WHITE PAPER

Supply chain networks are creating new business opportunities for finance providers

FINANCIAL SUPPLY CHAIN

Supply chains are continuing to grow increasingly complex as companies contend with modern business challenges, such as expanding globalization and increasingly stringent sustainability requirements.[1] As a result, many companies are devoting greater attention to their often-overlooked supply chains; finding ways to improve real-time visibility and increase end-to-end transparency. But in today's fast-changing business environment, just meeting these essential logistics needs may not be enough. Companies looking for a competitive edge need to be able to differentiate themselves with new business models and service offerings.

And wherever there's change, there's also new opportunities. A growing number of companies are embracing supply chain networks and enabling real-time visibility to the supply chain. This level of accessibility to real-time, business-critical data represents an untapped "gold mine" of information that supply chain finance providers can leverage to deliver new services up and down the supply chain. Finance providers that are willing to evolve alongside the supply chain industry can be at the center of this evolution. Read on to learn why and how.

1. APICS & Michigan State University, Managing the Supply Chain Complexity Paradigm, February 26, 2019.

Financing beyond invoices

Most supply chain finance programs currently just deal with approved invoices—essentially at the end of the transaction lifecycle. Only once a buyer (such as an apparel company) approves an invoice of its supplier (such as a clothing manufacturer in Bangladesh), does a finance provider then pay the supplier. For the finance provider, this is typically a low-risk service that provides decent returns. Unfortunately, many competing finance providers also offer post-invoice-approval services—rending this service not much of a strategic differentiator.

It's in the areas outside of post-invoice-approval services where finance providers can find ample opportunities for differentiation. There are multiple points earlier in the transaction lifecycle where suppliers desperately need capital—such as during ordering, production, and shipping. If a finance provider can offer services at these earlier points, it could become a strategic partner in the supply chain—promoting growth and generating long-term value.

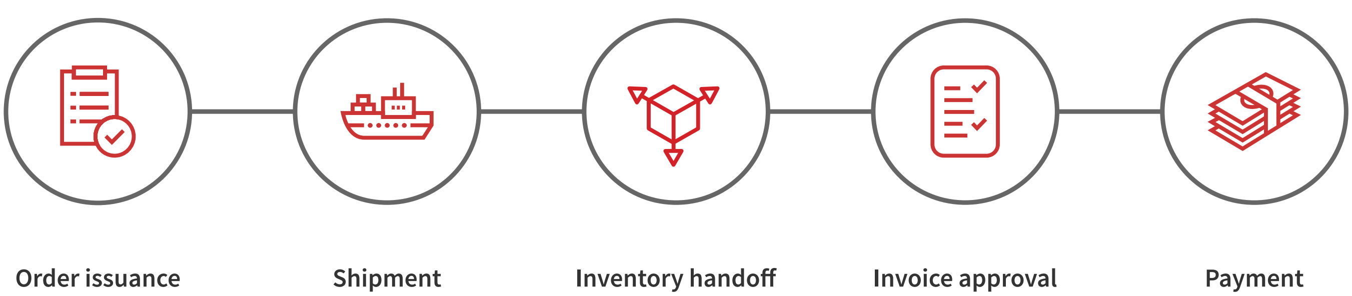
This is a fairly recent concept for finance providers, as financing at earlier points in the transaction cycle has traditionally been difficult to execute. For finance providers to release capital when a purchase order gets issued, or when production begins, or when a supplier ships goods, the finance provider requires knowledge of precisely when each of these events happen.

Four types of precision supply chain financing

- **PO financing**—Suppliers gain access to capital to accept and begin work on orders—removing strain and risk from both suppliers and buyers.
- **Performance-based financing**—Suppliers are rewarded with better rates based on performance scores, such as transactional performance and social-responsibility metrics.
- **Inventory financing**—Working capital is freed up by financing inventory or by removing inventory from the books.
- **Data-driven financing**—Financing is made available to qualifying suppliers based on insights from the network data, such as performance history and compliance.

