Financial supply chain solutions
Helping trade entities optimize working capital management despite ongoing financial market instability

Passion to Perform
Deutsche Bank’s White Paper series provides in-depth analyses of the broad spectrum of issues affecting the global corporate treasury management industry today. By identifying and evaluating the reasons for, impact of, and potential solutions to the latest game-changing developments in this space, White Paper charts the course to maintaining a competitive edge despite challenging market conditions. In this White Paper Jon Richman, Managing Director and Head of Trade Finance North America and Financial Supply Chain Americas, discusses how FSC programs provide treasurers with alternative financing to better manage their working capital needs.

As globalization marches on, supply chains have lengthened and become more complex. Given that increased complexity is synonymous with increased risk, this has sparked a trend for the take-up of financial supply chain (FSC) solutions, which are designed to mitigate the financial risks associated with cross-border trade with minimal cost and disruption to existing systems and processes. When effectively employed and implemented, FSC programs can optimize working capital management, reduce risk and increase the transparency and flow of transaction data between trade counterparties without the need for costly and overly-complex implementation and configuration procedures.

Although FSC solutions are – at least at a fundamental level – fairly well-established, the increased corporate need for additional sources of liquidity following the financial crisis of 2008 has put the potential of FSC programs into the spotlight. The so-called “credit crunch” has resulted in a diminished number of financial players, the severe restriction of bank-supplied credit lines and ongoing turbulence in the capital markets. As a result, corporates worldwide are placing an increasing focus on improving working capital management in order to decrease dependency on debt, and the stability of their suppliers to ensure supply chain strength and longevity. This heralds a significant shift in mindset for many companies. Pre-crisis, advances in working capital management solutions were largely driven by banks, who were often more aware of the inefficiencies and potential pitfalls in corporates’ existing systems and practices than corporates themselves. However, this has been reversed by the liquidity freeze, with corporate treasurers assuming strategic responsibility for bottom-line improvement and procurement, and IT and logistics departments having a growing input with respect to implementing new solutions. This is particularly the case for multinational corporations (MNCs), which tend to have more complex working capital requirements than their local and regional counterparts. Given this, many MNCs have begun to explore the potential of FSC programs, which has given rise to notable sector advances at this level of commerce. There remains, however, significant scope for solutions development to further increase possible cost savings and efficiency gains.
Although improved access to liquidity is the principal aim and advantage of FSC programs, the ancillary benefits – such as enhanced operational efficiency and enhanced end-to-end supply chain visibility – merit individual analysis for the part they can play in keeping global trade flowing.

Increased visibility, which comes as a result of improved processing efficiency, is a significant gain. The increasing length and complexity of supply chains comes with a growing awareness (and perhaps unease) among corporates that all it takes is one weak link to have potentially catastrophic effects on the entire supply chain and, as a direct consequence, working capital management. Not only is effective working capital management crucial to commercial health and longevity; it can have a positive effect on how trade entities are viewed by the market as working capital metrics are increasingly regarded as an indicator of management effectiveness.

The inextricable link between problems in the supply chain and company cash flow has been demonstrated several times. First – and most notably – by the freezing of market liquidity following the credit crunch. One of the most damaging outcomes of the economic downturn was the conflict that ensued between buyers and suppliers, with the former calling for relaxed payment terms and the latter desiring earlier payment. These opposing forces posed a serious threat to supply chain security, and underscored the need for alternative sources of financing for the longevity of trade flows and commercial cycles.

The second example is the supply chain woes caused by natural disasters, such as the Japanese tsunami of March 2011, which in some cases ground business to a halt. Though events of this nature are hardly a regular occurrence, contingency plans must be in place to prevent or minimize business interruption throughout even the most extreme or seemingly unlikely of situations. Preparing for all eventualities is not possible without end-to-end transaction visibility and the increased access to – and sharing of – transaction data. FSC solutions, in facilitating the flow of data and information between trade partners, can significantly improve counterparty relations, and ultimately improve risk mitigation. When combined with the optimization of cash flow management that FSC programs can bring, the end result is the creation of a solid foundation for international trade.
The benefits of FSC solutions as a stable and reliable source of liquidity are increasingly recognised as companies across the globe experience an ongoing reduction in capital availability and a resulting pressure to improve cash flow. Unlike other sources of liquidity, such as credit from the capital markets, FSC programs are flexible and serve as an incremental source of credit as they add to – rather than consume – existing cash resources. These solutions can also serve to extend working capital cycles, thus enhancing working capital management. This practice is becoming increasingly common across the board as the arbitrage opportunities presented by FSC solutions become better understood.

