoring vs Dynamic Discounting

### Similarities
1. Both buyer-driven financial arrangements
2. Often facilitated by technological platforms

### Differences
1. No bank involved
2. Extending payment terms is not possible
3. No expensive KYC checks are required for Dynamic Discounting
Några ord om marknaden för SCF
Most respondents have or are considering SCF. Reverse factoring is by far the most implemented solution.

- 55% of respondents are running a SCF programme.
- 23% of respondents are running more than one SCF programme.
- 41% of respondents who are not running a SCF programme are considering or implementing a SCF programme.

Note: see appendix for explanation of different SCF solutions.
The trend for SCF roll-outs continues to grow often driven by the finance function

Smaller companies are beginning to introduce Supply Chain Finance. Prior to 2012, SCF programmes were predominantly implemented in companies with revenues $>$ €1bn

Finance and Procurement are the departments most involved in the adoption of SCF solutions

Logistics and Sales, not surprisingly, had most limited contributed
Några ytterligare frågor

• Kort vs lång sikt
• Strategiskt eller ej – skulle kalla det taktiskt som en del av en bredare strategi
• Framtiden för SCF