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Payables Finance

A guide to working capital optimisation and supply chain risk management

3rd edition

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3rd edition

In August 2019, in response to overwhelmingly positive feedback from the industry, we published the second edition of this guide to payables finance. Like its predecessor, this follow-up also proved a hit – with copies flying off event stands and multiple requests for downloads.

Since then, there have been several major developments in this space. The Covid-19 pandemic has placed further strains on global supply chains, and controversies such as the insolvency of Greensill Capital have returned supply chain finance to the headlines.

Against this backdrop, this 2021 edition includes a series of new case studies; a focus on the growing secondary market for payables finance debt; an update on how sustainability performance metrics are creating lasting impact and outcomes; a closer look at how industry bodies are codifying and structuring practices; and how digital tools are transforming into techniques related to payables finance.

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Foreword

Daniel Schmand,
Global Head of Trade Finance & Lending and Institutional Cash Management, Deutsche Bank

Three years ago, in response to questions our clients were asking us, we decided to produce the definitive guide to payables finance. With the guide now in its third edition, the global trade landscape has shifted significantly since our first publication – and is arguably more volatile than ever.

Alongside the ongoing challenge of protectionist tariffs and nationalist policies, the Covid-19 pandemic has served to further disrupt global trade. It has highlighted an array of weaknesses built into modern supply chains – making buyers acutely aware of the need to either support suppliers, or risk broken supply chains and lengthy production delays. Against this backdrop, payables finance is coming into its own. While buyers have traditionally used supply chain finance programmes to increase the efficiency of their supply chains, they are now turning their attention to one of the technique's secondary benefits: helping to facilitate and improve supply chain resiliency. By employing a payables programme, buyers have been able to provide their suppliers with liquidity at a critical time – ensuring minimum disruption and the continuation of trade flows.

Yet, for all the disruption born of the pandemic, there were at least some positive takeaways for the industry. Covid-19 – and the home office environment it fostered – has acted as a catalyst for the digitalisation of trade finance. This has driven demand for the adoption of new tools, such as the Trade Information Network (TIN), a multi-bank platform for purchase order finance and digital portals for dynamic discounting (see *Section 7.1: Purchase order financing* for more details). It has also prompted regulators to update their legal frameworks to incorporate new processes, such as digital signatures. With the growing need for seamless communication, transparent reporting and digital flexibility, this is a trend that looks likely to continue.

In recent months, it is not just the pandemic that has catapulted supply chain finance (SCF) into the headlines. While payables finance has proven its worth as a useful tool for suppliers – offering much-needed flexibility and stability during times of crisis – it has also come under fire elsewhere for its perceived role in the collapse of Greensill Capital in March 2021. While the controversy has since proved to revolve around the company's use of "future receivables", which is not a recognised SCF technique, it has nonetheless attracted media attention and criticism for the trade finance industry.

As the global climate crisis continues to evolve, corporates are also looking to future-proof their supply chains with increasing levels of urgency. Climate-related natural disasters regularly effect the early links in global supply chains and, if steps are not taken to ensure stability and liquidity for suppliers facing these challenges, the knock-on effects could be disastrous. Payables finance continues to gain momentum as a means of offsetting these risks, by helping corporates not only to integrate ESG processes into their own operations but also to spread sustainable practices across their supply chains.

With the market for payables finance – and our understanding of it – continually evolving, this paper offers a revised and updated guide (replacing our 2019 edition) that seeks not only to factor in the latest developments, but also to re-evaluate the key questions that define the industry.

What role do digital tools have in supply chain finance? What does the growing secondary market for payables finance debt mean for those involved? How is the increased demand for ESG components effecting supply chains? What factors contributed to the demise of Greensill Capital?

We hope you find this third edition a valuable tool and welcome your input into the discussion.

Daniel Schmand
Global Head of Trade Finance & Lending and Institutional Cash Management, Deutsche Bank

1

What is supply chain finance; what is payables finance?

Payables finance and supply chain finance are two terms often used interchangeably. While full consensus and standardisation have yet to be realised, the most widely acknowledged and endorsed interpretation of these terms attributes different, though similar, meanings to each.

