



STRENGTHEN Your Financial Supply Chain

**To optimize working capital,
supply management executives are
rethinking their perceptions of this
vital segment of the profession.**

By April Terreri



Organizations today are searching for the same visibility in their financial supply chains that they enjoy in their physical supply chains. In the attempt to minimize incremental costs at every touchpoint along today's long and complex global supply chains, they are looking more closely at receivables and payables. This is because every activity that happens along the physical supply chain generates a financial effect. Essentially, the financial supply chain involves the flow and use of cash throughout the physical supply chain, where there is an accompanying flow of cash in the transfer of products, services and information.

For this article, I spoke with experts in supply chain finance to discover how organizations can optimize their global supply chains through astute monitoring and management of the financial effects generated by their physical supply chain. When organizations perceive their inventories as working capital in motion, and they integrate both supply chains holistically, they can achieve impressive dividends.

Lowering The Overall Cost Of Goods

The amount of time it takes between ordering goods from international suppliers and receiving cash from the sale of those goods has lengthened, sometimes by two or more months, reports Anthony Brown, managing director — international of New York-based First Capital.

“Increasingly, suppliers are financially weaker than the organizations they supply, and these suppliers are often located in credit-impaired countries where the cost of working capital is high,” he says. “Such high-cost supplier financing is driven by the offshore credit market conditions and the supplier’s credit standing. Therefore, the challenge is how to lower the cost of goods by minimizing or eliminating uncompetitive financing costs while, at the same time, underpinning the financial health of suppliers.”

Let’s take a look at the term “financial supply chain.” Several years ago, ISM defined the financial supply chain as “inclusive of the flows of cash from firm to firm, incurred expenses, investments and costs of processes involved in the creation and delivery of goods and services.”

Its usage has gained popularity within the last five years, according to Thomas Nash, CEO of Xalles Limited, a global management consulting firm in Herndon, Virginia. “Previously, you would talk about treasury management, cash management or freight payment — in other words, the isolated financial processes. But companies were more concerned with physical supply chain efficiencies. The financial side and process integration

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have really lagged behind. The paradox is that it takes longer to make payments than it does to move tons of goods around the world," he says. This also holds true for domestic operations.

One of the challenges facing organizations is how to manage their complex international financial supply chains. One solution is available from large banks and IT global trade platform providers that offer supply chain finance programs (or payables programs). Such programs allow organizations to use the bank's unsecured extended credit facilities to negotiate longer credit terms with international suppliers, thereby extending payables obligations, explains Brown. "In addition, many organizations work out deals with their bank to pay the supplier early, thus triggering discounts for prompt payment of the organization-approved invoices. Such discounts can be passed on to the buyer organization to lower the overall cost of goods."

Working Capital In Motion

Because every activity in the supply chain has a financial ramification that is reflected on the income statement and balance sheet, organizations strive for end-to-end and interrelated processes of physical, information management and financial activities.

Financial settlements maximize payable and receivable cash flows, while inventory management protects and optimizes sales price by having the right product at the right place at the right time, explains Bernard Hart, logistics product head at New York-based JPMorgan Chase. "What we are really dealing with is working capital in motion."

It doesn't make economic sense for organizations to deal separately with their financial and physical supply chains, continues Hart. Both sides of the transaction need concurrent management. If a supplier is inefficient, a supply executive will end up paying more for his or her products, or

they won't be delivered on time, thereby diminishing their value. The ultimate goal of supply chain management is to assure the realization of the expected sales price and achieve high customer satisfaction for the lowest possible cost.

Supply management is gradually moving to this level of integration between the physical and financial supply chains, Hart observes. "I say gradually because many organizations are examining what they can do to drive down the price per unit with their brokers, carriers, freight forwarders and banks. But they are not looking at the environment holistically to improve their overall supply chain from the perspective of the ultimate impact to the customer on price, on-time delivery and product quality as measured by customer satisfaction."

By integrating the two supply chains, organizations can manage end-to-end mechanisms put in place to optimize financial settlements, inventory management,

Chinese Manufacturer Solves Cash-Flow Problems

This story is a familiar one for international manufacturers: slow payments and unbalanced cash flows that jeopardize the manufacturing flow. Sunfor, based in Chengdu, operates three factories in the central-western region of China. It produces photo-luminescent materials (PLMs), energy-saving lighting devices and LED lighting products. "We had a cash-flow problem because we had to wait a long time to be paid," reports George Deng, international marketing manager. "This is why we are trying to find a solution working with Xalles Limited."

Sunfor began its relationship with Xalles in June 2007 and, so far, the company is beginning to feel less of a pinch. "We can finance our production without worrying about delays in payment. Xalles manages our financial supply chain for us, and we can focus on making our PLMs and lighting products," Deng says.

