TRENDING TOPICS

SUPPLY CHAIN FINANCE PROGRAMS

HELP DRIVE WORKING CAPITAL PERFORMANCE

Trending Topics represents an executive summary compilation of news, information and perspective on matters affecting businesses and business leaders today. This insight is being provided to keep you up to date on the latest developments and trends influencing these topics. These views do not necessarily represent the views and opinions of PNC Bank. For additional research on these topics, please consult the sources cited in this article.

One of the legacies of the 2008 financial crisis is that companies are now much more focused on managing working capital. For many businesses, supply chain finance programs, by complementing traditional sources of capital such as bank lending, are playing an important role in boosting working capital metrics.

Prior to the financial crisis, few industries beyond automotive and retail participated in supply chain finance. Today, however, companies across a range of industries, and their C-suite executives, have become much more focused on working capital goals — and supply chain finance (SCF) has provided a valuable tool for achieving those goals.

Typically, with SCF, a buyer can enable its supplier to get paid faster while receiving financing from the buyer's bank at the higher-rated buyer's lower cost of funding. In turn, the buyer can negotiate extended terms or a discount on the invoice. The buyer's ability to extend terms with the supplier through SCF can help drive working capital metrics to new heights.[1]

SCF AND THE CASH CONVERSION CYCLE

A working capital metric that many companies have begun using is the cash conversion cycle, which measures the amount of time cash is tied up in the production and sales process before it is converted into liquid funds. The metric takes into account the three "levers" a company can adjust to improve working capital — payables, receivables and inventory. The formula looks like this:

  Days sales outstanding (DSO)
\+ Days inventory outstanding (DIO)
− Days payable outstanding (DPO)

= Cash conversion cycle days

Companies look to improve working capital by lowering their number of cash conversion cycle days by adjusting one or more of the three levers. Extending payment terms with suppliers allows buyers to increase DPO, which in turn reduces cash conversion cycle days and improves working capital performance.

Citing "industry sources," multinational management consulting firm McKinsey & Co. has estimated that SCF could unlock $100 billion to $500 billion of liquidity by accelerating the cash conversion cycle for suppliers and extending DPO for buyers.[2]

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WHAT INDUSTRIES ARE THE BEST SCF CANDIDATES?

Beyond automotive and retail, look for supply chain finance to be an attractive solution in industries where suppliers are dependent on a handful of players and where relatively long payment terms, typically greater than 45 days, are the norm.

Business segments where SCF might be the best fit also include those with a high percentage of below investment grade suppliers, for whom SCF represents an important tool for offsetting their higher cost of capital.[2]

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LAUNCHING A SUCCESSFUL PROGRAM

Here are some best practices suggested by buyers who have rolled out a supply chain finance program:

- ***Obtain and maintain executive sponsorship.*** Don't launch your program until you have C-suite support, and then update senior management regularly.
- ***Arrange internal meetings up front*** to ensure that everyone across your enterprise — from Finance and Treasury to Technology and Procurement — understands and is on board with the program.
- ***Create a win–win proposition for each targeted supplier.*** Clearly illustrate how the SCF program will reduce suppliers' interest costs and increase their cash flow, for instance.
- ***Offer contract flexibility.*** As part of a give-and-take negotiation process with strategic suppliers, be willing, for instance, to consider adding a year or two to a contract to get the supplier's buy-in on extending terms.
- ***Send out a weekly scorecard*** highlighting the suppliers you are onboarding and those that are balking. This will keep everyone at your company accountable as you look to build your program.

To discuss these topics in more detail, please contact your PNC Relationship Manager.

1 *Supply chain finance: Enhancing working capital performance*, a 2014 PWC Working Capital Advisory, pp. 2–3.

2 "Supply chain finance: From myth to reality," *McKinsey on Payments*, October 2010, p. 24.

3 "For Buyers and Suppliers, Supply-Chain Finance Pays Off," *SupplyChainBrain*, September 3, 2013.

CIB ENT PDF 0615-063-193475