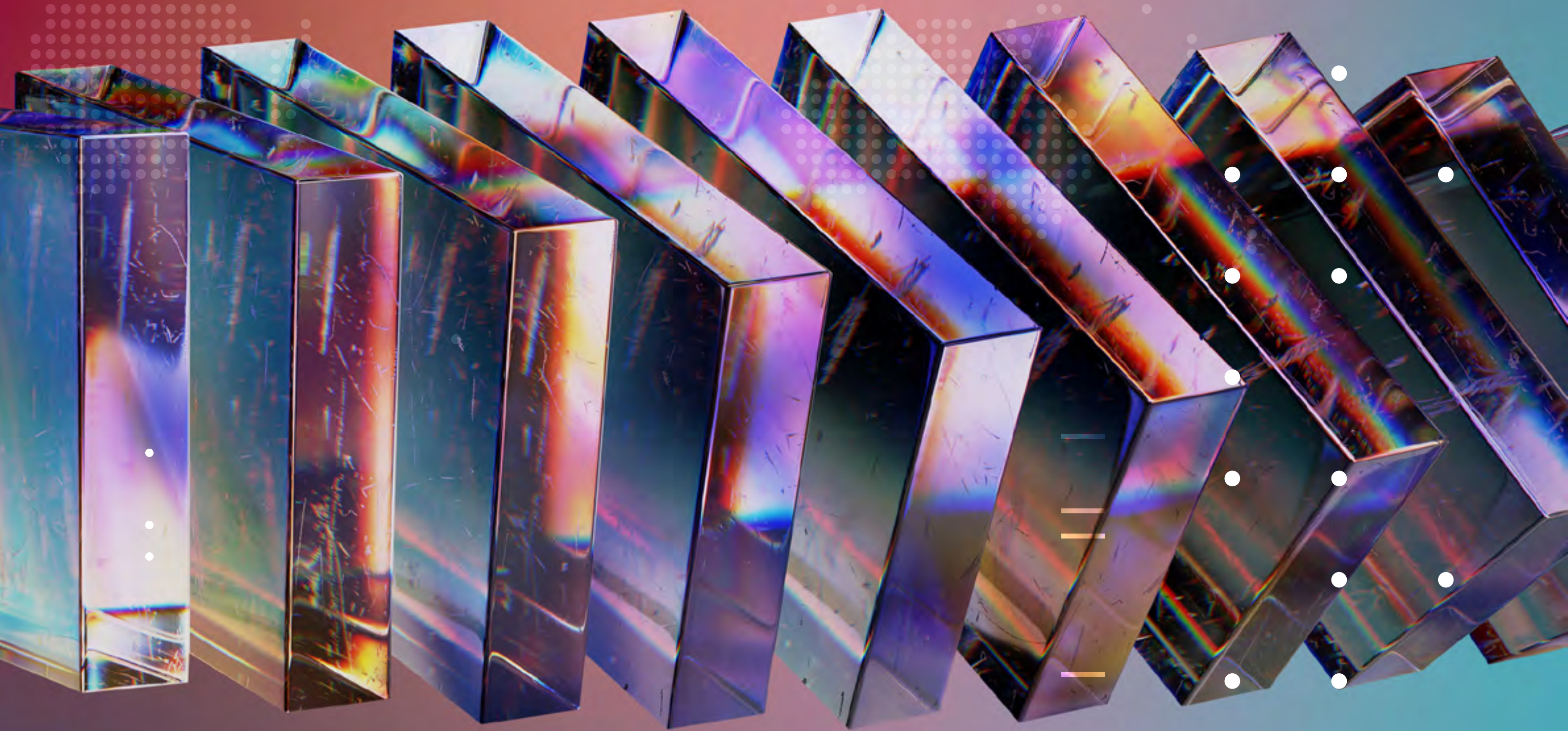
Supply Chain Synergy



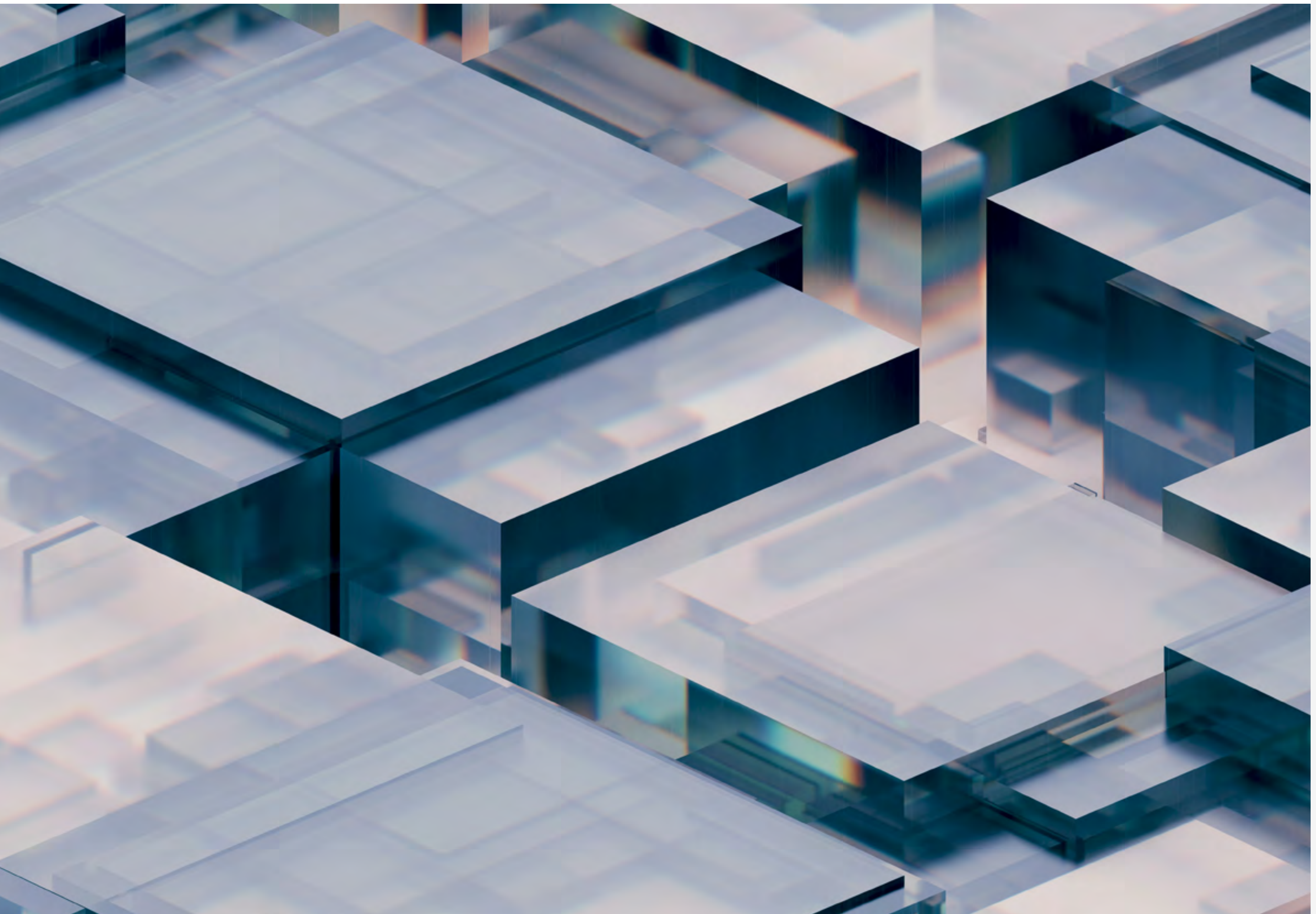
Everything you need to know about building resilience in Asia's trade ecosystem

"The dual impact of the current macroeconomic environment and geopolitical factors have resulted in enormous shifts in business models and supply chains. Our clients are now looking ahead, with sustainability and growth at the core of their strategy, enabled through digital and data."

Rajesh Mehta
Region Head, Asia Pacific,
Treasury and Trade Solutions, Citi

"Amidst a challenging backdrop, clients have sought to enhance their working capital and liquidity management capabilities. Optimizing the supply chain is a big part of addressing these challenges; Citi TTS has worked more closely than ever with corporations' Treasury and Procurement professionals in recent years, to provide accretive solutions that support their supply and distribution chains operationally and financially."

Shahmir Khaliq
Global Head of Treasury
and Trade Solutions, Citi



Foreword

The corporate landscape across Asia has rarely appeared more complex. Companies, big and small, face significant challenges; and how they go about overcoming them will determine their success or failure over the coming years.

This publication will provide Asian corporates telling insights from research conducted on leading businesses in the region. The research, carried out by Citi in partnership with East & Partners, identifies companies' principal concerns as they look towards 2023 and beyond. The following articles also offer clear and practical steps that companies should consider to overcome today's most pressing challenges.

Costs are rising, liquidity remains stretched and supply chains suffer disruption from a myriad of factors, including geopolitics. But strategies and solutions are at hand to manage these hindrances. Throughout this magazine, we have presented unique findings on how companies can discover ideas for improving credit terms and using structured products to lower their cost of capital and manage risk simultaneously. They can also learn how to invest effectively in digitalization and optimize working capital by improving efficiency via active payables and receivables management.