Through its Singapore-based personnel, Xalles has helped the organization break into a new market: the government of Singapore. "Xalles has a good relationship with the government and they know how to deal with them," notes Deng. "The government of Singapore is a creditworthy client. When we secure

orders from them, we can present our orders to our bank and they can help us finance our production, giving us the financial support we need to continue manufacturing."

With an improved cash flow, Sunfor can rearrange its resources and investments to enhance productivity, eliminating financial worries.

Having its financial supply chain managed also delivers transparency into Sunfor's transactions, something they didn't have before. Deng believes visibility is key to understanding the exact cost for each touchpoint throughout their financial supply chain. "Visibility gives us an understanding of the corporate costs like manufacturing, transportation, customs clearance, warehousing, marketing and all other expenses that occur along the supply chain involved in international sales," he says.

Deng is positive Sunfor is now on the right track to move more aggressively into other international markets, and especially into the United States. "Our goals are to increase our revenues and reduce our overall costs. Now that we are successful in domestic markets, we are ready to break into international markets and Xalles is helping us develop our business strategies so we can execute them effectively (for this next phase)."

and cost and expense management of the physical supply chain, explains Hart. “Getting the data to support the physical goods’ movement is key in providing the financial transaction for settlement services. We also advise organizations in overall risk mitigation by helping them improve their supply chain business practices,” he says.

Although organizations might purchase products internationally at a lower price, some of those savings could be eroded by the length of time needed to carry those products on the company balance sheet. “For this reason, the CFO is getting more actively involved, along with the international sourcing director,” says Brown. “The company’s bank, its investment analysts and its shareholders are interested in financial metrics like liquidity ratios and return on capital.”

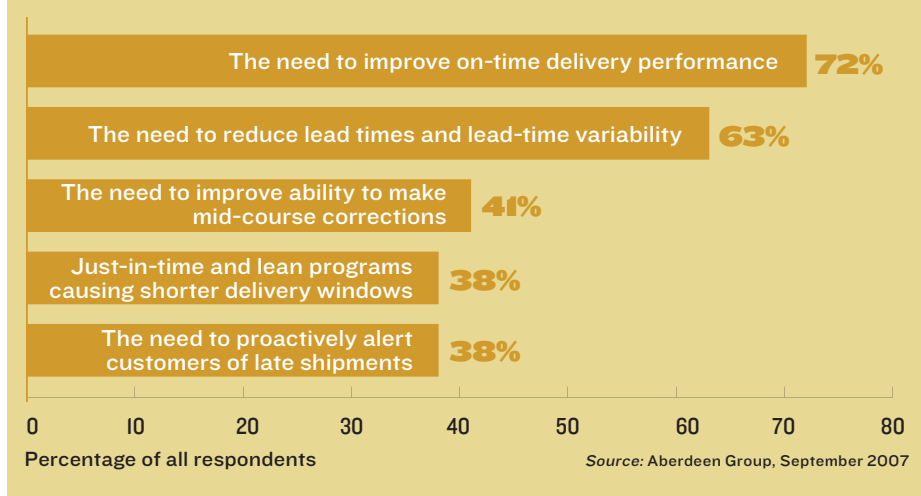
Holistic Integration

In addition to using financial instruments to optimize global financial supply chains, organizations are revisiting their financial practices with suppliers and customers to identify areas for improvement, states Viktoriya Sadlovska, supply chain finance and global trade research analyst at Aberdeen Group in Boston. “Companies are identifying where they could attract third-party financing for certain stages of their supply chains and what information technology platforms can help them streamline the payment and collection processes,” she says.

A current Aberdeen study, *The 2007 State of the Market in Supply Chain Finance*, shows that less than 50 percent of large organizations actually know their suppliers’ cost of capital. “This is really alarming,” Sadlovska says. “Supply executives involved in emerging-market sourcing should make the effort to discover what the financial pain points are for their suppliers, which will ensure that the entire supply chain is more stable. Large U.S. and European Union importers are helping their emerging-market suppliers get better access to trade financing by leveraging the buyer organization’s lower financing rates.”

Best-in-class organizations have been the most successful at integrating their

Top Five Drivers For Improving Global Supply Chain Visibility



physical and financial supply chain strategies, both internally across departments and externally with their suppliers and customers, adds Sadlovska. “Taking a holistic approach to the financial supply chain within one’s own organization is essential, since the goals and metrics of particular departments in an organization may differ.”

