



# SUPPLY CHAIN FINANCE **FUNDAMENTALS:**

What It Is, What It's Not and How it Works



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## What It Is, What It's Not and How it Works

The supply chain ecosystem is a complex one – especially for multinational companies that work with suppliers all over the world. The health of a global supply chain isn't just measured by revenue and profit. A more relevant indicator is how efficiently capital flows between buyers and suppliers. Slow moving capital, much like slow moving inventory, creates unnecessary costs and inefficiencies in a supply chain.

Working capital is critical to every business, but its importance is underscored in an environment that is inherently more susceptible to global and regional economic shifts, industry volatility, geopolitical changes, manmade and natural disasters, and many other factors. To be considered high performing, global supply chains must be agile, innovative and competitive in spite of these variables – and all that's fueled by working capital. Given these factors, it's no surprise that finance and procurement professionals are seeking ways to more easily access working capital that is trapped in their supply chains.

Enter supply chain finance. Many finance and procurement executives may have heard of it, but what exactly is it? What is it not? How does it work? A host of misperceptions exist concerning these questions, due in part to an increasingly crowded marketplace of solution providers, many of which bend the definition to fit their offerings.

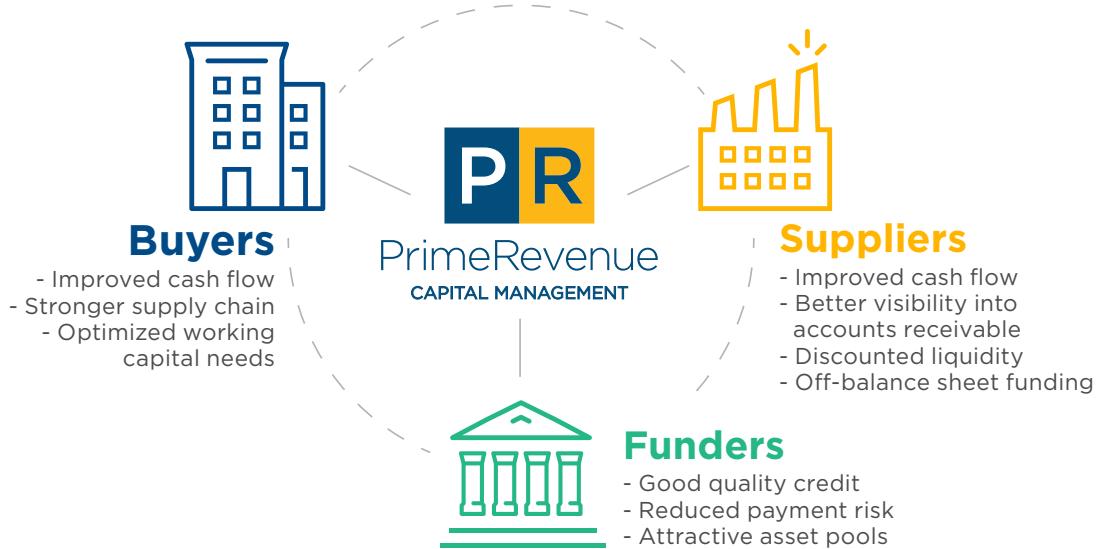
### What is supply chain finance?

A way to increase working capital and reduce supply chain risk. SCF allows businesses to increase supplier payment terms and while giving them the option to get paid early.





# Understanding the Supply Chain Finance Ecosystem



To operate effectively, supply chain finance requires an ecosystem that **improves the velocity of working capital across a supply chain**. Participants in the ecosystem are as follows:

**Buyers:** Typically, large organizations that rely on a multitude of supplier-provided goods and services to deliver products for their customers. Buyers often operate on a global basis.

**Suppliers:** Companies that supply goods and services to buyers in the supply chain ecosystem. Some suppliers are large enough to also operate as buyers **thereby having their own complex supply chains** and the **same need to optimize cash flow**.

**Funders:** Bank and non-bank sources of investment capital that **advance funds** to cover the cost of approved supplier invoices.

**Platform providers:** Technology solution providers that facilitate the supply chain finance ecosystem and program management. Today, **leading platforms are cloud-enabled**, meaning they do not require installation and operation of specialty software systems.



# Supply Chain Finance Defined

Supply chain finance — also known as supplier finance or reverse factoring — is a set of solutions that optimizes cash flow by allowing buyers to extend supplier payment terms. Increasing the time it takes to pay a supplier improves several financial metrics (e.g. days payable outstanding or DPO), and most importantly, frees up cash that would otherwise be trapped inside the supply chain. A buyer can use increased cash flow to invest in operational, competitive and innovation initiatives that will drive additional growth. They can also return cash to shareholders in the form of dividends or stock repurchases.