Put together, the data from our survey and the practical advice from some of our trusted partners can help companies define and activate the quickest route out of today's complexity; for a route that offers greater clarity of the future and sets companies up for better times ahead.

Megha Chopra
Asia Pacific Head of Trade Sales
and Client Management, Treasury
and Trade Solutions, Citi

Building resilience with supply chain finance

Industries are feeling the strain of rising costs but financial products can help strengthen the supplier ecosystem

The resilience requirement

If companies across Asia hoped that the post-pandemic world would mean easier times ahead, the first few months of 2023 are signaling otherwise.

With inflation on the rise and global trade still vulnerable amid the aftereffects of Covid-19, business leaders are focusing more than ever on building resilience in supply chain financing.

"Whether companies have one or two big suppliers in one country, or many suppliers across different geographies, they have to take extra care of their supply chains," says Megha Chopra, Asia Pacific Head of Trade Sales and Client Management, Treasury and Trade Solutions, Citi. "If they don't, these supply chains could become an acute area of risk."

24%

Geopolitical tensions are front of mind for one in four large APAC corporates

But what exactly are companies' greatest concerns over the coming months? And what strategies are they employing to make their supply chain financing resilient to further shocks?

Challenges ahead

Research by Citi in partnership with East & Partners showed that geopolitical concerns remain top of mind for almost one in four businesses in the region, as conflict in Ukraine and escalating tensions in the South China Sea take their toll.

The fall-out from the supply chain disruption of the last three years continues to weigh heavily: the research identified that 17% of enterprises across Asia consider a supplier default as the single most pressing concern. Companies are also worried about ongoing supply chain disruption and logistics delays, with 14% citing this as their biggest concern.