Granted, the question of where to start in financial supply chain optimization can be daunting. “It goes beyond the simple payment of goods,” says Nash. Xalles’ clients are solution providers that work in relatively niche areas. Look at the big picture to identify where the low-hanging fruit is and what creates the biggest cost inefficiencies, Nash advises. “It could be a matter of treasury management or it may be something that can be optimized using simple document automation so the proper staff receives and acts on the appropriate documentation. For very little investment, there is a wealth of online collaboration tools and customizable document management tools so a company doesn’t have to spend millions of dollars on SAP or Seibel to share documents.”

Starting at the highest level, Xalles drills down quickly to find and solve problems. That might be as simple as instituting basic process re-engineering with the proper people to implement a “people solution” quickly without having to build new

systems. “Other times, it could mean a \$50,000 automation solution using simple repository tools that allow access of paper-based information to users through the Web,” Nash explains.

Organizations should think of an overall project as a series of mini-projects, each with its own business case, Nash says. Some common challenges with each mini-project include compliance issues, lack of visibility, financial inefficiency and the need for greater risk mitigation.

Another way supply management grapples with taming the financial supply chain is by rethinking inventory. “People prefer to avoid owning it,” states Brown. First Capital offers its Inventory Purchase Program, buying presold inventory for cash when it arrives in a U.S. warehouse near the buyer organization’s locations. “Foreign banks or suppliers can get paid faster. Lenders are cozying up to logistics companies that recognize the importance of creating end-to-end visibility platforms for the movement of goods. They understand that what is freight for them is collateral for a lender,” Brown adds.

End-To-End Management

Cost is the driver for financial supply chain optimization. “Companies are looking at a cost-to-deliver model and a cost-to-serve model in supply chain

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financing,” notes Mickey North Rizza, research director for AMR Research in Boston. This means optimizing across their networks and ecosystems of suppliers and customers by using an outside-in approach in understanding the effects of their cash flow on themselves, on their suppliers and on the final cost of goods or services they move and deliver.

When companies are efficient with their working capital, they borrow less, states Alenka Grealish, managing director of banking process for Celent, based in Boston. “This is the bottom line,” she affirms. She adds that banks play a role upstream of payment by helping facilitate invoice by collection in order to help fund suppliers.

Although financial supply chain optimization is a hot topic, implementation is spotty at best, agree the experts, and implementation is usually deployed

incrementally. Hart at JPMorgan notes customers want embedded solutions that focus on their current processes.

Supply chain finance is an emerging category in which a variety of services and technology offerings are possible, explains Sadlovska. According to the Aberdeen current state-of-the-market study, organizations are divided on whether they would like to obtain these offerings from banks, technology providers or partnerships between the two. “This indicates that the market is still being defined and will continue to evolve over the next several years.”

The supply management profession is developing the infrastructure to facilitate end-to-end management through one-stop shopping, while providing definitive value at a lower piece price, notes Hart. This can mean guaranteeing end-to-end transactions while also guaranteeing the financial flows, logistics flows and compliance requirements

at a lower discount through defining trade lanes that are secure environments. “We can manage and back these environments,” he says.

Taming The Network

Automating the financial supply chain provides transparency into every transaction along the chain. “Problems arise when organizations are called and asked where payment is,” notes Grealish at Celent. “A (buyer organization) might answer it has disputed the invoice, so automating the dispute process can really shrink the time down significantly, especially if the people who are involved in the workflow are in different locations.”

Some financial supply chains are closed-transaction networks that allow the supplier to send out invoices automatically, so that organizations have the opportunity to review and communicate directly

Inventory Purchase Program Delivers Pipeline Liquidity

Sourcing goods globally and buying them locally offers buyer organizations opportunities to improve their financial metrics. First Capital’s Inventory Purchase Program allows them to do this painlessly, as First Capital buys the required goods for buyer organizations from international suppliers. “A big benefit to this program is the goods remain off the buyer’s balance sheet. This is done in a way totally compliant with accounting and regulatory standards,” states Anthony Brown, managing director — international, for First Capital, New York.

First Capital assumes ownership of goods ordered by a buyer organization from offshore suppliers when they arrive in the United States. Against assignment to it of the buyer’s orders, First Capital pays the suppliers cash on delivery, he explains.

A major U.S.-based international food corporation is one of the first clients to enroll in this new program. Here is how it works: The food company sources many of its raw materials globally, such as a variety of food ingredients and packaging materials. Goods are delivered to a third-party logistics (3PL) warehouse close to the food corporation’s location so the company can have goods delivered as needed. The overseas supplier is the importer of record. The food company issues purchase orders to its suppliers, and those POs are assigned to First Capital. The seller then receives cash payment against its invoices to First Capital.

“The logistics costs are controlled. The supplier gets financing upfront when the goods arrive in the United States, and doesn’t have to own and finance the goods during the holding period, which can be anywhere between 30 days to 180 days,” Brown says. “We are ensuring liquidity in the supply chain that can be used by the food company’s supplier to promptly pay its own suppliers.”

