STUDENTS' ECONOMIC FORUM

A monthly publication from South Indian Bank

To kindle interest in economic affairs...
To empower the student community...

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Theme 330

"SUPPLY CHAIN FINANCE"

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SIB STUDENTS' ECONOMIC FORUM

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Theme No: 330: **"SUPPLY CHAIN FINANCE"**

A well informed customer will make the policy makers as well as organizations which produce goods and render services more responsive to the customer needs. This will also result in healthy competition among organizations and improve the quality of its products.

The "SIB Students' Economic forum" is designed to kindle interest in the minds of younger generation. We highlight one theme in every monthly meeting of the "Forum". This month the topic for discussion is "Supply Chain Finance"

The concept of Supply Chain Finance has emerged through the globalization of trade where the suppliers are trying to receive their payments as early as possible while buyers are increasing their payment terms. Over the last decade, traditional trade finance has suffered from increased costs and complexity because of stricter compliance requirements and the introduction of new capital rules under Basel II and III. Supply chain finance has now surpassed traditional trade finance in market revenues. This trend is expected to accelerate over the next three to five years. Supply chain finance is the better option for getting an easy business loan because of the simplicity of the contract involved. Trade finance requires a lot of negotiations due to the sheer number of parties involved, whereas supply chain finance is a straightforward collaboration between the supplier, the buyer and the financier.

What Is Supply Chain Finance?

Supply chain Finance is a set of technology based business and financing processes that link the various parties in a transaction- buyer, seller and financing institution for lowering financing costs and improving business efficiency. It has the potential to deliver working capital to suppliers more quickly, widely and also at lower cost. This will help small and medium-sized enterprises (SMEs), which often have trouble in accessing working capital as Corporates are always anxious about the financial health of the suppliers.

Supply Chain Finance is a solution designed to benefit both suppliers and buyers; suppliers get paid early and buyers can extend their payment terms. Under SCF, suppliers sell their invoices or receivables at a discount to banks or other financial service providers. In this manner the suppliers get faster access to the money they are entitled, enabling them to use it for working capital, while buyers generally get more time to pay.

SUPPLY CHAIN FINANCE PRODUCTS

Under the Supply Chain Finance, the products are broadly classified into

Vendor Finance

It is a facility provided to the Vendors/Suppliers who supply goods to Corporate/ Buyers. The Bank/Financier will finance the invoice accepted by the Corporate/ Buyer. On the stipulated due date, payment has to be made by the Buyer/Corporate to Bank/Financier.

Process Flow

The Buyer (Principal/Corporate) raises a purchase order requesting a consignment of goods and forwards it to Vendor. The Vendor ships the consignment and initiates the request for finance by uploading the invoices electronically on the supply chain finance platform. Once the invoices are electronically accepted by the Corporate/ Principal, validation of the transaction for parameters like availability of credit limit, validity of invoice, overdue position etc. is digitally verified by the Supply Chain Finance system. On successful validation, finance is instantaneously credited to Vendor's operative account. On the due date the Corporate/Principal liquidates the outstanding invoice amount. The entire process is fully automated and featured with real time e-alerts and e-reports which is sent to the clients at each leg of the transaction.

Dealer Finance

The product is designed to provide financing facility to the dealers or distributors of a particular Corporate exclusively for the purchases made from that Corporate in the industry with significant presence and market share.

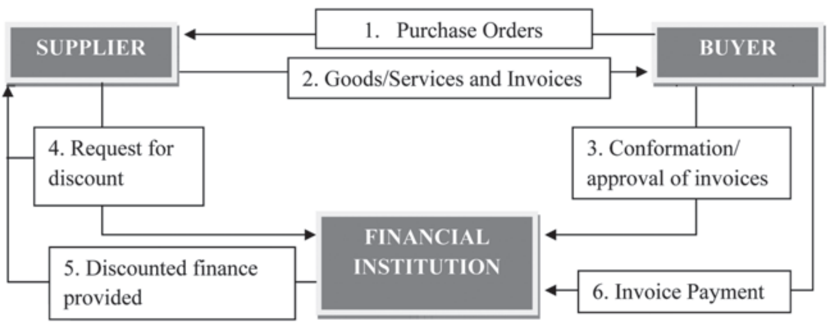
Process Flow

The Buyer /Dealer raises purchase indent requesting for the consignment of goods and forwards it to Corporate/Principal. The indent will be uploaded by the dealer on the supply chain finance platform. Once the invoices are electronically accepted by the Corporate/Principal, validation of the transaction for parameters like availability of credit limit, validity of invoice, overdue position etc. is digitally verified by the Supply Chain Finance system. On successful validation, finance is instantaneously created by the system and disbursement is credited to Corporate's operative account. On the due date, the dealer/buyer liquidates the outstanding invoice. The entire process is streamlined and mostly automated with less manual intervention.