A relatively new challenge is rising costs. Across the region, only one in four companies are yet to face higher inventory costs, with those in Vietnam and India least affected.

Resilience-driven solutions

In response to spiking costs, companies are adopting a range of strategies to build greater supply chain resilience. More than one-third of those surveyed said that they were increasing inventory buffers by switching from a "just-in-time" supply model to a "just-in-case" one.

Greater supplier integration was a focus for 58% of respondents, who cited it as a way to face down the latest economic headwinds. "Given the impact from global events, corporates have been carefully re-evaluating their supply chain priorities" says Andrew Betts, Global Head of Trade Sales and Client Management, Treasury and Trade Solutions, Citi.

"Effective supply chain management is proving even more critical to optimum working capital flows and risk mitigation."

Andrew Betts
Global Head of Trade Sales and Client Management, Treasury and Trade Solutions, Citi

"With all that is going on in the world, there needs to be a higher level of trust and integration with suppliers," Chopra says. "Corporates that have managed to take their suppliers along with them are the ones that are going to emerge as winners."

"We've had to become much more proactive with our suppliers and really treat them as partners rather than simply providers."

Treasurer, US$1.8bn
Indian Light Manufacturer

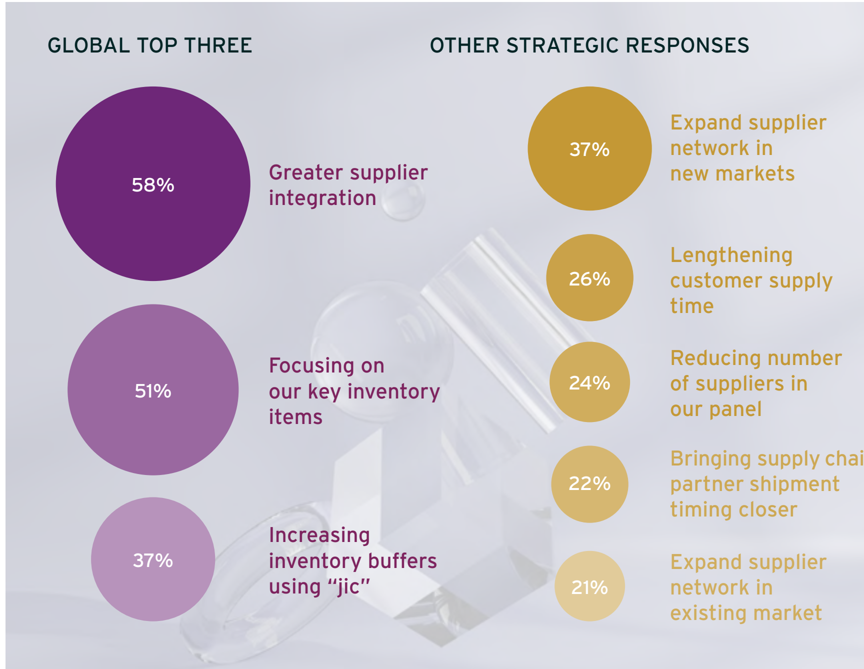
Pepco, a chain of discount shops with 115 strategic suppliers in Asia, has done just that. When Covid-19 hit, it decided to extend payment terms for its suppliers from a maximum of 15 days to 30 days, and then again to 60 days.

A year into the pandemic, supply chain costs—notably logistics and commodity costs—started to increase as the global economy recovered. Pepco wanted to help its suppliers, ensure supply chain resilience and minimize the impact on its own cost base. The company decided to extend payment terms further. Crucially, it wanted to use supply chain finance to reduce costs for its strategic suppliers because, as the terms got longer, the impact to suppliers grew too.

The supply chain finance solution allowed suppliers to be paid in 10 days, saving them significant effort and expense associated with factoring, and enabling them to offset increased commodity and other costs.

Citi's Chopra explains that Pepco's approach should serve as a model for others. In an inflationary environment with increasing interest rates, the differential between the cost of investment-grade and non-investment-grade finance is becoming significantly wider, putting pressure on smaller suppliers. Supply chain finance uses the higher rating of buying companies to enable suppliers to gain early access to attractively priced finance. This increases suppliers' resilience, shoring up the physical supply chain. Chris Cox, Global Head of Trade and Working Capital Solutions, Treasury and Trade Solutions, Citi, confirms that.

Top strategies companies are using to improve supply chain resilience:



"A stronger financial supply chain results in a more robust physical supply chain."

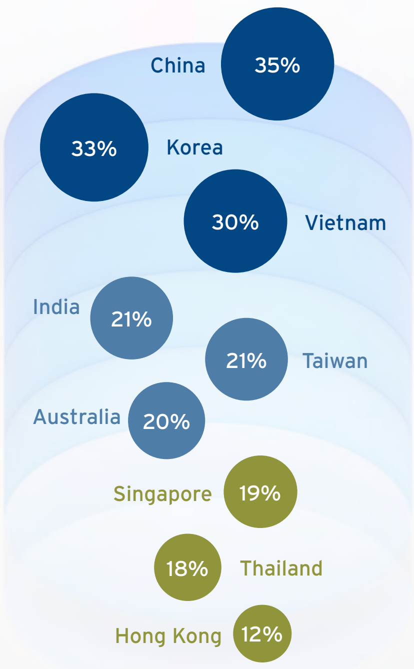
Chris Cox
Global Head of Trade and Working Capital Solutions, Treasury and Trade Solutions, Citi

Sustainable Future: Responsible supply chains in Asia

The rise of sustainable finance in Asia has given companies in the region a valuable tool to integrate suppliers along environmental, social and governance lines

When German industrial and consumer heavyweight Henkel wanted to accelerate its sustainability journey in Asia, it realised that it needed to join forces with its suppliers. In fact, their operations had as much impact on its sustainability metrics as Henkel's own activities.