Fig. 1: Expanding into more areas of the supply chain transaction lifecycle

There are many opportunities for financing prior to the invoice approval stage:



This kind of visibility isn't feasible when buyers and suppliers interact through outdated, point-to-point communication means like spreadsheets, emails, and phone calls. In fact, when buyers and sellers rely on these types of limited communications, they may not know if or when a crucial supply chain milestone has taken place until well after the fact. And finance providers typically only get this information after the buyers and suppliers manually provide them with it.

Modern technology, however, offers a solution. Cloud-based supply chain networks can directly connect buyers, suppliers, and third parties together—with all transactions taking place on a single, shared platform. This gives finance providers the infrastructure to expand supply chain finance beyond just approved invoices. For this happen, a supply chain network must have these four crucial capabilities:

- Create a "single version of the truth." With only one route of communication, and one set of forms and confirmations that everyone works from, there should be no conflicting reports about whether or not, for instance, a supplier has received a purchase order.
- Make communication between buyers, suppliers, and third parties instantaneous because network platforms provide updates in real time.
- Ensure that events pertaining to the physical and financial flow of goods are completely visible and verifiable. For example, a supplier can update the network the moment production begins—with the buyer, finance provider, and any other stakeholders being instantly notified.
- Enable finance providers to become strategic players in the transaction lifecycle by being connected to real-time supply chain events.

When supply chain networks can serve as an independent, reliable, and up-to-date systems of record among many different organizations, they provide the foundation on which finance providers can uncover and leverage lucrative financing opportunities earlier in the transaction lifecycle. When finance providers connect to these cloud-based supply chain networks, they can create innovative financing programs that buyers and suppliers rely on to free up working capital, cut costs, and improve operations.

Serving underserved suppliers

There's a "long tail" of neglected suppliers whose needs have been underserved by current financing programs. These suppliers are a huge market opportunity for finance providers, but servicing them requires:

- Detailed performance data
- Easily scalable models
- Services to onboard and support the suppliers

With a preestablished supply chain network, meeting these requirements becomes easy. A supplier might already be connected to a platform for other financial functions. This makes it easy to onboard the supplier for financing. The entire network can serve as a single place to access up-to-date information and help drive decision-making.

Unlocking greater value for customers

Many finance providers regard supply chains as an attractive market due to the sheer number of transactions that take place between buyers, suppliers, and other third parties. Capital can change hands just as frequently as physical goods in the supply chain. But to date, most finance providers get involved primarily after invoice approval—typically to extend payables for buyers and help suppliers get paid early.

This highlights the value that comes when all parties collaborate together: Buyers free up working capital, suppliers get paid early, and financial institutions provide a transactional service. But helping buyers extend payment terms and paying suppliers early are just the start of what's possible for financial providers. When a finance provider can gain true, end-to-end visibility across the supply chain network, this unlocks even more potential value to buyers, suppliers, and finance providers by injecting capital at earlier, critical parts of the transaction lifecycle. At the same time, gaining "precision financing" capabilities from end-to-end visibility can also lower the risk to services that finance providers offer.

Reducing risk with networks and big data

When finance providers receive documents via fax, email, phone, courier, or EDI, this information is document-based, not data-based or automatically updated. So, for finance providers to evaluate buyers, suppliers, and their transactions, they have to collect the needed information manually. Without a supply chain network in place, information about when exactly a buyer issued a PO, when a supplier received it, when production began, when it finished, when products shipped, and when carriers took possession is all fragmented.

This spread-out and limited information has made it difficult for finance providers to assess risk—forcing them to traditionally rely on credit history as the main metric for supply chain finance. Working with an invoice that's already approved is considered the "safest" moment to engage with the supply chain.

Supply chain networks have completely changed all this by providing a simple, but powerful information model that securely connects organizations together and enable seamless collaboration on both physical and financial transactions.[2] Since all engagement between organizations (documents, notifications, communications, etc.) occurs through a common, shared platform, there's a single, clear record of what happened, when, where, and to whom. This end-to-end visibility enables finance providers to reach beyond traditional approaches (like credit history and post-invoice-approval) to become more engaged in additional aspects of supply chain finance.