Simultaneously, supply chain finance offers suppliers a way to mitigate the effect of payment term extensions and to accelerate their own cash flow. Suppliers who participate in a program have the option to get paid early — typically as soon as an invoice has been approved by a buyer. The supplier can accelerate payment on some, all or none of their receivables, depending on their financial position and funding requirements. For those receivables that are paid early, the supplier will pay a small finance charge or discount.

All of this occurs without negatively impacting either companies' balance sheet. Accounting treatment for supply chain finance, when done properly, does not count as additional debt for a buyer or supplier.

Furthermore, since the buyer is the obligated party, financing is offered to the supplier at rates that are typically more favorable because they are based on the buyer's credit history and rating. For many suppliers, this access to a lower cost of funding is exceptionally important.

Supply chain finance thus creates a win-win situation for both buyers and their suppliers. The buyer optimizes working capital because it has more time to pay suppliers. Meanwhile, suppliers can generate additional operating cash flow by getting paid early without affecting their balance sheets.

**Supply chain finance unlocks the cash that's hidden in your supply chain.**



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# What Supply Chain Finance is Not

The world of trade finance is complex and varied. There are numerous ways to increase business capital on hand and, in many cases, the differences are slightly nuanced. Given this landscape, it's not just important to understand what supply chain finance is; it's also important to understand what it is not.



**It is not a loan.** Supply chain finance is an extension of the **buyer's accounts payable** and is **not** considered **financial debt**. For the supplier, it represents a non-recourse, true sale of receivables. There is no lending on either side of the buyer/supplier equation, which means **there is no impact to balance sheets**.

**It is not dynamic discounting or an early payment program.** Early payment programs, such as dynamic discounting, are **buyer-initiated programs** where buyers offer suppliers earlier payments **in return for discounts on their invoices**. Unlike supply chain finance, buyers are seeking to lower their cost of goods, not to improve their cash flow. Dynamic discounting and early payment programs often turn out to be expensive for both suppliers (who are getting paid less than agreed upon) and buyers who tie up their own cash to fund the programs.

**It is not factoring.** Factoring enables a supplier to sell its invoices to a factoring agent (in most cases, a financial institution) in return for earlier, but partial, payment. Suppliers initiate the arrangement without the buyer's involvement. Thus factoring is typically much more expensive than buyer-initiated supply chain finance. Also, suppliers trade "all or nothing" meaning they have no choice to participate from month-to-month to the degree that their cash flow needs dictate. Finally, most factoring programs are recourse loans, meaning if a supplier has received payment against an invoice that the buyer subsequently does not pay, the lender has recourse to claw back the funds.



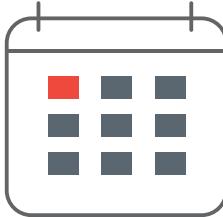
# SUPPLY CHAIN FINANCE:

## How it works

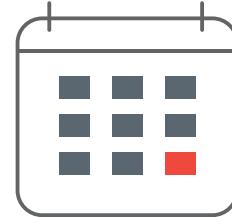
Supply chain finance employs two primary methods. The first is the extension of supplier payment terms. In this approach, the buyer extends payment terms with all of its suppliers – for example, from 60 to 120 days. This dramatic slowdown of cash outflow gives the buyer access to more working capital.

The second tactic in supply chain finance is a counterbalance to the first. The buyer gives selected suppliers the option to get paid early by selling their invoices to financial institutions (or funders). This offsets the negative impact of longer payment terms on suppliers, while still enabling the buyer to meet its cash flow optimization objectives.

### Two primary methods:



**Buyer extends payment terms with all suppliers**



**Suppliers get paid early by selling their invoices**

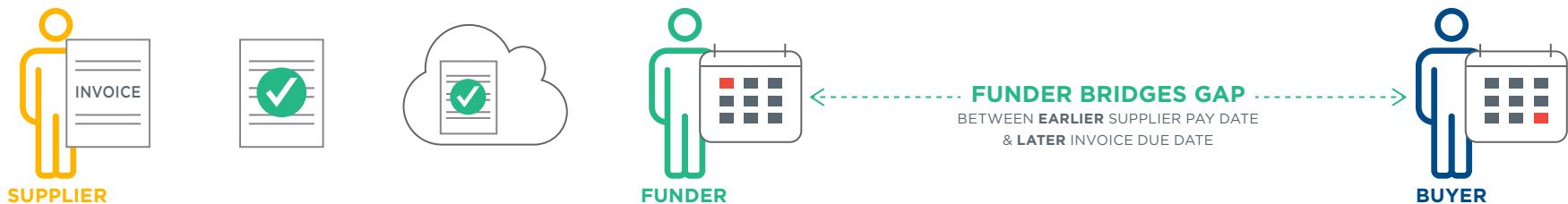
Invoice selling (or trading) is facilitated through a buyer-side implementation of a supply chain finance platform and program. In this program, buyers identify and invite target suppliers to participate in the program (usually based on the size of spend and/or the strategic value of the supplier). Once a supplier accepts the invitation, they are onboarded into the program and its finance team is trained on how to use the processes and tools that will facilitate invoice trading. They are also matched to a funding partner or financial institution.

