Making a success of supplier finance

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Characterised by smoke and mirrors, supplier finance is seen by many as something of a dark art. In reality, it is a practical means of enabling key suppliers to secure an early cash flow injection on better-than-normal credit terms, while allowing the corporate buyer to obtain a longer settlement period, reduce the risk of supplier failure, and increase supplier loyalty. So why does this 'win-win' solution still have an air of mystery about it and how can companies make the most of supplier finance?

Different banks and providers use myriad names for it – some misleading or even erroneous. Little surprise then that there is often confusion around what supplier finance actually is. Referred to by many under the generic supply chain finance (SCF) banner, and by others as 'reverse factoring', supplier finance is actually a form of receivables-driven financing that is initiated by the buyer, through their relationship bank(s).

A balance sheet efficient solution, supplier finance works by allowing the supplier to leverage the buyer's credit rating and access an agreed percentage of the due payment up front from the bank. It is described as a 'win-win' since, in return, the buyer is able to extend out payment terms or benefit from early settlement discounts, safe in the knowledge that their supplier is being supported financially – and that there is no arrangement fee to pay.

Despite the obvious benefits, "a number of misconceptions still exist around supplier finance," says Rene Chinnery, Head of Supply Chain Finance, Lloyds Bank Commercial Banking. "On the buyer side, there is a fairly widespread perception that supplier finance programmes require a great deal of systems integration, for example. That's simply not the case. All that needs to happen is for a report to be written and the file to be exported from the company's standard accounts payable system."

On the supplier side, continues Chinnery, "the main misconception that we encounter is that 'there must be a catch' – it seems too good to be true. But supplier finance is referred to as a 'win-win' solution for very good reason."

Somewhat ironically however, it is precisely this 'win-win' label that seems to be one of the factors holding supplier finance back. After all, when a bank comes knocking at your door promising a solution that works in favour of all parties, it's only natural to feel a little suspicious. As Anil Walia, Head of Supply Chain Finance, Global Transaction Services, RBS notes: "There is still a lack of education on the mutual benefits of supplier finance, so there is a certain amount of insecurity around the way it works – not least the fact that it is a form of off-balance sheet financing."

In many senses, these psychological barriers are the most difficult to overcome. As supplier finance becomes more deeply embedded in the consciousness of treasurers and procurement professionals, however, the rationale for such programmes should seem increasingly obvious to both buyers and suppliers – these mental barriers will shrink. And as more and more supplier finance programmes become a success, momentum will only continue to gather. But how can corporate buyers make their supplier finance programme one of these success stories?

Get your ducks in a row

The first step towards supplier finance success is getting internal buy-in and making sure that all the relevant departments within the corporate are ready for the programme to begin. According to Oliver Petersen, Global Head Supply Chain Finance, ING, "one of the main challenges is internal alignment. If a large buyer is not ready from an internal perspective to implement a supplier finance programme, it is unlikely that the rollout will achieve maximum efficiency."

There is a dialogue which needs to happen within the corporate, he says. "It's not a very 'typical' conversation because it actually requires the alignment of people from treasury, procurement, the IT department, and accounting and legal as well. In our experience, it is very beneficial if this alignment is also supported from top down. You need upper level management support, from the CEO to the CFO."

RBS's Walia agrees, saying: "Every buyer has its own environment, both internally and externally, and that is actually what creates the challenge when implementing a supplier finance programme. Corporates often still work in siloes and different departments will have varied, and sometimes conflicting, KPIs."

The approach that Petersen advises is "for KPIs to be implemented in line with the rollout to keep track of accountability. These KPIs could range from implementation dates to cash flow targets." He adds that: "A well-structured supply chain finance programme tends to generate free cash flow more quickly and generally grows larger than those programmes that are not so thoroughly thought through. This is because people are more engaged – and once the benefits start to show, everyone is motivated to continue."

Internal timing of the programme is another critical success factor, since supplier finance requires so many different corporate departments to come together and work collaboratively on the project. "If it begins in November for example, it is likely that delays will happen as the company will be busy setting up its annual report for the following year," Walia explains.

Case study
Auchan: a shining example
Arnaud Crouzet
Head of Group Global Payments Development

Arnaud Crouzet joined the Auchan Group in 2010 as Head of Group Global Payments Development. He is also General Manager of Auchan Suppliers Advanced Platform SA (ASAP SA), the company in charge of managing the Group's supplier finance programme. Here, Arnaud explains how the programme came about and what factors have contributed to its success.

