Multi-Enterprise Platforms Provide New Lending Opportunities in Today’s Uncertain Trade Environment

HOW RETAIL NETWORKS CAN REDUCE SUPPLIER RISK AND AID IN LENDING BEYOND APPROVED INVOICES

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New solutions tied to multi-enterprise platforms are enabling new working capital solutions that go beyond an approved invoice.

WHY TODAY'S EARLY PAY OPTIONS ARE SUBOPTIMAL

Much of the working capital innovation today is tied to large buyers facilitating early payments with their vendor base via techniques such as dynamic discounting and reverse factoring, commonly known as supply chain finance. But new solutions tied to multi-enterprise platforms are enabling new working capital solutions that go beyond an approved invoice.

Global Business Intelligence sees a significant opportunity for connected, **multi-enterprise platforms** to facilitate risk reduction and provide liquidity and working capital. Companies can now leverage their ERP data, network data, and other third-party data to enable funders to offer finance options to their total supply base and not leave small suppliers out in the cold. With advances in data access, algorithms, and predictive technologies, new lending solutions can scale to even the smallest of suppliers.

Up until about 2010, companies had few options to pay suppliers early. In fact, if you were not a giant, investment grade corporate that could offer bank funded Supply Chain Finance ("SCF") to your top-tier suppliers, your options were limited to P-cards and using prompt payment discounts.

Now, early pay options such as dynamic discounting and supply chain finance have become more common and offer a seller a way to extinguish a receivable early. These solutions have flourished as many companies are still pushing hard on working capital.

What is a multi-enterprise platform?

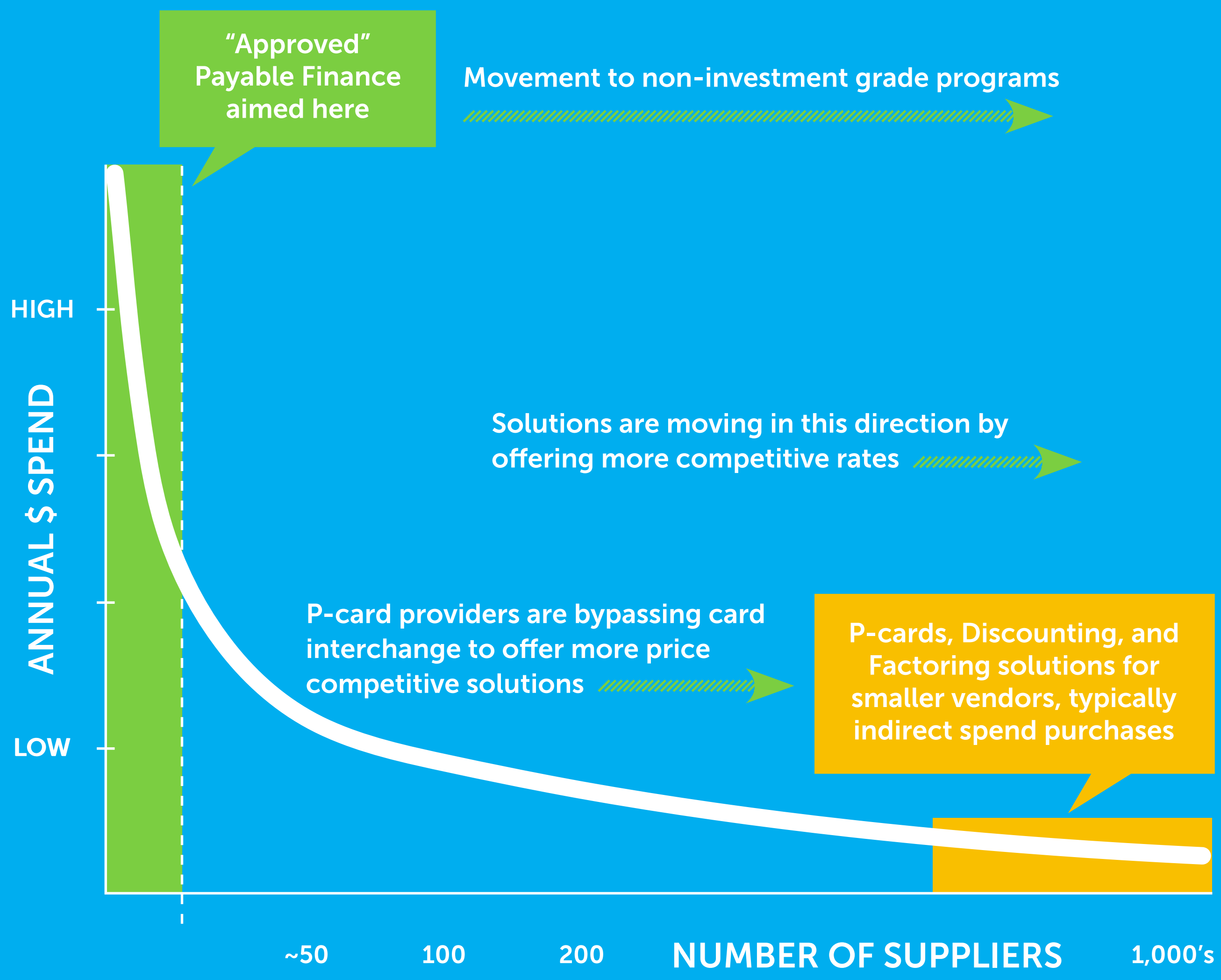
The analyst firm Gartner defines "multi-enterprise business networks" as B2B ecosystems that enable multiple & distinct parties to collaborate & optimize business processes in real-time across a shared data set. Multi-enterprise supply chain networks support a community of trading partners – of any tier and type - that need to work, communicate and collaborate on business processes, with an end-to-end, shared focus. These solutions emphasize supply chain visibility and optimizing processes.