Working capital and risk management are key concerns for corporates as the effects of the financial crisis continue. FSC solutions can address both issues by improving access to liquidity, increasing end-to-end transaction visibility and enhancing processing efficiency – all without costly and complex implementation and configuration procedures.

One way in which a buyer may seek to improve working capital is through extending the working capital cycle – that is, increasing days payable outstanding (DPO). This could mean that buyers have 60 days rather than 45, for example, in which to pay their suppliers. In exchange for such extended – and, more importantly, standardized – payment terms, smaller suppliers can leverage the credit-worthiness of their larger trading partners (known as the “anchor” corporates) to obtain more favorable credit terms than they could in a bi-lateral situation. Not only can this improve buyer-supplier relationships – vital in an age in which relationships are key – but also increase the financial stability of individual trade entities and boost the overall strength and security of supply chains.

In turn, greater financial security and supply chain strength help to mitigate the risk of financial loss. Between the order of goods and the receipt of payment, there is always the risk – no matter how small – that the trade process will be interrupted, resulting in financial loss to one or both parties. If trade entities are in a position to better absorb potential fiscal damage, short-term losses can be overcome with little or no effect to long-term business sustainability.
Despite the fact that corporate demand for (increasingly sophisticated) FSC solutions looks set to rise in response to ongoing market challenges and liquidity restraints, many banks are still in the early stages of product development or have yet to explore the sector. For those that have expanded into this space, FSC solutions may still be a product reserved for key customers – or a narrow market segment – with traditional trade credit instruments offered to the broader client base. Such a cautious, limited approach is, of course, far from ideal.

In recognition of this, the major trade banks – which have historically taken the lead in terms of technology development and product innovation – have responded by investing in sophisticated, global solutions that constitute a “full package” offering. Such holistic FSC solutions require a combination of expertise and experience in the formulation of credit structures (to ensure the most appropriate arrangements are put in place), and state-of-the-art technology platforms to provide maximum efficiency and rich functionality. This must then be backed-up by strong levels of customer service and support, on which the ultimate success of any FSC program depends.

As a trusted and experienced provider of FSC solutions, Deutsche Bank understands that client service and support, which includes securing buy-in from multiple business lines within organizations and rolling-out solutions to the broader supplier base – is the linchpin of success. Given this, we pride ourselves on our experience in both structuring solutions and tailoring the implementation process – in terms of both staff and technology – to suit the varying sophistication-levels of different types of trading partners. When combined with the advantages quintessential to global providers, such as an extensive network, broad geographic reach and a harmonized standard of service, the outcome is an end-to-end, market-leading FSC solution. From the corporate perspective, this makes for a consistent user experience – with clear responsibility and accountability for service delivery. And this forms the basis of a long-term bank-client relationship.
There are many challenges facing international trade today; none of which show any signs of abating. As market liquidity remains constrained, corporates will do all they can to decrease their dependency on unstable – or even inaccessible – sources of liquidity. Correctly structured and implemented FSC programs are a low impact and resourceful way to help them fulfil this mandate – as well as address concerns over operational (in)efficiency and supply chain sustainability.

Yet FSC programs, despite encouraging simplicity by working with established systems and supporting the rationalization of operations, are not without their challenges. Companies must bear in mind that an optimal solution has no choice but to meet the needs of each of the trading partners involved, meaning that the on-boarding process can be lengthy and complex – with differing legal structures and accounting issues being important supply chain considerations. In light of such difficulties a single global provider, such as Deutsche Bank, with an established track record of structuring, implementing and investing in FSC solutions, should be the partner of choice for corporates looking to explore the benefits of this sector.

While FSC programs present a resourceful, low-impact way to address concerns over supply chain sustainability, the structuring of an optimal solution meeting the needs of all trading partners can be complex. Corporates looking to explore the benefits of this sector must therefore choose a banking partner with the necessary experience, expertise and capability to meet their evolving needs – as well as those of their counterparties.
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