This level of visibility allows all parties to make financing decisions sooner and with lower risk. It can help finance providers work with buyers and suppliers—including smaller players and "long-tail" suppliers—to design innovative programs that inject cash earlier in the transaction lifecycle, using metrics that are far more powerful and relevant than credit history to asses risk.[3]

Becoming an integral part of the network

If a finance provider can become an integral part of a supply chain network, the finance provider can create value that also benefits suppliers and buyers.

Suppliers gain:

- Faster access to capital
- Better rates on capital
- Access to capital earlier and at more stages in the transaction lifecycle

Buyers gain:

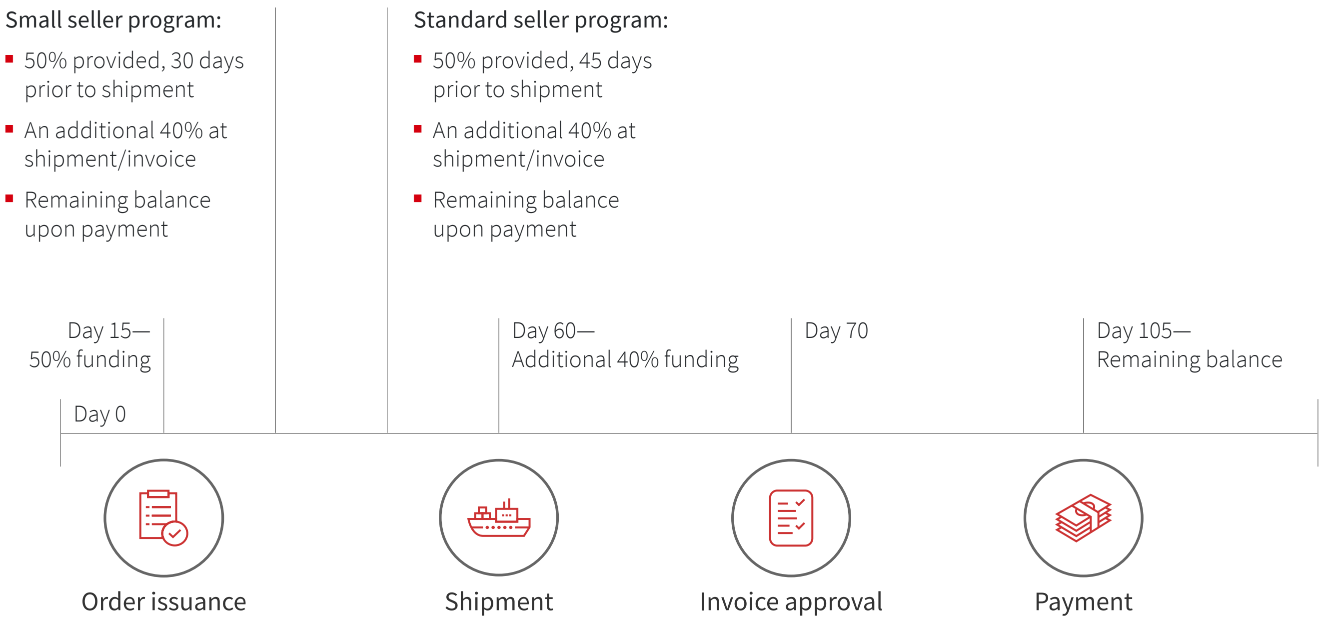
- Improved supplier relationships
- Reduced supply chain costs
- Assured supply

Finance providers gain:

- Visibility into real-time and historical transactions to reduce risk
- Streamlined processes for gathering performance data
- Reduced paper documentation
- Greater revenue opportunities to finance the supply chain

2. "Supply Chain Collaboration—The New Way to Drive Value!," Supply Chain Game Changer, May 29, 2020.
3. McKinsey & Company, "Long tail, big savings: Digital unlocks hidden value in procurement," June 2018.