The Hackett Group's recent study across more than 50 industries covered in their scorecard found Days Payable Outstanding (DPO) reached its highest level in 10 years, 57.4 days, up from 53.3 days in 2016. A decade ago, DPO clocked in at 40 days.

However, these early pay solutions offered by buyers to their suppliers continue to have significant gaps around addressing total spend. Companies that have $500M, or $1B, $5B or even $30B in global spend still have a small percentage of total suppliers on some early pay solution.

FIGURE 1 shows the supplier focus on early pay programs and some of the key questions impacting the early pay technique today.

FIGURE 1


"Approved" Payable Finance aimed here
Movement to non-investment grade programs
HIGH
ANNUAL $ SPEND
LOW
Solutions are moving in this direction by offering more competitive rates
P-card providers are bypassing card interchange to offer more price competitive solutions
P-cards, Discounting, and Factoring solutions for smaller vendors, typically indirect spend purchases
~50
100
200
NUMBER OF SUPPLIERS
1,000's

Early pay options such as supply chain finance programs are solicited to the top 50 or 100 suppliers and Dynamic Discounting programs are priced at very high hurdle rates, from 12 to 36%.

While there are many reasons these techniques only reach a small subset of suppliers, our analysis has shown it comes down to a few:

- Supply Chain Finance may not be offered to all suppliers because:
  - The buyer consumes bank credit lines in arranging this type of financing and runs the risk that this can be construed by their accountants as bank debt, versus trade debt, impacting their loan covenants. Costly and time-consuming Know Your Customer (KYC) supplier on-boarding requirements may limit the size of the supplier the bank is willing to actively onboard. Many times, banks or non-bank providers offer the supply chain finance programs only to the top 50 or 100 suppliers.
- Sliding scale Dynamic Discounting programs (using technology to enable companies to pay their suppliers early using their own cash) are often limited in size and priced at a high hurdle rate of 12, 18 or 36% per annum. Corporate treasuries do not want to commit sizable company cash to these programs and look to them for yield management, not necessarily to help suppliers. These programs also shorten DPO and another limiting factor is that retailers offer discounting programs to vendors that sell only indirect goods, as opposed to direct materials.
- Commercial Cards solutions have become a convenient buying tool for low dollar purchases and as a payment/finance vehicle (source of rebates as well), but it's also been poorly adopted in part because of perceived shortcomings related to fees, lack of detailed /flexible spend reporting, and poor integration into the broader procurement/Accounts Payable process ("P2P").