Example of Supply Chain Finance (SCF)

Let's say company A buys goods from supplier B. B supplies the goods and submits an invoice to A, which A approves for payment on standard credit terms of 30 days. If supplier B requires payment before the 30-day credit period, the supplier may request immediate payment (at a discount) for the approved invoice from company A's Bank. The Bank will remit the invoiced amount (less a discount for early payment) to supplier B. In view of the relationship between company A and its financial institution, the latter may extend the payment period for a further 30 days. Company A has thus obtained credit terms for 60 days, rather than the 30 days provided by supplier B, while B has received payment faster and at a lower cost than if it had used a traditional factoring agency. SCF generally involves the use of a technology platform in order to automate transactions, track the invoice approval and settlement process from initiation to completion.

The mechanics of Supply Chain Finance



1. Buyer ordering from the Supplier
2. The supplier then fulfills the order and invoices the buyer
3. The buyer then approves the supplier's invoices and confirms that it will pay the financial institution for these at invoice maturity
4. The supplier sells (discounts) the invoices to the financial institution at a predetermined discount rate
5. Supplier receives the funds
6. The buyer pays the financial institution as agreed on maturity of the invoice

THE BENEFITS OF SUPPLY CHAIN FINANCE

Benefits to buyers

- ✓ Lower cost of goods sold
- ✓ Longer DPOs (Days Payable Outstanding)
- ✓ Buyers maintain a good relationship with suppliers
- ✓ Promotes competition/ diversity in suppliers
- ✓ Allows buyers to make purchases in bulk to save costs
- ✓ SCF doesn't disturb existing bank relationships

Benefits to Vendor/Dealer

- ✓ Offers steady and economical source of working capital financing.
- ✓ Immediate access to cash - Suppliers can get paid earlier than their usual 30-day credit terms
- ✓ Improved Cash Flow visibility - Allows supplier to have the cash flow to work on numerous deals simultaneously
- ✓ Helps provide liquidity and reduces financing costs

Benefits to Banks/Financiers

- ✓ Cost effective Customer acquisition channel
- ✓ Income from financing
- ✓ New Customers- suppliers who require financing
- ✓ Cross selling opportunities

Opportunities

- ❖ E-commerce – In line with the current trend of Indian economy moving towards online sales from offline platforms. Corporates have a huge opportunity to fund their supply chains through SCF. It has already taken a major share in Mobile, Electronics & Apparels Industry.
- ❖ Integrated Approach – Opportunity to fund both forward and backward integration along the value chain ie, Vendor Finance-Inventory Funding -Retail Funding
- ❖ Online Platforms / Automation – Digitization enables big leverage in terms of both integration and flow of information between the Banks & other stakeholders.
- ❖ Potential Sectors- Focus on untapped or lesser explored industries such as Commodities, Electricals & Electronics, Consumer Durables, FMCG & Agro-based Industries to finance their Supply chain.

Challenges

- ❖ Acceptability and Awareness about the product among stakeholders such as Channel partners and suppliers.
- ❖ Concentration mostly on organized industries.
- ❖ On boarding & monitoring of dealers/suppliers due to geographical spread.
- ❖ Unsecured nature of lending.
- ❖ Diversion of funds for other purposes
- ❖ Prominent Lenders still use Traditional sourcing and Assessment Techniques
- ❖ Lack of availability of a common platform for financiers.

At a time when revenues from traditional trade finance are stagnating, banks can find opportunities to grow revenues and improve returns within each of the three waves of supply chain finance. Much of the upside in the next three years is likely to happen through the growth in traditional supplier and buyer led supply chain finance businesses, and banks must therefore focus on accelerating these at the same time as building the foundations for the third wave of growth.

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