Back in 2010, requests began coming in from suppliers across the different countries in which Auchan operates to assist with earlier payment of their invoices. This was in large part due to the difficult credit environment at the time. Some suppliers were asking for factoring arrangements, while others were looking to negotiate reduced payment terms. Since Auchan has very strong and valued relationships with its suppliers, the company's treasury function began looking into possible solutions.

"We analysed a number of possibilities, but it was reverse factoring that seemed to tick all the boxes," says Crouzet. Given that there were few large scale supplier finance programmes in the market at the time, there were some initial hurdles to overcome. "What we found was that many of the reverse factoring programmes that were out there were beneficial for the buyer, but not so interesting for the suppliers. Certain programmes virtually forced suppliers to join. But we felt that this was not a fair approach and it certainly didn't match the Group's philosophy," he explains.

“What we were looking for was something open, transparent and flexible that we could offer to all of our suppliers. We wanted a programme that suppliers could decide to use – or not use – however they wanted.” Additionally, Auchan needed a solution that would operate on a multi-country, multi-currency, multi-bank and multi-lingual basis. The best way to achieve this, it was decided, would be to manage the programme in-house, rather than outsourcing it to a third party.

A significant number of RFPs were sent out to gather information on the type of platform that would best meet the company’s requirements – whether it be an out-of-the-box solution or something bespoke. “We wanted to get the broadest possible view of the market, so the RFPs were sent out to banks and software vendors not only in Europe but also in the US and Asia. It was a huge amount of work, but it was definitely worth the effort,” says Crouzet.

What the research highlighted was the importance of a platform that would not only meet the company’s needs from a buyer/supplier perspective, but also from a treasury perspective. After consideration, Auchan chose to work with Kyriba to deliver the platform as the vendor was able to respond to all of the requirements set out in the RFP through its white-label offering, while addressing the need for integration with the treasury workflow. “We were pleasantly surprised by Kyriba’s response to our RFP. Only knowing the company by name, we spoke with some other corporates who were using Kyriba’s treasury software and the feedback was extremely positive. As such, we chose to run a pilot programme with Kyriba.”

A handful of companies were involved in the pilot, and it went very smoothly so Auchan was soon able to expand its reverse factoring programme. “The programme is currently live across several different countries and Auchan entities, with many different suppliers now onboard. On the whole, our suppliers are very pleased with the programme – we can see that from the level of uptake and the fact that once they are live with one Auchan entity, they are asking to go live with others. The platform gives them a single window on their transactions with the entire group. It also gives them a lot of flexibility – they can ask for payment manually or automatically, specifying their requested payment date. They also know exactly how much to expect, which helps them with their cash flow forecasting,” he notes.

Auchan chose to work with multiple banks to provide the financing for its supplier finance programme and this provides an extra level of flexibility for suppliers. “We arranged it so that the suppliers can access funds at a very reasonable rate – and through their bank of choice.”

It is precisely this flexibility and transparency that Crouzet believes has made the programme such a success. “Nothing is imposed on our suppliers. They are free to use the programme if they wish, or to leave it if they wish. What you see is what you get – there is no hidden agenda. For me, this is vital to make a real success of reverse factoring.”

Another key success factor, he believes, is the intuitive and user-friendly supplier portal, which Auchan has worked with Kyriba to enhance. “Financial software is often over-complicated. We wanted something very simple, so that no specific training would be required to use it. Not only have we achieved this easy-to-use functionality – suppliers can request payment in just two clicks – but it looks great too,” Crouzet explains. The supplier portal is also available 24/7.

For other companies thinking about implementing a supplier finance programme, Crouzet has the following advice: “Don’t forget the legal side of things. This can be extremely complicated and it’s very important to get it right, so make sure you allocate sufficient time and resources to that. Marketing the benefits of reverse factoring to suppliers is also key – if you make the business case clear to suppliers, this will help to speed up the onboarding process. However, I must re-emphasise the importance of not forcing suppliers to join the programme. A fair approach is always best.”

Choose the right partner

Although there are a handful of large corporates that run their own supplier finance programmes, without the help of a banking partner or third party provider, the vast majority do have external involvement. What is more, the choice of provider can have a significant impact on the seamlessness of the programme's implementation and its overall success.