Proportion of renewable energy used in operations



The solution was a sustainable supply chain finance programme to increase sustainability across the ecosystem by incentivizing environmental and social improvement while also enhancing supply chain resilience.

Henkel already had an existing supply chain financing structure, which its suppliers could access. But it decided to create an enhanced programme for suppliers that could demonstrate strong or improving sustainability performance to access financing at a preferential rate.

One of the challenges companies encounter when setting up such a programme is the complexity in measuring and monitoring supplier performance against independent sustainability metrics. To address this, Henkel partnered with a specialist company to provide independent assessments, reviewed every three years.

Regional complexities

Across Asia, companies are pushing to integrate environmental, social and governance (ESG) factors into their supply chains as part of their wider sustainability targets. But in stark contrast to Henkel's success, few are making headway. According to the research carried out by Citi in partnership with East & Partners, corporates in the region have hit multiple barriers on their sustainability journeys, from struggling with inconsistent definitions and high compliance costs, to an overly complex regulatory environment and suppliers who are resistant to change.

"The range of diversity, smaller countries, different regulations and mix of demographic profiles make it a challenge to have a long-term sustainability plan," says Megha Chopra, Asia Pacific Head of Trade Sales and Client Management, Treasury and Trade Solutions, Citi. "The consequence is that while many other regions of the world are gaining ground on sustainability, Asia is falling behind."

In India, for instance, 18% of corporates said that their efforts to integrate sustainability policies along their supply chain suffered from "overall complexity". The same percentage reported that a principal barrier was resistant suppliers.

Overall, only 5% of large companies in the APAC region either encounter no issues implementing sustainability measures or have already fully implemented them.

Solutions in the shape of sustainable supply chain financing

Citi's Chopra argues that amid the backdrop of slow-moving government regulation around ESG factors, CFOs and treasury departments in APAC can instead take advantage of sustainable supply chain financing to align suppliers on ESG ambitions.

"There is a huge global shift towards sustainable finance,"

Kanika Thakur
Asia Pacific Head of Corporate, Commercial and Public Sector Sales, Treasury and Trade Solutions, Citi

says Kanika Thakur, Asia Pacific Head of Corporate, Commercial and Public Sector Sales, Treasury and Trade Solutions, Citi. "That increases the scope for companies in the region to use this as a tool to improve their overall sustainability profiles."

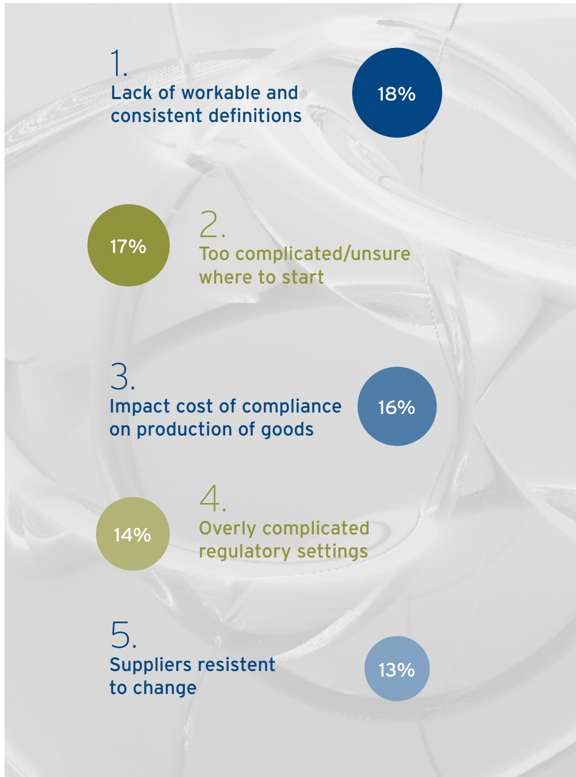
An obvious incentive to look at sustainable options is cost. "Everything sustainable has become slightly cheaper than the usual financing costs," says Steven Elms, Global Sales Head of Corporate, Commercial and Public Sector, Treasury and Trade Solutions, Citi.

"If you are able to pursue a genuine green path with your suppliers, not only can you help them reduce their interest financing costs but also move faster towards an integrated ESG ecosystem."

Steven Elms
Global Sales Head of Corporate, Commercial and Public Sector, Treasury and Trade Solutions, Citi

A second and more fundamental reason, Elms says, is that ESG factors have become essential to a company's long-term survival and success. "ESG is no longer a good to have; it's a must have."

Top five obstacles to greater ESG supply chain integration



Embracing digitalization

"We see big wins coming from digitalizing more of our supply chain process—our suppliers are asking for it, especially DLT (distributed ledger technology) where we're reducing our processing costs significantly and winning new relationships."

Treasurer, US$1.2bn
Taiwanese Electronic Components Manufacturer

Asia's recent meteoric rise as a global trading region provides a unique opportunity for companies to leapfrog several generations of technology

When chemicals giant BASF's Shanghai operation decided to relocate its merchandise business to China to better serve local markets, it had four key objectives:

1. improve documentary quality;
2. shorten documentation delivery lead-time;
3. optimize costs; and
4. digitalize to allow greater flexibility, especially amid the changing environment of the Covid-19 pandemic.

