CIPS Procurement Topic

Supply Chain Finance (SCF)

Supply chain finance helps bridge ... the supplier's desire to be paid quickly ... and the retailer's desire to extend credit terms (Morrell)

CIPS members can record one CPD hour for reading a CIPS Knowledge download that displays a CIPS CPD icon.

Introduction

Supply chain finance (SCF) is a relatively new concept. It is most relevant to logistics, supply chain management, collaboration and finance fields (Hofmann, 2005; International Institute for Management Development, 2009). SCF is an approach for two or more entities in the supply chain to plan, steer and control the flow of financial resources (Hofmann, 2005). In most situations, the collaboration partners commit to share relational resources, capabilities, information and risk on a medium- to long-term contractual basis (Hofmann, 2005). Companies can use SCF to support a range of procurement objectives, including price reductions (cost), term extensions (capital) and supply chain financial risk reduction (risk) (Kramer, 2011).

SCF is comparable with reverse factoring (International Institute for Management Development, 2009). Under both approaches the buyer takes the initiative to finance a certain purchase volume through a third party. Under the SCF approach, both the buyer and supplier contribute to its formulation and structuring, with a financial service provider acting in the background (Hofmann et al., 2011). A simple SCF scheme: the supplier sells its invoices to the bank at a rate discounted against the credit rating of the retailer, the bank pays the supplier when the supplier requests payment, the retailer pays the bank in line with normal payment terms (Morrell, 2009).

Elements of SCF are: (1) dematerialisation and automation: eliminating paper and automating processes are important factors for accelerating financial and informational flow/producing timely solutions; (2) Transparency: automation integrates a lot of information by enabling internal and external sources to exchange data; (3) Predictability: unlike paper-based processes that limit predictability, automation facilitates predictability by providing access to various sources of data; (4) Control: transparency and predictability are required to identify exceptions and confirm the actions, adequate control mechanisms and results that comply with both internal and external standards; and (5) Collaboration: SCF facilitates the creation of win/win situations and stable trading relationships, helps to connect with internal and external partners in the supply chain and encourages collaboration within the procurement, logistics, finance and treasury departments (Hofmann and Belin, 2011).

Definition

Supply Chain Finance (SCF) is an approach used by two or more organisations in a supply chain to "jointly create value through means of planning, steering, and controlling the flow of financial resources on an inter-organisational level" (Hofmann, 2005:3).

Successful application

Unlike factoring, implementing SCF is a long-term initiative that may take a couple of years to set up. A transaction platform provided by either a banking institution or another independent provider usually acts as the main precondition for SCF. Successful implementation of SCF requires a good level of trust between suppliers and buyers (Hofmann et al., 2011).

Steps to successful application

1. As the buying organisation, select SCF technology and service providers to set up the technology platform to connect the buyer, suppliers and the bank.

2. Selects bank(s) to provide financing to suppliers through the SCF technology platform (purchasing or merchandising department usually selects the technology/services provider and the treasury department selects the bank(s)).
3. As a buyer, send approved payables to the technology platform after the SCF services provider trains suppliers.
4. Receive early payment requests from the supplier (who had already viewed approved payables and made early payment requests), which will be paid by the bank the following day.
5. Receive a notification from the technology platform on the invoice due date and on where the supplier fund should be directed (the bank if the supplier has sold receivables for early payment or the supplier if the supplier has not sold receivables).

Hints and tips

Success of SCF depends largely on appropriate supplier involvement (Hofmann et al., 2011). Many suppliers undervalue the importance of gathering and evaluating buyer financial data (Hofmann and Belin, 2011). It is important to reduce dilution risk of SCF implementation through better transparency, good credit management and quicker response times (Hofmann and Belin, 2011).

Potential advantages

- For a supplier SCF can lead to lower cost of financing and greater cash flow certainty (Morrell, 2009).
- For a retailer SCF can reduce cost, working capital and risk in the supply chain. Risk can be lowered due to better shared visibility of supply chain events arising from SCF (Hofmann and Belin, 2011; Morrell, 2009).
- Effective SCF can reduce a company’s working capital by between 2.5% and 7.5% of annual spend (Morrell, 2009).

Potential disadvantages

- Introducing SCF can take up to two years due to the high level of supplier involvement required (Hofmann et al., 2011).
- SCF requires paper-intensive and manual collection processes. As these processes are slow, unpredictable and often costly, SCF requires an initial investment in automated solutions (Hofmann and Belin, 2011).
- Financial flows do not always contain detailed information for manual or automated systems to accomplish their jobs. Additional resources are required to find missing information (e.g. invoice-level detailed information such as ID numbers, item quantities and purchase order (PO) data) (Gavirneni et al., 1999; Hofmann and Belin, 2011).

Performance monitoring

- Focusing on collaborative relationships should concentrate on measuring shared processes and benefits (and costs) that produce faster time-to-market, better quality, lower costs and increased flexibility (Supply Management, 2010).
- Measurement and assessment of risk is integral to supply chain finance (e.g. credit ratings) (Hofmann et al., 2011).
- Monitor price reductions as well as information gains about supplier finances (IMD, 2009).

- Measure capital cost reductions and improvements in cash flow resulting from reductions in cash-to-cash cycle results (Hofmann et al., 2011).
- Consider using a balanced scorecard approach that focuses on traditional financial as well as non-traditional measurements (e.g., the customer, internal business processes) (Kaplan and Norton, 1992).