It's important to note the critical role of a strong onboarding program and the availability of multiple funding sources in this process. The onboarding process should be efficient, simple and immediately beneficial to the supplier. Furthermore, access to multiple financial institutions ensures that the supply chain finance program is always well funded and suppliers are partnered with a source that understands the geographical, regional and/or industry nuances of their business.



# THE SUPPLY CHAIN FINANCE PROCESS

Following onboarding, it boils down to these five simple steps:



1

**Supplier submits an invoice** to the buyer following normal protocol.

2

**Buyer approves the invoice** and uploads it into the supply chain finance platform.

3

**Supplier selects invoices for early payment** from assigned funder(s) via PrimeRevenue's supply chain finance platform portal.

4

**Funder receives and processes request and provides early payment to the supplier.** The full sum of the invoice – less a small financing fee or discount – is transferred electronically to the supplier's bank account.

5

**Once the invoice has matured,** the buyer is instructed to pay either the funder (if the supplier has sold the invoice) or the supplier (if they have not sold the invoice).



# THE BENEFITS OF SUPPLY CHAIN FINANCE

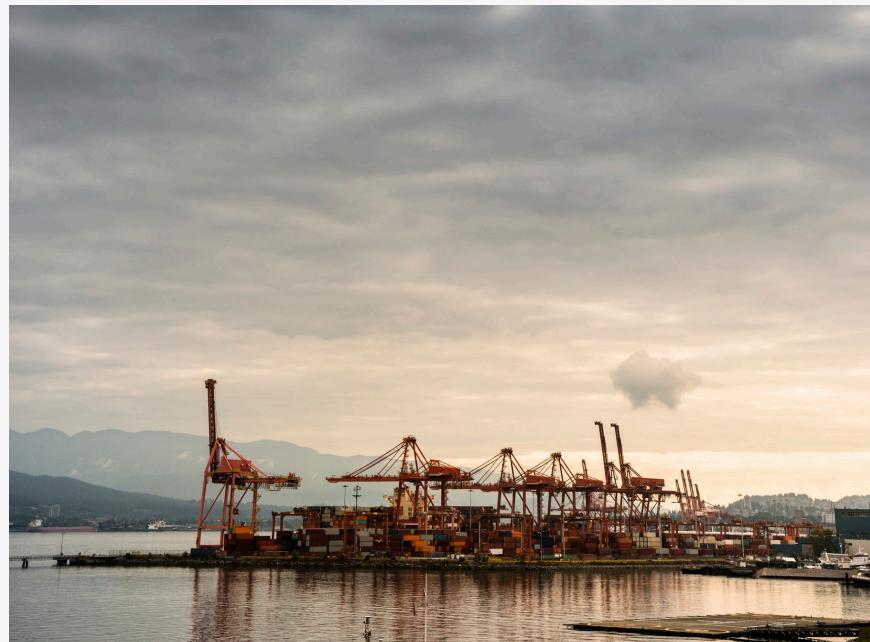
Supply chain finance is one of the few financial health improvement tactics that works for organizations on both sides of the supply chain. Buying organizations can extend their payment terms, and suppliers can get paid earlier. It's a true win-win solution for both trading partners.

A meaningful increase in working capital can be transformative for today's global supply chains, many of which operate with razor-thin margins. Whereas conventional finance tactics may yield \$15M in added cash flow, supply chain finance yields an average of \$200M for large, multinational buyers. Furthermore, suppliers also realize substantial gains in cash flow as they now have the option to get paid early on each invoice they submit to the buyer.

This working capital can be used by both buyers and suppliers to fund new innovation or competitive initiatives. It can be used to weather economic or industry volatility, and protect or grow margins. Money that has traditionally been tied up in accounts payable/receivable can now be used to generate income and gain strategic advantage in the marketplace.

Supply chain finance also strengthens supplier health and relationships. Not only does it minimize or negate the impact of extended payment terms, but also, suppliers can receive near-immediate payment for invoices at an interest rate often many times lower than other financing approaches. This increase in cash flow can protect suppliers which are often more vulnerable to marketplace dynamics.

**Growth, stability and innovation** – these are three tenets of a successful supply chain. Supply chain finance is an elegant way to unlock working capital that serves each of these elements for buyers and suppliers alike.



## About PrimeRevenue

PrimeRevenue is the leader in supply chain finance solutions, managing and optimizing cash flow for more than 20,000 customers in over 70 countries. Each year, PrimeRevenue processes more than \$100 billion in supplier transactions through its cloud-enabled platform, helping companies unlock significant amounts of working capital.

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