BASF assigned its Asia Pacific Trading Centre in Kuala Lumpur to centrally prepare thousands of trade documents against payment (DP), documents against acceptance (DC) and export letters of credit, for the countries in the Asia market.

Its innovative e-trade solution provided an end-to-end handling procedure for documentary trade transactions. This comprised a streamlined processing flow with different counterparties at various locations, and a robust online model to centralize the operation.

Digitalization across Asia

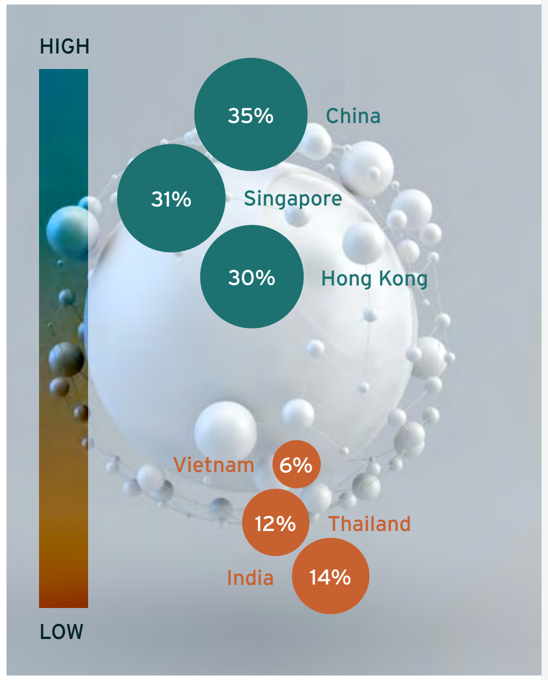
As Asian corporates rethink and reorganize supply chains and trade finance driven by the disruptions caused by Covid-19, the uptake and implementation of digital technology has emerged as a vital tool for managing uncertain operating environments.

Despite its increasing relevance, digitalization and its uptake are at best patchy across the APAC region. According to research carried out by Citi in partnership with East & Partners, one in three companies in China, Singapore and Hong Kong are using new, innovative tools for trade. Yet only 6% of companies in Vietnam, 12% in Thailand and 14% in India are embracing the digital uptake.

The overwhelming majority of Asian corporates, at 87%, are already using digital technology to track the movement of goods along their supply chains. Beyond that, however, the implementation and use of digital technology is low.

Megha Chopra, Asia Pacific Head of Trade Sales and Client Management, Treasury and Trade Solutions, Citi, argues that while digital uptake to boost trade remains nascent in the region, the potential is huge. For one, it improves and accelerates supply chain integration, which is important for reacting quickly and efficiently to a bottleneck, staffing problems or restrictions on movement. Digital uptake can also help overcome signs of rising dissatisfaction with trade loans among importers and exporters.

Digital uptake in trade



Drivers of change

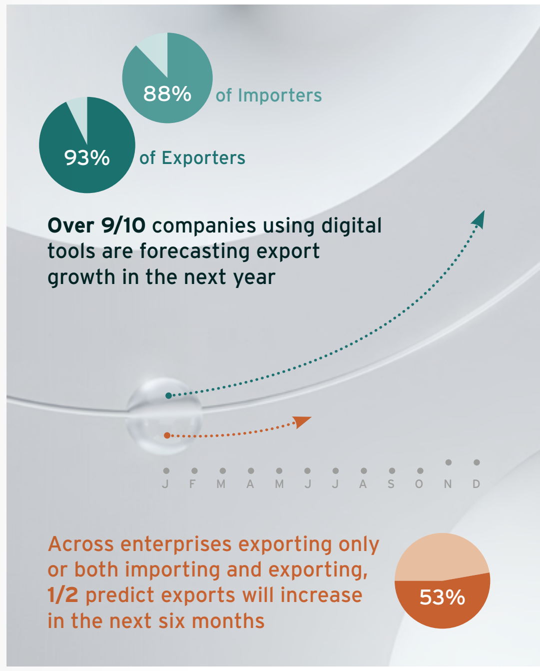
A possible catalyst for change is the agenda of some Asian governments to drive digitalization in cross-border trade. Santosh Dujari, India Sales Head, Treasury and Trade Solutions, Citi, says "in India, improving ease of doing business has been a strategic priority of the government and simplifying cross-border trade has been at the core of this transformation. A few years ago, trade in India was extremely paper intensive, but today, on account of digital platforms and processes, trade flows are completely paperless.

"We are seeing a digital impetus across the entire trade ecosystem, be it supply chain platforms, trade funding structures or trade instruments."