Case studies

- When implementing SCF, Lowe, a home improvement store, was pursuing the following objectives: term extensions, cost reductions, packaging improvements and improving supplier relationships. The company used SCF to support an initiative to extend supplier payment terms thereby driving reductions in working capital and increasing cash flow. As a result, Lowe managed to generate nearly $100m in working capital reduction and cash flow improvement (Kramer, 2011).
- In 2006 truck maker Scania assisted its suppliers' finance growth when demand surged in 2006. Although Scania does not encourage traditional factoring, the company helped smaller suppliers to benefit from unprecedented liquidity levels. In some cases, suppliers received payment in five days or less (International Institute for Management Development, 2009).
- In 2008 ASDA launched the new SCF system that allowed suppliers to check the system to see where their invoice was. Unlike traditional supply chain finance models, Asda's system allowed suppliers to request early payment as and when they wanted it. This option was motivated by being more transparent and open with suppliers and improved business relationships (Morrell, 2009).

Further Resources/Reading

Web

- Prime Minister announces Supply Chain Finance scheme http://kburl.me/gnd5k
- Payment concerns over supply-chain finance move http://kburl.me/7h315
- BBC News: Plan to boost supply chain finance http://kburl.me/zteiu
- Supply Chain Finance Definition by Purchasing Insight http://kburl.me/quosj
- The Financial Supply Chain http://kburl.me/5if7v

Books

Supply Chain Finance Solutions: Relevance, Propositions, Market Value ISBN 978-3642175657

Ways Out of the Working Capital Trap: Empowering Self-Financing Growth Through Modern Supply Management (Professional Supply Management) ISBN 978-3642172700

Guide to Supply Chain Management ISBN 978-3642176753

Financial Supply Chain ISBN 978-0070656666

Management and Cost Accounting ISBN 978-1844805662

References

Aberdeen Group (2011) Supply Chain Finance: Gaining Control in the Face of Uncertainty. [online] Available at:

www.aberdeen.com/aberdeen-library/6833/RA-supply-chain-finance.aspx
[Accessed 17 November 2011].

BuyIT Best Practice Network (2006) Selecting an e-procurement solution.

Gavirneni, S., Kapuscinski, R. and Tayur, S. (1999) Value of Information in Capacitated Supply Chains. Management Science, Vol.45(1), pp.16-24.

Hofmann, E. (2005) Supply Chain Finance: Some Conceptual Insights. In R. Lasch and C.G.Janker, eds. Logistik Management: Innovative logistikkonzepte, Wiesbaden.

Hofmann, E. and Belin, O. (2011) Supply Chain Finance Solutions: Relevance, Propositions, Market Value. Springer: London.

Hofmann, E., Maucher, D., Piesker, S. and Richter, P. (2011) Ways Out of the Working Capital Trap. Springer: London.

International Institute for Management Development (2009) Supply Chain Finance: What's it Worth? Perspectives for Managers, Vol.178, October.

Kaplan, R. and Norton, D. (1992) The Balanced Scorecard. Measures that Drive Performance, Harvard Business Review. Jan-Feb, 1992.

Kirkpatrick, D., McInally, S. and Pridie-Sale, D. (2007) Integrated Logistic Support and All That: A Review of Through-life Project Management. In P.W.G.Morris and J.K.Pinto, eds. The Wiley Guide to Project Technology, Supply Chain and Procurement Management. Wiley: Hoboken, NJ.

Kramer, B (2008) Lowe's Supply Chain Finance. Supply Chain Finance Insider. January 28th. [online] Available at: scfinsider.com/tag/supply-chain-finance-case-study/ [Accessed 17 November 2011].

Morrell, L. (2009) Supply Chain Finance: A Capital Idea. Retail Week. September 25th.
Supply Management (2008a) Downturn may hit supply chain finance [online] Available at: www.supplymanagement.com/news/2008/downturn-may-hit-supply-chain-finance/?locale=en [Accessed 17 November 2011].

Supply Management (2008b) Increase in firms using supply chain finance [online] Available at: www.supplymanagement.com/news/2008/increase-in-firms-using-supply-chain-finance/?locale=en [Accessed 17 November 2011].

Supply Management (2010) How do I measure SRM? [online] Available at: www.supplymanagement.com/resources/q-and-a/2010/how-do-i-measure-srm/?locale=en.

Video

Cass Business School on risk, finance and supply chains
https://www.youtube.com/watch?v=e2vfilEXTAY

CIPS Group Easton House, Easton on the Hill, Stamford, Lincolnshire, PE9 3NZ, United Kingdom
T +44 (0)1780 756777 F +44 (0)1780 751610 E info@cips.org

CIPS Africa Ground Floor, Building B, 48 Sovereign Drive, Route 21 Corporate Park, Irene X30, Centurion, Pretoria, South Africa
T +27 (0)12 345 6177 F +27 (0)12 345 3309 E infosa@cips.org.za

CIPS Australasia Level 8, 520 Collins Street, Melbourne, Victoria 3000, Australia
T 1300 765 142/+61 (0)3 9629 6000 F 1300 765 143/+61 (0)3 9620 5488 E info@cipsa.com.au

CIPS Middle East & North Africa Office 1703, The Fairmont Hotel, Sheikh Zayed Road, PO Box 49042, Dubai, United Arab Emirates
T +971 (0)4 327 7348 F +971 (0)4 332 5541 E mena.enquiries@cips.org