SELL-SIDE FINANCE TECHNIQUES HAVE CHALLENGES AS WELL

Sell-side finance techniques such as invoice discounting, market auctions, pre-shipment finance, purchase order financing, factoring, distribution finance, etc. suffer from shortcomings as well.

1. In traditional factoring, the factor undertakes credit management and collection of its clients' book debts. This adds additional operating costs such as ledger management, collections and credit insurance that are avoided with early pay programs. Also, factors finance 75% to 90% of the invoice value to manage dilution risk.

2. Supplier-centric solutions involving data from the supplier's third-party accounting programs introduce risk due to data inaccuracy, lack of confirmation of invoice status and potential for fraud. This increases the supplier's costs, limits the available facility size and limits advance rates (as low as 60% to 70% of the invoice face value).

3. Unsecured/secured lending facilities may only advance 60% of the invoice value, requiring a supplier to obtain additional equity capital to scale their working capital in line with increasing sales. For suppliers without physical assets such as inventory or facilities obtaining secured loans is difficult.

Factors finance 75% to 90% of the invoice value to manage dilution risk, not the full invoice value. Unsecured/secured lending facilities may only advance 60% of the invoice value.

HOW MULTI-ENTERPRISE NETWORKS CHANGES THE SELLER LENDING GAME

How companies buy and sell goods is rapidly changing. Multi-enterprise product and supply chain network platforms bring a supply chain together into one "ecosystem." Participating organizations collaborate and contribute their piece of data to the one platform, which results in total visibility across the supply chain. These organizations can include retailers, CPG, auto parts, pharmacies, grocery stores, manufacturers, inspection companies, carriers, freight forwarders, customs, banks, financial institutions, etc.

Multi-enterprise platforms provide different functionality along the Source-to-Pay spectrum, with some offering specific functionality (e.g., an e-invoicing suite for suppliers with a portal or an Accounts Payable Automation suite) or much broader functionality, such as product innovation, product development, and supply chain collaboration.

HOW CONNECTED PLATFORMS CAN AID IN RISK MITIGATION

For lenders that are involved in the provision of finance, risk mitigation presents considerable challenges. One of the highest risks lenders face when dealing with purchase order financing is that retailers may cancel the order, or the order will not be appropriately fulfilled, or funds are diverted for other means.

Two key dynamics in the marketplace in the last few years that can change risk assessment:

1. The ability to provide for the highly efficient exchange of 'real-time' transactional information and open, global collaboration among buyers, sellers, and financial institutions
2. The level of supply chain integration and digital data and document exchange has dramatically increased over the last few years, both upstream and downstream.

Suppliers working on orders and incurring expenses months before an invoice is issued and approved can look to new techniques to enable finance. Shipment data that is cross-validated among multiple enterprises reduces risk in transactional finance, leading to lower rates and increased advance rates.

Many procurement organizations are entering new levels of maturity with their source-to-pay applications and networks now serve as a foundation for a range of trade financing initiatives, starting first with approved invoices as a trigger for early payment. These different networks are leading to new forms of supplier finance, both those based on the network platform volume and non-platform volume, to offer suppliers both invoice finance and lines of credit.

FIGURE 2 shows various source to pay networks enable some form of early pay finance.