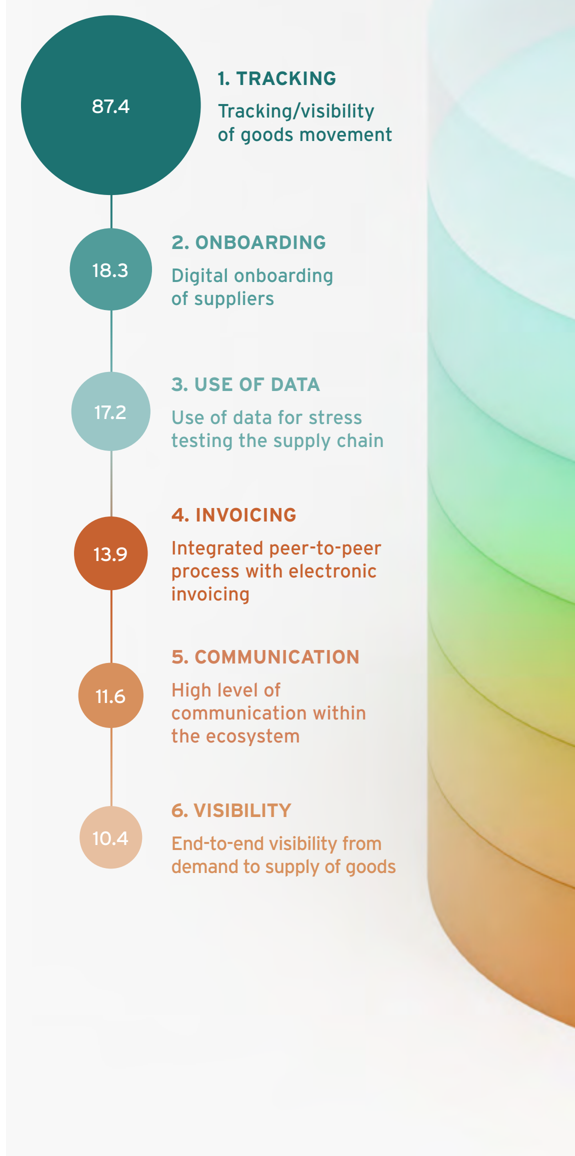
Santosh Dujari
India Sales Head, Treasury and Trade Solutions, Citi

In the meantime, Chopra explains that Asia's more recent rise as a global trading region provides a unique opportunity compared to other regions. "Asia does not struggle with legacy systems, so there is a real chance to leapfrog several generations of technology."

Digital prowess is a key conduit for growth



How digital is your supply chain?



Taking liquidity management mainstream

Since the pandemic, managing working capital has become a strategic imperative but companies in Asia aren't using all available tools

For companies across Asia and the world, the Covid-19 pandemic dealt the biggest blow to supplier terms and balance sheets, pushing liquidity management to the top of treasury departments' priorities.

The aftermath of higher inflation, rising interest rates, heightened risk-management concerns and a paucity of cash gave rise to critical questions around how best to manage liquidity.

Trapped working capital

Against that backdrop, and given Asia's place as the world's biggest manufacturing centre, just how healthy are corporate credit profiles? And what tools are they using—or not using—to improve liquidity management?

Research carried out by Citi in partnership with East & Partners found that one in two Asian corporates have between 20% and 40% of their working capital trapped in so-called days payable outstanding (DPO)—a ratio that indicates the average number of days it takes for a company to pay its bills and invoices.

At the same time, the research showed that 57% of companies in the region have between 20% and 40% of their working capital trapped in so-called days inventory outstanding (DIO)—the average number of days that a company holds its inventory before selling it.

Behind those startling figures lies a complex mosaic of supply chain relationships, which makes it all but impossible for companies to adopt a one-size-fits-all approach to liquidity management.

Additionally, the Account Receivables cycle is also lengthening as customers demand more credit terms to manage their own working capital. To add to this, 76% of corporates reported that their customer credit profiles were weakening.

Creating liquidity buffers

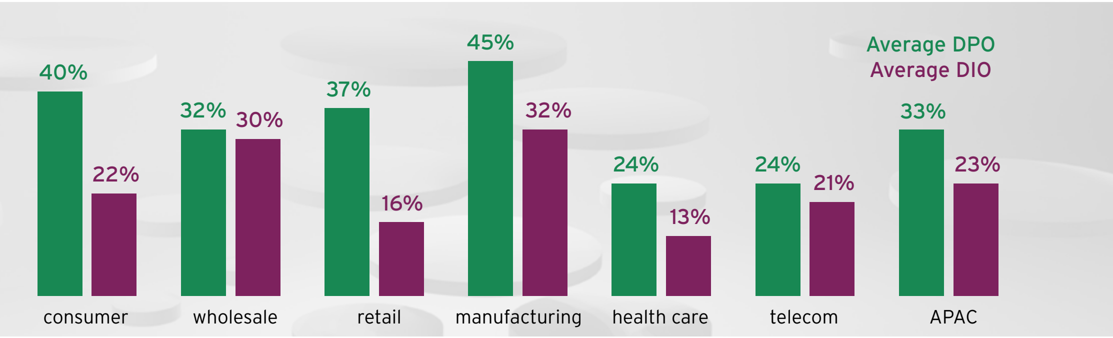
At a time when companies face challenges on both payables and receivables front, unlocking liquidity from multiple avenues provides the necessary cushion, helping companies to become both more agile and more resilient in the face of many unknowns.

For example, companies now must have sufficient liquidity to provide better credit terms to push sales in newer markets or increase market penetration by grabbing market share in existing markets. Added cushions are required to bolster stocks in the event of supply chain problems and absorb periods of rising costs.

