

SUPPLIER BENEFITS

Companies can reduce their financing costs by improving their supply chain management.

by Sankar Krishnan

SUPPLY CHAIN MANAGEMENT is emerging as a critical tool in the corporate treasurer's arsenal to reduce short-term financing costs.

Components of a successful supply chain platform can include:

- working capital optimization through supplier financing;
- monetizing receivables through global distribution financing or sales financing, and
- getting your inventory to work for you through inventory financing.

How can working capital be optimized through supplier financing? Take the case of a medium/large North American retailer that imports from a variety of Asia-Pacific countries. Looking to improve its working capital position, its treasurer links up with a global banking partner to work to the benefit of the company and its suppliers.

The bank advises the retailer to avoid expensive letters of credit and move to open-account transactions (if it has not already done so), then centralize procurement with just a few suppliers, subject to quality of goods.

At the time, the retailer pays its suppliers on a 60-day basis. Included in the cost of procurement is a financing fee that its suppliers incur in Asia. Since these suppliers are typically small entrepreneurial companies that don't have access to capital markets, this fee amounts to more than Libor + 250 bps. By working with a global bank, the retailer can use a supply-chain platform to manage procurement. This allows the bank to monitor the transactions and provides lower-rate financing to the supplier, based on the buyer's credit quality. The supplier's financing costs can then be reduced in the short term by Libor + 180-200 bps, with the savings captured in a lower cost of goods sold.

This approach can also help the retailer, since its suppliers gain adequate access to financing, even in the midst of

regional economic problems or credit constraints. The suppliers can then be migrated to the supply chain platform, because the bank can credit-underwrite the buyer at significantly lower cost.

The end result? A win-win. For the retailer: improved day's purchases outstanding and lower cost of goods sold, significantly improving working capital conditions. For the supplier: access to a new liquidity channel and lower and more flexible need-based credit.

As for monetizing receivables through global distribution financing, let's take the example of a Canadian business that's experiencing 25% growth in global sales per annum. To compensate for a business slowdown in North America, the company's global sales teams are under a mandate to begin selling in emerging markets.

The company's treasurer, aware that some emerging-market countries present greater business risks than others, faces the prospect of monetizing global receivables, either through costly insurance or sale or through discounting of more risky ones.

As an alternative, the treasurer can use the supply chain platform of a global bank. The bank can much more readily manage this risk than the company, because it has an established, on-the-ground presence and a local currency balance sheet that can accommodate the liquidity needs of small and mid-sized companies.

If the company sells to emerging markets on a 45-day basis, it can also recover all monies due on day one, on a discounted basis, instead of waiting 45 days. This also improves concentration-of-risk limits on buyers, since the seller gets all credit-related performance

information without incurring credit risk. Wall Street and investors are increasingly rewarding treasurers who can improve their company's day's sales outstanding and demonstrate improved performance over their peer group.

Finally, a supply-chain platform can also make a company's inventory work harder. A Toronto retailer, for example, whose treasurer wants to improve working capital by using better inventory

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planning, must currently pay its supplier within 60 days of shipment. However, whether goods are shipped from Madras, India, or Madrid, Spain, one thing remains certain: it takes 30 days for the goods to arrive in Toronto. That means the retailer has to pay its supplier within 30 days of receiving the goods.

Alternatively since global banks will take risks on suppliers based on the buyer's commitment to purchase, the 60-day payment period can be structured from date of landing in Toronto, rather than from date of shipment. Voila – the retailer regains those 30 days.

By working with a global bank treasurers of Canadian companies can reduce financing costs and broaden their financing options, encourage suppliers to join their supply chain, improve management of working capital, and reduce costs throughout the supply chain.

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