SUPPLY CHAIN FINANCE

1. BACKGROUND

In October 2012, after an initial discussion with the Bank of England and some of the largest UK companies (including Carillion and Balfour Beatty), the then Prime Minister David Cameron spoke about the significance of reviewing the supply chain financial market and stressed that the Government understood the importance of creating sustainable a means for protection and growth of SMEs. It was felt that through the supply chain finance scheme, implemented with great success in the sub-prime recession of the USA, large corporate businesses could potentially provide up to £20bn of additional funding to their SME suppliers.

2. WHAT IS SUPPLY CHAIN FINANCE?

Supply chain finance (also known as supplier finance), is a set of solutions that improves cash flow by allowing large corporate buying businesses to reduce their suppliers payment terms through a banking facility which is based on the large buyer's balance sheet credit rating- it provides the option for SME suppliers to get paid early.

The purpose of the scheme is to borrow the credit rating of the larger buying businesses balance sheet for the benefit of the smaller supplier's cash flow in order to tackle the issue of protracted payment and improve efficiency of working capital.

Large corporates across different sectors have introduced supply chain finance programmes in order to improve suppliers' cash flow while maintaining their own working funds .

3. WHAT IS THE PURPOSE OF THE SCHEME?

SMEs struggle to get sufficient funding to cultivate, invest and grow their businesses. Unlike larger companies most SMEs experience higher costs of financing and limited access to capital. The purpose of the scheme is therefore to help to tackle these issues and to:

- get paid earlier
- secure cash flow
- improve stability of working capital
- secure the supply chain
- improve R&D, protect jobs, boost innovation and increase investment in training

The scheme enables these goals by proposing earlier payments to suppliers based on the credit worthiness of their customers.

[1] http://www.supplierfinancing.org/scf-scheme-uk/

[2] Trade Finance Global: https://www.tradefinanceglobal.com/finance-products/supply-chain-finance/

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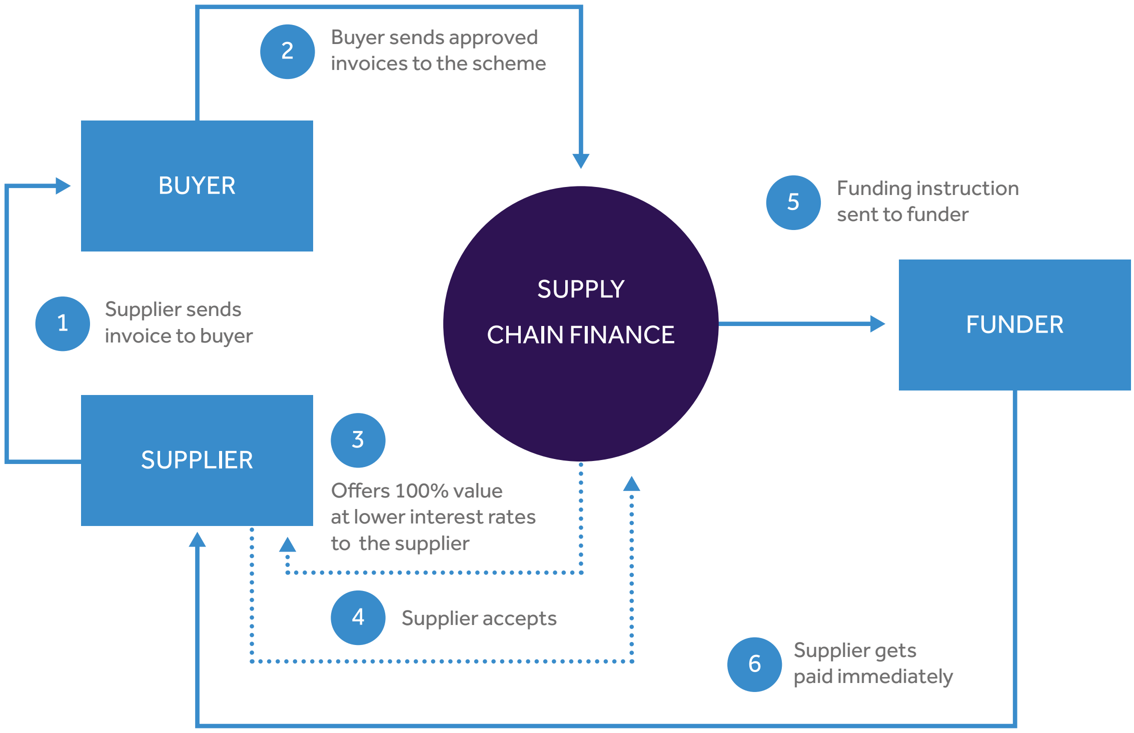
4. HOW DOES SUPPLY CHAIN FINANCE WORK?