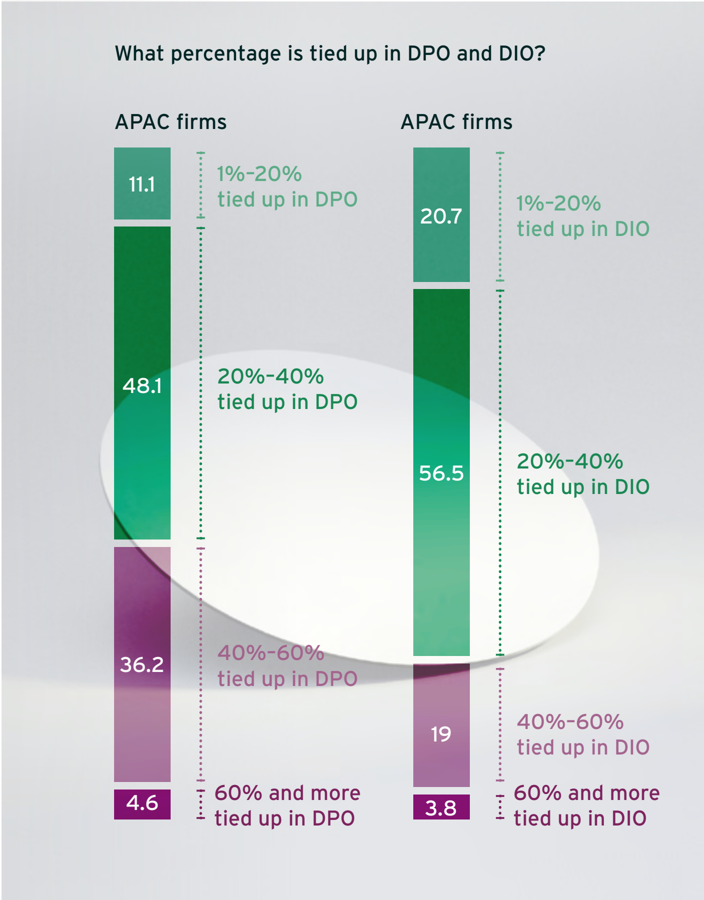
As supply chain finance solutions are a good fit, another key working capital management tool that is generally less utilized is Receivables Finance. The Research with East & Partner reveals that only one out of six corporate use Receivable Finance as an option in trade financing.

At SRF, an Indian manufacturer that produces everything from textiles and chemicals to packaging, rapid global expansion in recent years has required its treasury to be an enabler across business units and geographies. This means it has to deliver on working capital optimisation, credit risk mitigation, reduction in days sales outstanding (DSO) and increase in DPO. The treasury team also delivers on increased debt capacity.

Working capital trapped in DPO and DIO by sector



What is weighing down your working capital?



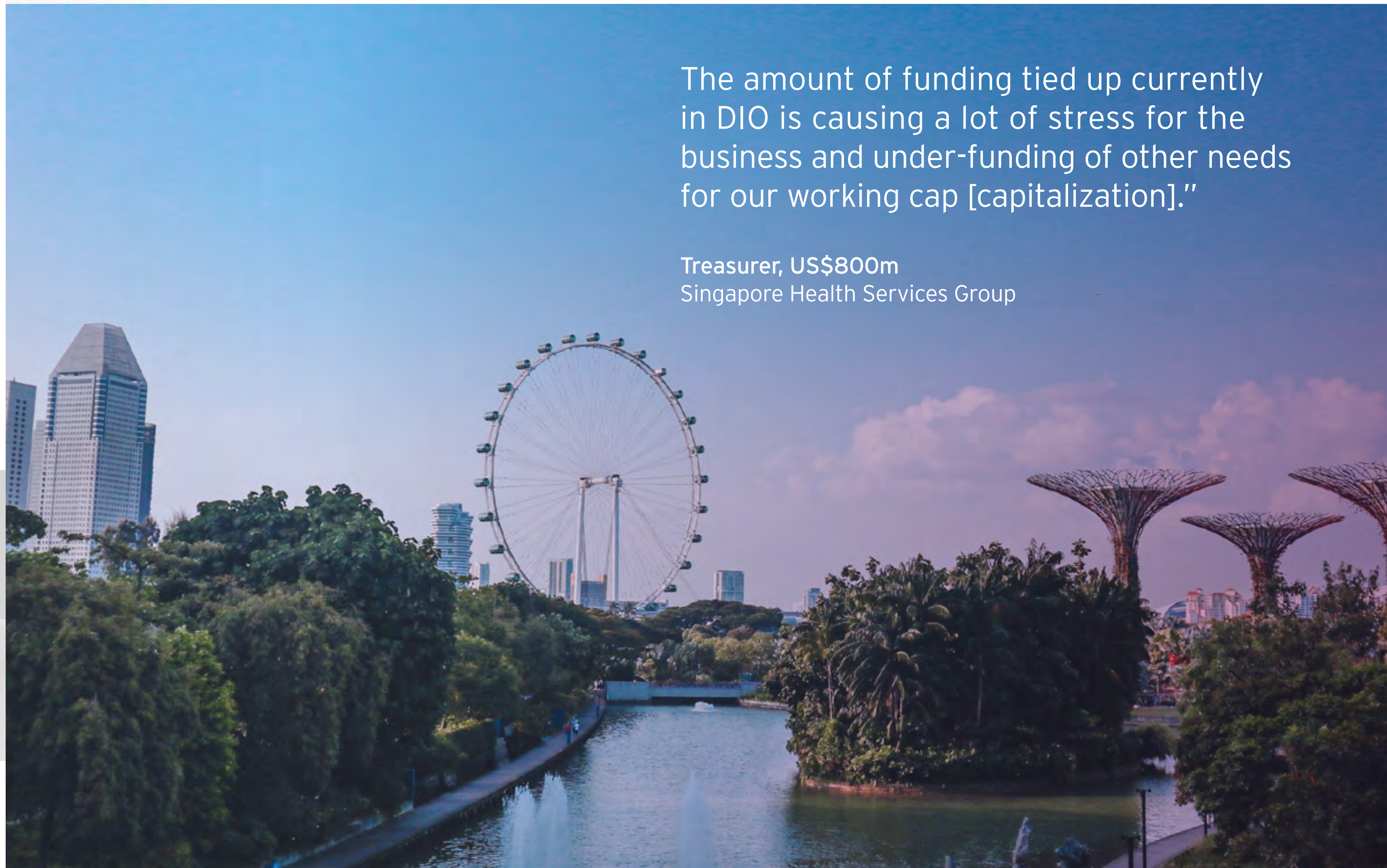
Working with Citi's Treasury and Trade Solutions, SRF came up with a suite of solutions to optimize working capital. On distribution finance, an accounts receivable financing solution gives the company the flexibility to cover a substantial portion of its sales on a portfolio basis and provide liquidity. For export letter of credit (LC) discounting, the solution identified credit-worthy banks for the core banking partner and worked with customers to restrict LC issuance with the selected banks. These LCs were then centrally discounted by the core banking partner.

