GSCF's VIEWS

DISTRIBUTION FINANCING: WHY PROGRAMS ARE DIFFICULT FOR FUNDERS TO MANAGE

At present, companies have a wide range of Supply Chain Finance program types available to manage their working capital efficiently. These can be based on accounts receivable or on accounts payable.

Distribution Financing (DF) is a receivables-based financing highly attractive to companies as it allows them to enhance sales via the extension of payment terms offered to Buyers, and at the same time enables them to generate an improvement in liquidity through the acceleration of receivables collections. Buyers benefit too, as their cash flow and working capital metrics improve, making Distribution Financing a win-win program type. DF programs involve an invoice-originating company (or Vendor) with possibly various invoicing entities and a portfolio of Buyers, which can be located in different jurisdictions and trade in multiple currencies. In addition, as DF transactions tend to be large-sized, they can involve a syndicate of participating Funders and possibly also multiple Credit Insurers.

With a global invoice financing market estimated at USD 3 trillion per annum[1] there are multiple funding entities, including banks and specialized supply chain Funders, that are keen to offer DF to companies, however, only some of them can entirely manage the processing complexity of these programs.

Processing hurdles

Global Supply Chain Finance Ltd. (GSCF) as an independent servicer with over 25 years-experience in the setup and processing of DF programs on behalf of Funders, has gathered the key issues encountered by companies when having Funders process their DF programs in-house:

- ***Rigidity***: Funders´ in-house systems are designed for standard programs and lack flexibility to accommodate individual companies´ particular requirements. Vendors have to adjust to the Funders´ processing system (e.g. on communication protocols and formats), instead of the other way around. Any enhancement to a Funder´s system usually has a long lead time involving budgeting, feasibility analysis, approvals and technical backlogs.

- ***Low level of automation:*** In-house technology infrastructures of Funders do not offer the level of automation required for complex transactions, thus are unable to handle real-time processing, monitoring and asset allocation between the participating Funders (in the case of

[1] World Supply Chain Finance Report 2018 - BCR

syndications). Furthermore, many times DF programs are managed on a manual basis, which is cumbersome, error-prone and has high operating costs.

- ***Limited reporting capabilities***: DF programs have extensive and bespoke reporting needs from the different stakeholders involved, like Vendor, Buyers, Credit Insurers and participating Funders. These require custom-made reports and in some cases entail interfacing with their own systems, which Funders´ processing systems can rarely deliver.

- ***Inadequate handling of Credit insurance***: In the case of credit insured portfolios, complying with all the conditions established in the credit insurance policy is challenging as it requires intense monitoring and timely reporting, for instance in case of a claim. Funders relying on their less sophisticated in-house systems run the risk of losing the credit coverage by missing one condition or step foreseen in the policy.

Conclusion

Distribution Financing represents the most attractive type of supply chain finance programs for companies as well as for Funders. For the latter, well-established DF programs tend to run for a long period of time and offer an attractive risk-reward compensation. However, in order for Funders to be able to establish and manage DF programs successfully, they need a flexible servicing platform that works with advanced technology and can master complex cases. This can be either developed in-house requiring time and a hefty investment by the Funder, or outsourced to a specialized and proven third-party servicer that can overcome the processing hurdles described above, such as GSCF.