Connected networks can address risk assessment through the power of rich, real-time information that has been cross-validated by multiple parties in the transaction. For example, information about a shipment's readiness can be cross-validated across the supplier, inspection company, freight forwarder and carrier to ascertain that the shipment is acceptable within the allowed ranges as defined by the buyer. The challenge is to build intelligent underwriting models to address financing activities within the network. If you can tie the transaction to the purchase order, contract, shipping and receiving data, etc. and take this data and make credit decisions, that is a powerful advantage. Multi-enterprise supply chain platforms like the one depicted below have data contained in their network to enable funders to lend money.

FIGURE 2

S2P SOLUTION	DESCRIPTION
MULTI-ENTERPRISE SUPPLY CHAIN NETWORK	Supply chain collaboration platform enables companies to run direct sourcing and import programs through a cloud-based platform connecting forwarders, suppliers, large corporate buyers, financing banks, etc.
ePROCUREMENT	eProcurement enables employee having access to an electronic requisitioning tool with linkages to budget/cost-centers, appropriate workflow approvals and documentation, etc. complete with contracts for all vendors and catalogs for SKU-based goods and items.
A/P AUTOMATION & eINVOICING	eInvoicing and connectivity solutions provide complex invoice workflow, matching, approvals and overall process management that optimizes the linkage between procurement, payables and treasury requirements and priorities.
SUPPLIER NETWORKS	Functionally, supplier networks can simply be looked at as next-generation EDI-hub approaches that dangle varying degrees of application capability of the core connectivity infrastructure.

SUPPLIER FINANCE ORIGINATE FROM THESE SOLUTIONS

- Dynamic Discounting
- Approved Invoice Finance – Buyer Agreement
- Approved Invoice Finance – No Buyer Agreement
- Non Approved Invoice Finance
- Seller-centric Digital Lending

FOR EXAMPLE, THE NETWORK DEPICTED BELOW COULD HAVE SUPPLIER INFORMATION ON:

- Annual volume,
- Transaction history
- On-time performance
- Completeness of shipment (partials or full)
- Possibly some KYC/AML information that could be helpful to lenders
- Quality assurance rating based on inspection agency testing, a big risk factor to fulfilling a purchase order,
- Relationships to agents, factories, and mills
- Payment (tying back Bank payment details)
- History of Credit Note adjustments

This incredible avalanche of collected data about supply chain transactions provides the raw materials that algorithms need to assess risk. By using performance history and real-time data along with visibility and underwriting models, various events or triggers in the supply chain can be used to release cash.

While distributed ledger technology and connected API-driven platforms will help facilitate the movement of assets and credit in the future, these initiatives involve an incredible amount of change on an ecosystem and typically do not have the extended functionality of a multi-enterprise supply chain collaboration platform that can help with source-to-pay functionality. Multi-Enterprise platforms can be thought of as a private, cloud ecosystem in which the participating companies write their data to the platform similar to a blockchain.

FIGURE 3 shows the six triggers that can be used across the supply chain to move beyond approved invoice finance.

FIGURE 3


Pre-shipment Inventory & Product Finance
In-transit Inventory
Post Shipment & Invoice Finance
SIGNED CONTRACT
MATERIALS ORDERED
INVOICE ISSUED
PURCHASE ORDER ISSUED
SHIPPING STATUS VERIFIED
INVOICE APPROVED

The effects of the financial crisis that unfolded between 2007 and 2008 uncovered systemic weaknesses in the global financial and banking system.

THE NEED FOR NON-BANK CAPITAL TO FILL GAPS

The effects of the financial crisis that unfolded between 2007 and 2008 uncovered systemic weaknesses in the global financial and banking system, including excessive lending and risk-taking without the support of adequate capital and liquidity buffers. Regulators quickly moved in and enacted regulations to address these flaws, while also enforcing compliance rules that were in effect. While the aim was to make banks more resilient and reduce the impact of bank failure on the economy and taxpayers, these changes had many unforeseen consequences that have permanently impacted the lending landscape, particularly for non-investment grade companies and small and medium-sized enterprises:

- Substantial increases in mandated Regulatory Capital, governed by the Basel Accord, has increased capital costs for loans to both non-investment grade and non-rated companies, especially small and medium enterprises.
- Combined with increased capital, requirements to reduce leverage forces banks to shrink their assets to meet new regulations.
- Enforcement of Know Your Customer (KYC) laws and a lack of common KYC standards has increased onboarding processing costs for both banks and corporates. On the company side, this has negatively impacted both Supply Chain Finance and commercial card programs. Corporates are caught up in bank demands for KYC documentation, and banks lack a 'common standard', so corporate treasurers can face frequent and inconsistent KYC document requests from their banking group.

