EXPLAINER

Five Steps to a Successful Supply Chain Finance Program

Banks have focused on large suppliers in the corporate supply chain, leaving out the small businesses that could be the real beneficiaries of supply chain finance programs. Photo credit: ADB.

Banks need to update their business models as competition from fintechs disrupts the supply chain finance market.

Introduction

Supply chain finance programs have been around for more than 20 years. These have increasingly found traction with corporates, largely driven by the need to drive business efficiencies by unlocking working capital.

Today, however, industry practitioners and followers are asking: What defines successful supply chain finance solutions and why do many programs fail to achieve the desired impact? These questions have surfaced with the arrival of fintechs. They introduced innovations and efficiencies into supply chain finance, which increasingly relegate banks to mere funding providers on the fintech platform.

So, what will it take for bank-led supply chain finance programs to survive and thrive? The answer lies in a series of common-sense steps.

1. Target the Long Tail

In general, banks focus on large, lumpy exposures provided by big suppliers/dealers, ignoring in the process the small businesses, which could be the real beneficiaries of corporate-sponsored programs. Inefficient targeting of the program leaves out this long tail to the detriment of all. Problems are attributed to a combination of complex documentation, geographical spread of the players, and supplier onboarding being seen as a time-consuming and low value-added activity. Furthermore, the inability of banks to view suppliers/dealers as potential full relationship banking customers has contributed to this paradigm.

More recently, central banks in many countries have directed commercial banks to increase lending to the micro, small, and medium-sized enterprises, and this is increasingly pushing banks to amend their business models to ensure far more comprehensive coverage of supply chain finance programs, thereby bringing the smaller businesses within the corporate supply chain into focus.

2. Build Program Ownership and Approach

Traditionally, the core client or anchor of the supply chain has limited its role to putting the program in place and negotiating bank rates with, thereby limiting the potential impact of supply chain finance on small and medium-sized companies. The two major stakeholders in the program, namely, the bank and the anchor, should own joint responsibility for the success of the program at the most senior levels. While the bank obtains a large number of customers with potential to upsell, the anchor has its own interests in increasing working capital efficiencies and investing in its supply chain partners.

Within the bank’s organizational structure, it would help to house all supply chain finance activities within a division separate from traditional offerings but with strong relationships with the corporate banking team to enable leveraging of the bank’s corporate banking relationships.

3. Reach Out

The next critical step is outreach to suppliers/dealers.

A well-designed program rollout should involve representatives from both the bank and anchor, and should be clustered with a manageable group of dealers/suppliers. Case studies and informational brochures should be used in a workshop setting with cogent and synchronized messaging aimed at bringing absolute clarity to the rollout process.

More often than not, implementing a supply chain finance program entails a significant change in the processes of the anchor–supplier/dealer relationship. This requires investing time in building trust and confidence among suppliers and dealers.

Modern supply chain finance programs leverage technology platforms. E-invoicing is an integral part of this deployment. The process of switching to e-invoicing should be easy to understand and implement.

Interest rates are always a critical component of any lending facility. Supply chain finance brings its own questions on the interest rate front. Options include centrally negotiated rates with anchors or negotiated rates with each individual small supplier/dealer. There are pros and cons to each approach, which must be carefully evaluated prior to rollout.

The regional sales/purchase hierarchy should be intimately involved as they hold the relationships with the dealers/suppliers. This approach is useful in monitoring the performance of the program (collections, credit default, etc.).

4. Assess Credit Risk

It is critical to include credit risk in the product design at an early stage. A number of areas need to be in place to successfully and safely scale up the supply chain finance program. Appropriate credit assessment methodology, early warning systems, a well-thought-out collections policy and strong relationship management with anchors are some of the critical areas of focus to drive success.

Conducting detailed credit assessment and specifying collateral cover as normally implemented for standard working capital arrangements have proved to be a significant hurdle in achieving an optimum rollout velocity, apart from the fact that dealer/supplier balance sheets do not approach the ideal balance sheet desired by banks. The approach should recognize the risk and assignment of that risk as well as take into account various non-financial comforts provided by the anchor and the transactional controls of the program.

5. Reduce the Paper Trail

Assuming the first four steps are done right, there is still one area which can trip up the entire program—the actual onboarding or sign-up of the suppliers/dealers.

As far as possible, use an electronic platform for receiving and responding to information requests from suppliers/dealers. Leverage information already available with all parties.

Supply chain finance programs should reduce the physical interface (site visits to the suppliers/dealers) unless this is necessary, and at the same time limit the need for voluminous documentation.

E-invoicing needs to be the standard mode of operations without exception. Eliminate paper invoices by getting supplier/dealer buy-in for the new system and by removing bureaucratic hurdles within the anchor company.

Conclusion

Success factors for supply chain finance programs have not been clearly defined and banks have focused on large suppliers in the corporate supply chain, leaving out the small businesses that could be the real beneficiaries of increased access to finance provided by such programs. A number of factors, chiefly competition from fintechs and the directive from regulators to increase lending to small businesses, is leading to a change in banks' business models for supply chain finance. Significant investments are being made to refine processes, build efficient credit assessment models, and improve outreach deep into the corporate supply chain. At the same time, initiatives like centralized KYC (know your client) services through industry-level initiatives have the potential to further increase velocity of program rollouts.

A combination of innovations in technology, product design, and credit and on-boarding processes can provide the much-needed agility to sub-performing programs. The Asian Development Bank's fledgling Supply Chain Finance Program will work with banks to implement these success factors to boost the growth of small and medium-sized enterprises and job creation in developing markets

Resources

Asian Development Bank. Supply Chain Finance Program.

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Sunil Mascarenhas is the focal person for the Asian Development Bank's Supply Chain Finance Program. He is responsible for establishing a strong platform for the program and for growing the supply chain finance business in ADB's target markets. He has extensively worked in commercial banking and supply chain finance at HSBC and International Finance Corporation across Asia.

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