This section will provide an introduction to payables finance, the specific focus of this paper, situating it in its wider context as a sub-set of supply chain finance and providing an overview of recent developments in the sector.

1.1 Definition of supply chain finance

Broadly speaking, and in line with the *Standard Definitions for Techniques of Supply Chain Finance*[1], supply chain finance (SCF) can be defined as the use of a range of financing and risk mitigation practices and techniques to optimise the management of the working capital and liquidity invested in supply chain processes and transactions.[2]

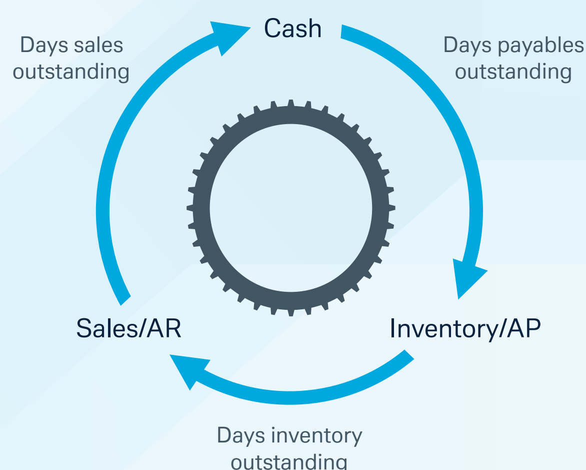
SCF is best understood by breaking down its constituent parts and examining the interplay between "supply chain" and "finance". The "supply chain", or the physical chain, is made up of a series of business processes that fall under three categories: procurement, manufacturing and distribution – the processes by which goods and services are purchased, transformed, and delivered. Each part forms its own complex process, typically requiring some form of funding and/or risk management. The "finance" aspect of SCF represents any instrument that provides financial support to participants in the supply chain. The term encompasses a range of financing and risk mitigation practices – from payables finance to pre-shipment finance. The need for SCF is usually triggered by supply chain events, such as purchase orders, invoices, receivables and other related pre-shipment and post-shipment processes.

Figure 1: The cash conversion cycle

The cash conversion cycle (CCC) is the flow of cash as it is converted through inventory and accounts payable (AP), sales and accounts receivable (AR) and back into cash.

This is measured by days payables outstanding (DPO) which denotes the time it takes to pay suppliers, days sales outstanding (DSO), the time between selling and being paid by buyers) and days inventory outstanding (DPO), the time to turn inventory into sales, meaning CCC = DSO + DIO – DPO.

The shorter the cycle, the more efficient a corporate's operations, so treasurers must seek to increase DPO (extending time taken to pay outstanding invoices) and reduce DSO (ensuring incoming payments are received and processed as quickly as possible) if they are to unlock previously idle pools of liquidity.



Source: Deutsche Bank

"Most corporates have a lot of capital tied up in inventory, but accounting complications make (off-balance sheet) inventory financing a more complex and challenging exercise than many would like. One of the attractions of payables finance is that it can be a means of cross-financing inventory: instead of reducing DIO, corporates can use payables finance to extend payment terms and increase their DPO, which ultimately creates the same result in terms of the cash conversion cycle. Payables finance has been particularly valuable during the crisis, as businesses have sought to keep hold of more inventory, thereby driving up DIO"