The diagram below outlines how supply chain finance works:



5. WHAT ARE THE RISKS?

Product risks – are the risks seller accepts i.e. performance warranties, agreed maintenance, service obligations. The buyer must contemplate the risks of potential external factors for example negligence during production or extreme weather during transport storage an, delivery and installation, which could lead to disputes between the buyer and the supplier. It is therefore crucial for the supplier to word the contract correctly as any plant/equipment/materials changes may have an impact on compensation provisions.

Manufacturing risks – are the risks arising out of custom-made plant/equipment/materials. Usually the supplier covers the costs of alterations to the product until the buyer sees fit, because the product cannot be resold to other buyers. These potential risks should be addressed earlier, which means the buyer has to enter payment commitments at even earlier stage (part-payment and separate guarantees may be offered to off-set these risks in the contract).

Transport risks – risks related to the movement of the plant/equipment/materials from one party to another. An insurance scheme outlining the terms of delivery should be considered, to cover the changes in routes or transportation.

Currency risks – a risk to the fluctuation of the currency value, i.e. party based in another country agrees to purchase plant/equipment/materials should consider currency value and make provisions in their contract accordingly.

[2] NOTE: an enquiry report, under Part 1 section 6 (2) of the Enterprise Act 2016, must not identify the complainant, unless the complainant consents.

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6. WHAT ARE THE BENEFITS?

BENEFITS

BUYER

- Reduces and stabilises financial volatility risks in the supply chain
- Improving working capital with 3rd party funding paid for by the supply chain
- Improving relationships with the suppliers
- Improving quality and programme of projects relationships with the suppliers

SUPPLIER

- Meeting cash flow critical dates at lower finance rates
- Improving working capital by getting paid in timely manner
- Reducing necessity for more expensive external borrowing
- Transparency on undisputed debts
- Reduced credit control overheads

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7. SUPPLY CHAIN FINANCE IN CONSTRUCTION:

- URICA [3]
- Textura [4] now Oracle [5]

URICA, a web-based supply chain finance platform, was awarded a commitment of £10 million funding from the Business Finance Partnership in May 2013, which empowers businesses to pay and get paid on the terms they want, releasing cash into the supply chain with zero debt and zero risk. URICA allows companies turning over just £5m or more to offer supply chain finance, addressing concerns that companies further down the supply chain are not able to take part in existing programmes. [6]

According to the report nearly 200 subcontractors and suppliers have used its SCF program for more than £540 million in payments. [7]

In response to the working capital challenges in the construction industry, technology solutions provider Textura (now part of Oracle) launched a supply chain finance program in 2014 to enable general contractors to provide an accelerated payment option to their subcontractors. Along with the Textura Payment Management Cloud Service it allows eligible subcontractors to elect to be paid significantly faster than normal payment timing in exchange for a modest fee. The programme — developed in partnership with financing experts at Greensill Capital — is the first broadly available SCF program for the construction industry.

In the UK, many businesses agreed to consider establishing or expanding existing supply chain finance programmes for their supply chains including: [8]

- Carillion
- Balfour Beatty
- Willmott Dixon
- Kier
- AB Foods
- Jaguar
- Land Rover
- EDF Energy
- Rolls Royce
- Statoil

[3] For URICA access here: **http://info.urica.com/finance-for-construction-projects**

[4] Textura can be accessed here: **http://www.texturacorp.com/texturacorp/assets/File/white-papers/Textura-EPP-Supply-Chain-Finance-Solving-Working-Capital-Challenges.pdf**

[5] Oracle can be accessed here: **http://www.texturacorp.com/improving-construction-payments/unlocking-the-power-of-supply-chain-finance-in-construction/**

[6] To read more about an action plan for government and industry: **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/407071/bis-15-6-strengthening-uk-manufacturing-supply-chains-action-plan.pdf**

[7] Supplier Satisfaction Survey for the Carillion Early Payment Facility (EPF) can be found here: **https://carillionplc-uploads-shared.s3-eu-west-1.amazonaws.com/wp-content/uploads/2016/02/1204MN-epf_survey_summary14-original.pdf**

[8] To see the extended list of companies please access here: **https://www.gov.uk/government/news/prime-minister-announces-supply-chain-finance-scheme**

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There are now many capital platforms funded by non-bank organisations available to provide product support to the SMEs as well. These include Oxygen finance, Trade River Finance, and C2FO. Many retail, manufacturing, consumer products and pharmaceuticals companies are among those most likely to set up SCF programmes.

However, the drawback is that some businesses in construction saw the supply chain finance initiative as an opportunity to reverse the principles of balance sheet lending – in other words, they extended their original payment terms borrowing even more money from their SME supply chain at no cost to themselves, only to use the credit based banking facility as a means of paying those who were prepared to sacrifice a proportion of their debt to be paid 'early', i.e. on their original payment terms.

This is initiative not supply chain finance as it was meant to be implemented, but abuse of supply chain finance directly contrary to the principles of the system.

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