None of the above is great news for companies looking to finance their trade flows. This is where alternative lenders provide an answer. Alternative lenders are not under the same restrictions as banks, there is a massive opportunity for non-bank originators and funders to supplement the traditional bank-driven business model as demand for Supply Chain Financing grows amongst customers, and traditional sources of bank funding shrink.

NON-BANK ORIGINATORS AND FUNDERS SUPPLEMENT THE TRADITIONAL BANK-DRIVEN MODEL AS THE DEMAND FOR SUPPLY CHAIN FINANCING GROWS AND TRADITIONAL SOURCES OF BANK FUNDING SHRINKS.

Final Thoughts

Today, most large companies have multiple early pay options such as P-Cards, dynamic discounting, and supply chain finance that they offer to a specific segment of their supply base as seen in Figure 1. These companies will have one or two primary objectives around working capital that are related to payables. It could be yield, margin improvement, or debt ratio management.

Connected B2B networks deliver value to all enterprises on the platform giving Treasurers of all sizes new alternatives for funding their receivables.

These legacy solutions have grown around the fact that companies have multiple processes to manage different Spend Categories. For example, buying intercompany compared to buying consumables on an Amazon-like cloud system versus buying via contract manufacturers versus sourcing globally involve different ordering processes, technologies, approval processes and even payment and early pay finance opportunities.

Now, businesses working with multi-enterprise platforms will find new techniques driven by Specialty Finance lenders working with Multi-enterprise Platforms that are creating options for liquidity that can coexist with current finance programs. Much of this is being driven by connected B2B networks, which combine the power of rich, real-time information with funding sources to make an informed credit decision. These options are giving Treasurers of all sizes new alternatives for funding their receivables.

Companies can now leverage their ERP data, network data, and other third-party data to enable funders to provide finance options to their total supply base and not leave small suppliers out in the cold. With that advent of advances in access to data, algorithms and predictive technologies, new lending solutions can scale to even the smallest of suppliers We are still in the early days of such initiatives, but as commerce increasingly digitizes and multi-enterprise supply chain collaboration platforms become the norm, we believe new digital supply chain finance lending opportunities will flourish.

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About David Gustin and Global Business Intelligence

Global Business Intelligence, founded in 1997, conducts consortium and proprietary research and advisory services around financial supply chain, working capital, trade finance and global trade. We work with senior executives at importers, exporters, banks, credit insurers, global transportation and logistics companies, and software vendors interested in global financial supply chain and B2B issues.

David Gustin is the founder and president of Global Business Intelligence ("GBI") since 1996 and the co-founder of Trade Financing Matters. For almost 20 years, David has been running a global research and advisory practice centered on helping banks, vendors, and corporates with trade services, trade credit and financial supply chain matters. His clients included financial institutions, financial technology vendors, transportation vendors and professional service firms. As Co-founder of Trade Financing Matters, part of the Spend Matters properties David supports all things working capital and is currently involved in projects around alternative lending models. Prior to establishing Global Business Intelligence, David worked on various strategic and operational assignments in North America, Asia, Europe and Australia/New Zealand with Booz-Allen & Hamilton. He is a former VP of Security Pacific National Bank, and VP of Mellon Bank. David's formal education includes an Information Systems and Economics degree from Carnegie-Mellon University, an MBA from Purdue, and a Chartered Financial Analyst designation.