Philipp Wetzel,
Ph.D. HSG in Supply Chain Financing, University of St. Gallen

1.2 The supply chain finance universe

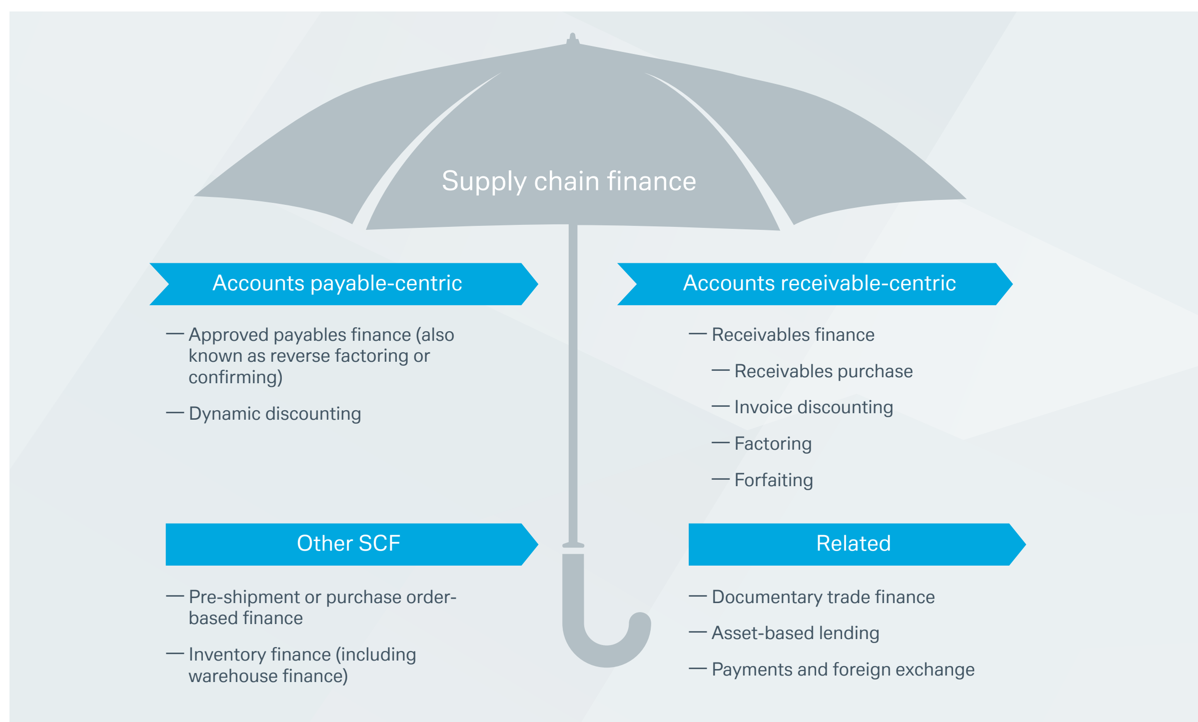
Over the past 30 years, the world of SCF has evolved into a complex and thriving universe. The SCF supplier market has been on a sharp upward trend since 2010, growing from no more than five SCF deals per year between 2000 and 2010 to up to 24 per year between 2010 and 2020.[3] SCF deals have also become larger, more capital-intensive and international, with a significant rise in average transaction values.[4] At Deutsche Bank (one of several banks providing SCF), SCF now makes a significant contribution to our total trade finance business, and the bank processes €30bn worth of SCF transactions annually with more than 3.2 million invoices flowing through the platform.

But what different processes populate this universe? Generally speaking, SCF techniques are based on either accounts payable or accounts receivable. Accounts receivable techniques are the most common – with the global factoring market expected to register a compound annual growth rate (CAGR) of 7.5% from 2020 to 2027.[5] Financing based on accounts receivable allows companies to sell on the debt held in outstanding invoices at a discount of the value of receivables pledged. This type of financing helps companies free up capital that is stuck in unpaid receivables, and also transfers the associated default risk to the financing company.

Meanwhile, the most prominent techniques based on accounts payable are payables finance (see *Section 1.3: Payables finance*) and dynamic discounting. While payables finance provides balance-sheet-optimised financing for both buyer and supplier, dynamic discounting allows buyers enhanced flexibility as to when they can use excess cash to pay their supplier, securing scaled discounts for early payments.

There are also a handful of non-debt-related techniques, including pre-shipment financing, post-shipment financing and inventory financing. Pre-shipment finance encompasses any financing that an exporter may need before sending their goods to a buyer (wages, production, raw materials etc.), while post-shipment finance helps ensure that exporters have sufficient liquidity while awaiting their payment. Inventory financing, on the other hand, is an asset-backed loan made to a company to purchase inventory, which then serves as collateral for the loan. A number of related techniques, such as documentary trade finance, payments, foreign exchange and asset-based lending, also support SCF processes.

Figure 2: The SCF "umbrella"



Source: The "Umbrella", EBA Market Guide to Supply Chain Finance – 2014

1.3 Payables finance

This guide focuses specifically on payables finance, a buyer-led SCF technique that enables a company to support its suppliers by granting them access to liquidity at favourable rates.