Fig. 2: The Opportunity for innovation



By being connected to a network, finance providers can offer capital at different stages of the transaction cycle and create programs that reward the completion of specific supply chain milestones.

Moving from the sidelines to the center of the transaction lifecycle

Just like all other pieces of the supply chain, suppliers need capital to fund their operations. Suppliers also require capital to maintain their strategic supply chain goals, such as assuring supply, conducting ethical production, and supporting sustainability initiatives—all made more challenging in a global business environment. Unfortunately, there are many factories around the world that have long track records of reliability, yet their size, location, or credit history prevents them from accessing capital.

Many suppliers also find themselves at the financial mercy of their customers. Pressure on buyers to cut costs or extend payment terms often results in customers making late payments to suppliers, or buyers sourcing from the lowest-cost vendor regardless of quality, or customers using size advantage to bully suppliers into unfavorable contracts. Such circumstances are typically volatile and can't be sustained long-term.

Finance providers can help fill these holes by becoming the center of supply chain transactions. For instance, finance providers can fund suppliers at earlier moments in the transaction cycle to help them meet their strategic supply chain goals. By doing so, they simultaneously free up working capital for buyers. Suppliers and buyers both come out winners.

To make this happen, finance providers need to connect to supply chain networks and be willing to embrace new methods of determining credit worthiness. Considering that many large buyers and suppliers already use supply chain networks for functions like procure-to-pay and supply chain visibility, finance providers should be able to join supply chain networks without having to rely on new, point-to-point integrations. Once finance providers are part of a supply chain network, they're in a position to offer services to virtually any organization in that network—including the smaller factories that have long been underserved.

Such underserved suppliers can be an enticing and lucrative market for finance providers, but capturing that market requires that finance providers use something other than credit history as the primary metric for setting financing terms. Many factors going into calculating credit ratings, and not all are relevant when it comes to setting financing terms. The ideal measurement finance providers should use is based on a supplier's reliability.

And the best way to know that is by evaluating how well a supplier has performed in the past—such as measuring how consistently the supplier produces and delivers on-time, on-budget, with quality, and according to specifications. Finance providers want to know how well a buyer proves payment, on-time, and according to terms.

Supply chain networks have detailed information about all of that payment history. As transactions take place in the network, the platform builds up a precise, data-driven record of suppliers, buyers, logistics providers, and their relationships to one another. Finance providers that are connected to such networks can gain direct access to this valuable information and use it as a more granular and reliable benchmark for assessing risk (than just using credit rating alone). This allows finance providers to safely tap into new markets, like underserved suppliers, while also offering innovative new programs to existing markets.

Carving out a competitive edge

Finance providers have the opportunity to become indispensable strategic partners to the entire supply chain. They can help buyers assure supply and free up working capital. They can help remove uncertainty and create strong, financially healthy suppliers. They can create situations where buyers and suppliers can get the lowest cost of capital—holistically.

When a finance provider is connected to a supply chain network, it can leverage those connections and access to information to create opportunities for innovation, such as creative financing programs that can be quite profitable.

Applying data-driven financing

An Infor® customer—a leading sporting goods company—needed to add additional suppliers to support production, but the company had credit issues. Because finance providers were able to see the company's strong payment and transaction records on a supply chain network platform, the financial providers were able to offer financing at favorable rates to the company's new suppliers—allowing the sporting goods company to grow and expand, despite its credit history.

For example, finance providers can provide initial funding to suppliers to purchase materials, more funding when production starts, and even more when a certain percentage is completed. And when it comes time to transport inventory, the finance providers can take ownership of the inventory—freeing up everyone else's working capital—before remitting final payment to suppliers after the approved invoice. By offering multiple programs, finance providers can generate more streams of revenue and generate potential for business growth.

With access to real-time information, finance providers can become active leaders in the entire transaction lifecycle, instead of merely "investing from afar." In the process, they create benefits throughout the entire supply chain. Finance providers need to seize these opportunities to (finally) tap into the unfulfilled potential of financing the supply chain. Those that do, can truly transform their business and carve out a competitive edge.

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