Trends in Supply Chain Finance

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Discussions Topics

• **Clarify Confusion** around Supply Chain Finance Nomenclature
• **Overview** of Early Pay Techniques
• **Critical Issues**
  – P2P Complexity: Direct vs Indirect Supplier Expenses
  – SupplierPay - Do Corporates want to be a Bank to their Suppliers?
  – Where are the Banks?
  – New Models disaggregating Banks and Factors for business credit
• **Key Questions** to Address
The vast majority of trade credit sits on companies balance sheets in the form of payables and receivables.

- Trade finance is a large, global and interconnected industry, encompassing nearly $8tn in notional credit*.

- Most of trade credit (~$7.5tn) is not intermediated directly and remains on corporate balance sheets (in the form of trade receivables).

- Banks are the main third party source of financing for corporate trade, but intermediate roughly $500bn of trade credit (12%).

*Note: $2tn in USA, an estimated 3 trillion Euros of accounts receivables outstanding in the EU, estimated $8tn globally
The term **Supply Chain Finance** is not universally accepted nor well defined.

**Self-Funded Early Pay**
- Supplier gets paid earlier than the due date on the invoice and money comes from the balance sheet of the buyer (e.g., static discounting, dynamic discounting)

**Funded by Third Party (Factor, Bank, Non Bank, Pcard)**
- What the market calls Supply Chain Finance – i.e., Taulia’s TED program or PrimeRevenue’s multi-bank model, or Orbian’s capital markets model — is when the supplier is paid early but the money comes from someone other than the buyer.

In addition, important to point out there are **five main triggers** that we see for supply chain finance that can involve taking information to trigger liquidity.
<table>
<thead>
<tr>
<th>Technique</th>
<th>Description</th>
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<tbody>
<tr>
<td><strong>Buyer Focused</strong></td>
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<tr>
<td>Supply Chain Finance</td>
<td>Supply chain finance is an uncommitted credit facility typically with near investment grade corporations that rely on approved invoices to fund receivables.</td>
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<td>Dynamic Discounting</td>
<td>Discounts are offered on all invoices approved, opening up the entire procurement spend, based on a sliding scale.</td>
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<td>Reverse Auctions</td>
<td>Buyer sets APR rates and submits approved invoices for suppliers to bid.</td>
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<td>Pcards</td>
<td>Small suppliers and low dollar invoices typically funded by a bank (eg. U.S. Bank, Citibank)</td>
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<td><strong>Seller Focused</strong></td>
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<tr>
<td>Seller Auctions</td>
<td>An alternative to factoring where companies sell single invoices that are not credit enhanced on an exchange.</td>
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<tr>
<td>Factoring</td>
<td>Factoring consists of several distinct services: receivables monitoring and collection, credit assessment, payment guarantees and financing. It is seller-focused as opposed to SCF and dynamic discounting that are buyer focused.</td>
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How Supply Chain Finance differs from Dynamic Discounting

**Supply Chain Finance**
- Supply Chain Finance is a credit and cash management product, and focuses only on investment grade or near investment grade companies.
- SCF programs typically have a ROI and that is tied to DPO extension.
- Funders typically “buy” receivables which makes it difficult to profitably implement bank funded SCF programs for SME buyers. (KYC, UCC filing costs, etc.)
- SCF program rates are based on Libor or Euribor plus a spread.

**Dynamic Discounting**
- Dynamic Discounting requires no bank line. Programs can be done by any corporate, investment grade, non rated, non investment grade, etc.
- Corporates tend to self-fund using their own surplus cash (although options are being developed to use third party non bank funds).
- Funding is based off Treasury hurdle rates and have APRs approaching 20%+
- Typically focused on the long tail of suppliers (smaller, more indirect spend).
How big of a challenge is pledged receivables?

Can solutions move in this direction by offering more competitive rates?

Can P-card providers change Interchange structure to go upstream?

“Approved” Payable Finance aimed here

P-Cards, Discounting, and Factoring solutions for smaller vendors, typically indirect spend purchases

Early Pay Finance Options Tend to Get Positioned Based on Relative Size of Suppliers

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Relative Size – Select Early Pay Models

Size of Market
– Various Approved Invoice based funding methods

Source: GBI Analysis, RPMG 2012 Pcard study
Percentage/share of spend in different categories

- Direct
- MRO/Catalog
- Specialized - Print, Telecom, Marketing, Logistics, IT, etc.)
- Services
  (simple + complex)
- Contingent Labor
- T&E
- Other indirect/catalog
Do we want our Large Corporations to be Banks to their Suppliers?

• Material effect on balance sheet

• What is the role of third parties to finance these early pay programs?

• Three drivers for Non Bank funding
  – Technology enabling (B2B, einvoicing, data warehouses, analytics, etc.)
  – Zero interest rate environment
    = impact on Corporate Treasurers + Investors
  – Vast regulation = unintended consequences + arbitrage opportunities
Bank regulatory costs become less efficient than third party at less than investment grade, creating intermediation businesses.
Business Banking

- Checking Account
- Cash Management
- Lending / Credit
  - Commercial Purchasing cards
  - Line of Credit (Letter of Credit)
- Loans
  > Small Business Installment
  > Commercial Mortgage
- Working Capital Loans
  > Asset Based Lending
  > Factoring
  > Invoice Discounting Line
  > Distributor finance
  > Supply Chain Finance

“Disrupters”

- MasterCard
- basware
- Funding Circle
- GSCF
- DEMICA
- Tungsten
- C2FO
- Taulia
- GT Nexus
- OpenSci
- Orbian
- Corcentric

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# Factoring versus P2P Supplier Network Model

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<tr>
<th>Factoring Model</th>
<th>P2P Model</th>
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<tr>
<td>• Relationship and Operation intensive</td>
<td>• Approved invoice (Buyer focused)</td>
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<tr>
<td>• Seller-focused</td>
<td>• Typically large global names as Obligor</td>
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<tr>
<td>• Labor intensive</td>
<td>• Supplier onboarding facilitated by Buyer</td>
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<tr>
<td>• Factoring consists of several distinct services: receivables monitoring and</td>
<td>• Provides great efficiency play for Buyer (business rules, workflow,</td>
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<td>collection, credit assessment, payment guarantees and financing.</td>
<td>dispute resolution, etc.) and supplier (customer service, etc.)</td>
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<tr>
<td>• Focused on small to mid market</td>
<td>• APRs 20%+</td>
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<td>• Risk is highly concentrated in one sector – RETAIL (footwear, apparel,</td>
<td>• Cash acceleration 20+ days</td>
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<td>furniture, etc.) Essentially you have major Big Buy retail that are the</td>
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<td>obligors to these factoring companies.</td>
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Key Questions to Address

• **Spend Analytics** – how long is your tail and have you put existing programs in place for early pay?

• Do you have the **technology to manage Early Pay**? E-invoicing, eProcurement, ERP, etc. Most companies have ERP systems, but the goal is to get all invoices submitted electronically from suppliers in a no-touch/low-touch manner so that cash can be truly optimized.

• **Onboarding suppliers** is always a challenge, regardless of technique – can you commit resources?

• **Governance issues** – Finance vs. procurement misalignment and conflicting KPIs- increase DPO versus Healthy Supply chain- How will you navigate?

• Do you have the ability to **enforce and monitor the success** of programs?
Any Questions?

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