Helpfully summarised by the Global Supply Chain Finance Forum (see *Section 8.1: Work of the Global Supply Chain Finance Forum*) as "a buyer-led programme within which sellers in the buyer's supply chain are able to access finance by means of receivables purchase", this technique "provides a seller of goods or services with the option of receiving the discounted value of the receivables (represented by outstanding invoices) prior to their actual due date" and, typically, "at a financing cost aligned with the credit risk of the buyer". The buyer, meanwhile, is often able to negotiate longer payment terms in return – paying the total value of the receivable to the financier on the due date.

"This SCF technique is subject to a number of naming conventions, as is clear from the number of synonyms recorded in the Standard Definitions. The Global Supply Chain Finance Forum decided that the term 'payables finance' is a generic and neutral expression that captures the essence of the technique"

Christian Hausherr,
Head of Product Management EMEA, Payables Finance, Deutsche Bank and Chair, Global Supply Chain Finance Forum

Under a payables finance programme, sellers in a buyer's supply chain are entitled to sell their trade receivables held against the buyer to the buyer's bank, receiving the discounted value of its receivables as represented by outstanding invoices. The buyer provides validation that an invoice submitted by the supplier is accurate, effectively confirming their obligation to pay the supplier for the underlying goods or services delivered. With this validation in hand, the financier can then accept the supplier's offer to sell the specific "confirmed" receivable, at a certain rate of discount and without recourse. Fundamental to the buyer-centric approach is that the financier relies on the buyer to validate and recognise the obligation owed to the supplier before the discounting takes place.

Within this structure, when the financing bank purchases a receivable from the supplier, they are in effect taking on the credit risk of the buyer. In a climate where credit capacity is scarce, the buyer may wish to ensure that the available capacity is targeted at those suppliers that are most strategic to their enterprise and in the greatest need of some financial support. Service providers should be able to share a best-practice approach with the buyer on supplier targeting and segmentation to help them optimise the allocation of credit capacity.

Today, payables finance, which was introduced into mainstream banking channels in the early 2000s, is one of the most commonly used SCF techniques.

1.4 Recent developments

Since the second edition of this guide was published in September 2019, the payables finance market has continued to evolve. The much-discussed value of the technique for shielding supply chains against liquid shocks has come into its own since Covid-19, while controversies have also arisen due to misuses and misunderstandings surrounding its process and mechanisms. Finally, payables finance has gained further momentum as a means of helping corporates not only integrate environmental, social and governance (ESG) processes it their own operations, but also to spread sustainable practices right through their supply chains. This section will cover each of these trends in turn.

1.4.1 SCF as a resilience tool

In the past, buyers have primarily used SCF programmes to increase the efficiency of their supply chains, which in turn allows them to apply consistent and favourable purchasing terms.[6] Covid-19, however, has brought one of the technique's secondary benefits to the fore –resulting in a sudden and urgent need to improve the resilience of supply chains.

The pandemic has shown modern supply chains to be fragile. Buyers have realised that if they don't support their suppliers where they are able, the chain can easily break, risking a scenario in which production grinds to a halt as critical parts become unavailable. Many suppliers have seen their liquidity dry up, but access to an SCF programme can help them to survive, ensuring they can continue to supply goods and prioritise those buyers that support them. In the months following the Covid-19 outbreak in March 2020, corporate demand rose significantly, with service providers reporting increases in volumes of as much as 200% on their platforms,[7] as buyers looked to implement SCF to help their suppliers stay afloat as sales fell sharply or dried up entirely.[8]

Many companies rely on just-in-time delivery, making them critically dependent on the resilience of their supply chain. There have been two main responses to the pandemic from businesses looking to protect their supply chains: the first was a marked shift towards "just in case" procurement, meaning inventory is stored for longer ahead of time to ensure supply shocks do not overwhelm production. The second saw many larger businesses implement or expand SCF programmes for key suppliers to minimise the risk of a shortfall in liquidity affecting their supply.