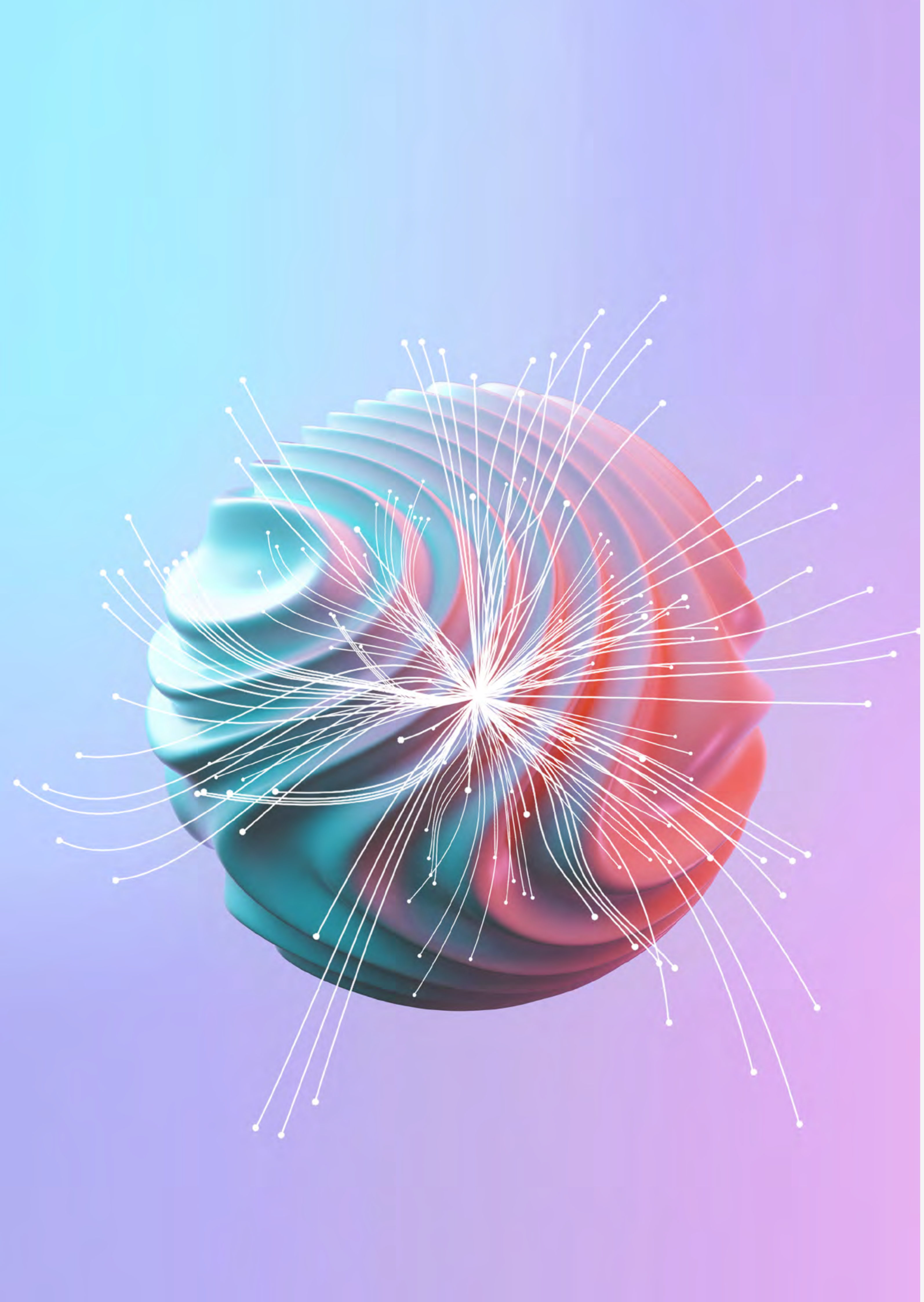
Megha Chopra, Asia Pacific Head of Trade Sales and Client Management, Treasury and Trade Solutions, Citi, believes that SRF's example illustrates the tools that companies in the region have available, but don't always use. Chopra says that companies can look at their receivables and arbitrage on the good customers to generate liquidity. They can also unlock liquidity problems in the supply chain via supply chain financing. A third avenue is to conduct inventory management, for example by securing suppliers at a competitive rate through structured-finance solutions.

As Chopra puts it:

> "The companies that prioritize liquidity management are the ones that survive the storm and thrive."

Megha Chopra
Asia Pacific Head of Trade Sales and Client Management, Treasury and Trade Solutions, Citi





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Statistic taken from "Best Practice Liquidity Management" slides, page 3, right column

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