The challenge here is, as Walia puts it, that: "All of the supply chain providers can talk the talk, but which of them can deliver? That's a key question for the treasurer to consider." Looking at implementation times and previous experience in the space will help the treasurer here. "Those providers that have established themselves well in supply chain finance now have quite streamlined business propositions in this field. From an RBS perspective, five years ago, it used to take us two to three months to put in place the connectivity between the buyer and our system – now it takes all of ten days," says Walia.

But it is not just the buyer's implementation experience that matters in the overall context of 'success'. The partner bank's standards and practices around supplier onboarding are also vital, and again these vary greatly from institution to institution – not least where documentation is concerned. "At RBS, our supplier documentation is simple and ranges between two and a half and four pages, depending on the jurisdiction," he notes. It is not uncommon for documentation to run into double figures, however, and this can be extremely daunting for smaller or family-owned suppliers.

The way that banks approach supplier onboarding can also have a significant impact on uptake. "Some banks believe that suppliers can be onboarded through overseas call centres," says Chinnery. "That's not Lloyds Bank's philosophy. We have a team of experts on hand to support the onboarding process at every step. What is more, they understand how each supplier's business works and where supplier finance fits within that."

Jacqueline Keogh, Managing Director of Global Trade, Lloyds Bank Commercial Banking, re-emphasises the benefits of this: "Each supplier has the support of a named point of contact at Lloyds Bank who is equipped with the knowledge to answer all their questions. We establish relationships with every supplier; they are never 'just another number'."

RBS's Walia supports this philosophy, adding that: "There needs to be a relationship of trust between each supplier and the bank, too. Before suppliers join an RBS programme, we assure them that we will not use their data to approach them for any other business – it's a question of mutual respect."

The right banking partner can also help to overcome any concerns the supplier might have, or iron out creases in the plan. Petersen explains that one such hurdle might be "if the supplier has existing financing in place that has essentially locked up the company's assets as security – meaning that all of the receivables can't be pledged." In this case, he says, "we would urge the supplier to go back to its lenders to either waive the overall requirement or ask for a basket in terms of what they can approve. After all, supplier finance brings in cash more quickly for the supplier, so it's in the best interests of both the supplier and its lenders."

Elsewhere, having a professional third party service provider, who has experience in implementing supplier finance programmes, either engage in a benchmarking or business case exercise or simply validate what the corporate buyer has in mind, can also be extremely valuable in ensuring the programme is a success for everyone, Petersen believes.

Support your suppliers

Ensuring suppliers are on side and up-to-speed with supplier finance is not just up to the provider, however. For Keogh, "a successful supplier finance programme is largely determined by the level of buyer engagement and support in promoting it. Some buyers are very restrictive around which suppliers they will allow to join, while others have been known to give their suppliers no choice but to participate. In our experience, best practice constitutes a supportive buyer who encourages supplier uptake, without making the programme mandatory."

Walia echoes this sentiment, saying: "In the spirit of best practice, the buyer should not be influencing suppliers by pushing them to join a programme. That said, much can be done around educating suppliers about the benefits of supplier finance."

This education might not be the typical 'small supplier' conversation, either. "If you have a supplier which is stronger rated than the buyer," explains ING's Petersen, "supplier finance can be a great risk management tool. Take a company that has just been acquired by a private equity firm, for example. All of a sudden, the credit metrics don't stack up – and if there is no credit insurance available, supplier finance is a very quick and efficient way to de-risk."

Embrace technology

The kind of technology that a supplier finance programme leverages can also have a significant impact on its success and uptake. User-friendliness is imperative. "When it comes to platforms, simplicity is key," says Lloyds Bank's Chinnery. "While our platform has global reach, is multi-currency and is available in multiple languages, we have never had to provide on-site training to a supplier because it's so intuitive."

Indeed, when looking to implement a supplier finance programme at French international retail group Auchan, the company knew that, among other key ingredients, the right technology platform would make a real difference to the overall outcome – as the case study opposite clearly illustrates.

Play the long game

A final word of advice for both corporates and banks in the supplier finance space is to think to the future. After all, supplier finance aims to build sustainable supply chains. According to Petersen, "it's all about the long-term view – this is not something that you put in place just for one or two years, it's about understanding how the client is developing and what the future business case is."

Keogh adds that: "Longer-term, the industry will need to further analyse and respond to the need for cross-border supply chain finance. While FI networks and partnerships are becoming more collaborative and transparent, cross-border supplier finance is most definitely an area that deserves greater attention going forward."