Brown reports that there is a symbiotic relationship between 3PLs and trade financiers because the 3PLs have the expertise to move, manage and provide transparency to goods. Most, however, are reluctant to finance the goods they handle, or worse, they are reluctant to purchase the goods for cash. “This is an emerging role for mercantile lenders, and organizations are interested in this model because they want to ease the financial constraints of their international suppliers and obtain a lower cost of goods for having arranged alternative and less expensive financing. Suppliers like the model because it gives them needed working capital to replace cash tied up in inventory.”

What drives this model is simple math. “If the suppliers’ costs of financing and logistics are transparent to the buyer organization, he can bring lower-cost alternatives to the table by leveraging the buyer’s relative creditworthiness and buying power,” Brown explains. “The result is that financial and operational inefficiencies are squeezed out of suppliers’ costs of goods — and a huge

without having to fax or phone suppliers, continues Grealish. “Suppliers are encouraging their buyer organizations to pay and remit electronically in order to expedite the process, which could mean discount rewards because suppliers receive their funds faster.”

Both buyer organizations and suppliers benefit from visibility. On the one hand, buyer organizations can outsource the management of all payables to a financial institution or an IT platform supplier. They can save significantly on administration in their accounts payable departments. On the other hand, international suppliers can see which invoices are approved as they are posted to a Web platform. This allows them to approach a third-party lender and borrow at a discount against the approved invoice amount, borrowing against their receivables at costs driven by the creditworthiness of their U.S. buyer organizations.

improvement in the buyer's margins. Transparency allows the buyer to choose between different suppliers on a level playing field.”

By taking ownership or control of these goods, First Capital acts like a lender, but thinks like a trader, explains Brown. “It is very important to understand we are not representing ourselves to any party as a trader in these goods. We are not looking to compete with our clients or to suggest we are experts in global sourcing. That is the responsibility of the transaction parties, and that’s clear in our inventory purchase agreements. We act as facilitators and fulfillment service providers.”

For First Capital, this symbiotic relationship with 3PLs relies on them having a global footprint. “We need them to be ultracompetent and we need them to have world-class online freight tracking systems because what is freight for them is collateral for us. With our thin lending margins, we can’t afford for there to be a snafu,” Brown concludes.

Brown points to several gaps in the financial supply chain that offer significant growth potential. Preshipment or production financing has not yet been fully integrated into end-to-end programs. “Supply chain finance programs do not typically cover the period prior to export from the originating country, when the factory has to finance the purchase of all the raw materials and labor to make the products the buyer organization ordered,” he says.

Another challenge for supply chain lenders — particularly banks — is extending credit to small- and medium-sized enterprises (SMEs), which are often straddled by large corporate entities on either side of the supply chain, according to Brown. “With the substitution of open account terms for letters of credit to settle international payments, banks have begun to offer payables programs to the most financially sound, investment-grade buyer

organizations,” he says. “But there are thousands of SMEs that are not rated and that account for a sizable portion of international business, yet they are ill-served by bank-sponsored trade payables programs. This gap is being filled by mercantile lenders better able to assess the risks of extending credit to this segment.”

One way First Capital serves the needs of international SMEs is by developing partnerships with foreign national banks, particularly in Asia. “These foreign lenders often don’t have any presence in the large Western consumer-buying countries,” Brown says. “Therefore, they find it difficult to assess the creditworthiness of their clients’ SME importers to collect and remit receivables and to control their clients’ offshore inventory. In turn, we are challenged to provide production financing to Asian manufacturers within their markets. So we team up to provide each other complementary supply chain services that, in combination, offer an end-to-end solution to our respective clients.”

He adds that multinational buyer organizations are best served by international banks, while non-bank-owned finance companies are the best domain for small- and medium-sized companies.

The future looks bright for continued evolution in financial supply chain management. Sadlovska notes that an Aberdeen study on global supply chain visibility found 51 percent of respondents were highly interested in managing their supply chain, procurement and finance processes from one collaboration platform. Visibility used to be a desired thing, but today it is essential. “Now it’s impossible to optimize an organization’s global supply chain operations without having visibility into its key supply chain events. It also plays a critical role in managing the financial processes, leading to improved supply chain finance practices,” she concludes. **ISM**

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Top Five Global Trade Trends

- 1) **Increased reliance on overseas sourcing;**
- 2) **Global manufacturing capacity mushrooms, increasing competition among exporters — forcing them to accept open account payment and local delivery terms;**
- 3) **Movement to direct buying/selling (no middlemen);**
- 4) **Lean manufacturing means inventory push-back to exporters for just-in-time delivery;**
- 5) **Trade, finance, logistics and IT are converging to offer improved risk management, collateral control and financial service innovation.**