EXPANDING

TRADE PROGRAMS

Bob Dyckman
BNY Mellon, Managing Director,
Head of Trade Finance, Americas

NEED WORKING CAPITAL? LOOK TO YOUR SUPPLY CHAIN

When looking to boost working capital, many companies overlook the significant value of leveraging their core payables function into a working capital advantage that can help fund other strategic initiatives, such as increasing dividends, share repurchase or plant expansion. A robust supplier finance program set has the potential to accomplish this while also offering the ability to lower the overall cost of the financial supply chain.

Not long ago, companies needing additional working capital sought financing on their own terms with rates reflective of their own financial situation. With buyers and sellers having conflicting goals – the buyer wanting to extend payment terms for as long as possible to maximize working capital and the seller seeking to accelerate collections to increase cash flow – a single, mutually beneficial program for both buyers and sellers seemed unattainable.

Supplier Finance Programs

In recent years, however, this dynamic shifted as it became apparent that the larger, more financially strong player in the supply chain could support the credit/risk needs of its supply chain while meeting the working capital needs of all involved by instituting supplier finance programs. Demand for these services – for both domestic transactions and imported purchases – increased during the 2008 financial crisis as bank credit lines dried up and the financial viability of the core supplier base became vulnerable.

The concept behind supplier finance programs is fairly simple: a large corporate buyer leverages its financial strength by approving supplier invoices in advance of payment, allowing the supplier to receive an early-payment discount from a bank or a third party provider at a rate that reflects the buyer's creditworthiness in the market. The bank accepts the buyer's repayment risk and receives settlement for advancing funds to the supplier at the time of the invoice. Generally, the buyer will look to extend payment terms to suppliers and realize a working capital gain (e.g., $2.7 million per day based on $1 billion in cost of goods sold) in return for giving suppliers access to low-cost financing and accelerated payments. Other buyer benefits include payment term standardization; reduced bank disbursement fees (as the bank or third party is now making supplier payments); and a strengthened supply chain given the reduced cost and working capital support provided to suppliers.

For suppliers, the benefits of supplier finance programs include greater visibility into the procure-to-pay process – a valuable cash forecasting tool; the ability to marry collections to cash flow needs; sales concentration risk mitigation through true sale accounting treatment (i.e., turning the receivables into cash); and the potential to boost borrowing capacity by removing receivables from the credit borrowing base.

Supplier Finance Programs for Importers

The supplier finance concept is also adaptable to import transactions where the presentation of documents drives the payment process. In this situation, the supplier is allowed to present documents to the buyer's chosen bank for examination and the bank then processes the documents in accordance with pre-set criteria and notifies the buyer of its findings (i.e., compliant or discrepant). Once the documents are approved for payment, the supplier can opt for an early payment at a discounted rate that is priced relative to the bank's view of the buyer's financial strength. This process is commonplace in replacement of letters of credit or to complement open account structures, and meets the working capital goals of both buyers (via extended payment terms) and suppliers (allowing for accelerated payment of receivables).

Win-win Scenarios

Whether applying the supplier finance model to domestic transactions or in support of imported purchases, the overriding objective is to create a win-win proposition for both the buyer and its suppliers. Buyers, regardless of their leverage in the supply chain, are wary of harming supplier relationships or entering into programs that will drive up costs.

The ability to deliver on a meaningful credit arbitrage that reduces the supplier's costs is the key to overcoming this concern. Further, a strong supplier on-boarding strategy, fully supported by the buyer, that clearly articulates the value proposition of the supplier finance program, is a critical success factor. For the model to succeed, both buyers and suppliers must be convinced that their objectives will be met – a goal directly supported with supplier finance programs.

For more information on supplier finance programs or any of BNY Mellon's extended trade finance services, please contact treasury@bnymellon.com or 1 800 424 3004 (option 2).

BNY MELLON