Over the course of the pandemic, while the effects of Brexit have also generated financial difficulty and uncertainty in supply chains with UK-related flows, SCF has proved that it can be a strong tool for bolstering resilience in supply chains.[9] Beyond this, buyers are also considering how SCF can be used to reduce the cost of funding across the supply chain, thereby lowering the cost of production and increasing competitiveness.[10]

The pandemic has also encouraged buyers to consider how to support the long tail of their supply chains. Due to the costs of Know Your Customer (KYC) checks, smaller suppliers have not traditionally been supported by SCF. However, newer SCF solutions, such as dynamic discounting (see *Section 7.2 Dynamic Discounting*), can help buyers to spread the benefits of SCF across the whole supply chain.[11]

1.4.2 Misuse and the Greensill Capital collapse

"Payables finance has had a bad press during the pandemic as smaller and riskier businesses have found it hard to access finance and as the sector itself has come under scrutiny. However, it remains a clean and efficient way for payments to be made through a supply chain"

Dr. Rebecca Harding,
CEO, Coriolis Technologies

The demise of Greensill Capital, which filed for insolvency protection on 8 March 2021, has intensified the spotlight on SCF and payables finance. However, the main point of controversy was not SCF or payables finance but the financing of so-called "future receivables".

Most SCF techniques, including payables finance, are offered on the basis of invoices already issued, but the future receivables financing offered by Greensill was based on sales that had not yet occurred and, as a result, were a far riskier investment. In 2020, Greensill Capital sold more than US$11bn in securities based on future receivables to Greensill Bank AG.[12] It was these future receivables that ultimately proved the firm's undoing, costing Germany's deposit fund, one of its investors, more than €3bn. It's worth noting in this guide that the sale of speculative future receivables is not a recognised SCF technique, despite the media attention that it has attracted.

In an episode of Trade Finance TV, International Trade & Forfaiting Association Chair Sean Edwards commented on the ensuing complications for the funds that invested in Greensill's future receivables vehicles: "The Achilles heel of those funds was the fact that, although they invested in non-investment-grade names, they were elevated to investment grade for the use of credit insurance. And it was the withdrawal of the credit insurance that actually brought down the funds, and eventually Greensill itself, because there was really nothing else that was worth selling in the traditional business."[13]

After taking evidence from the involved parties, on 14 July 2021, the UK's Treasury Select Committee published its report on the lessons from the collapse of Greensill Capital. The report states that "'Prospective receivables' [future receivables], as described by businessman and owner of Liberty Steel Sanjeev Gupta [one of Greensill's main borrowers and the subject of much discussion due to defaults and concentration risk], would appear to result in a significantly riskier form of lending than traditional supply chain finance and is more akin to straightforward unsecured lending."[14]

Significantly, the report states that "We do not believe that the failure of Greensill Capital has demonstrated a need to bring supply chain finance within the regulatory perimeter for financial services."[15]

1.4.3 SCF as an ESG financing tool

Following the adoption of the Paris Agreement on international climate change in December 2015 and with environment-focused discussions set to continue with the 26th UN Climate Change Conference of the Parties (COP26) from 31 October to 12 November 2021, recent years have seen a distinct culture shift. Investors and consumers now expect companies to have their own clear environmental, social and governance (ESG) transition strategies and formally report on their ESG impact as part of their corporate governance processes.[16]

This has meant that, as a new generation of environmentally and socially conscious consumers and investors comes to the fore, sustainable practices make sense from a business perspective. Integrating ESG considerations into the business helps with stakeholder rebalancing and strong ESG credentials help to secure buy-in to a company brand – including from investors, who are increasingly aware that ESG factors represent material risks that must be managed. A strong and credible ESG story will help companies meet and exceed investor expectations, while improving access to finance in the capital markets.

Corporates are also becoming increasingly aware that their supply chains are a key ESG consideration in themselves. Even if a company is faultless as an individual entity, if it is supporting suppliers with less laudable credentials, its broader sustainable footprint is less positive. Supply chain finance has an important role to play in sustainability, as it enables large corporates to encourage sustainable practices across the supply chain (see *Section 5: Environmental, social and governance considerations* for more details) and can be a powerful driver for change.

Case study

1.5 GEA

Founded in 1881 and headquartered in Dusseldorf, Germany, GEA Group AG is one of the world's largest suppliers of food processing technology. Though not necessarily a familiar name to many of the world's consumers, the most of them likely come into contact with its products and services on a daily basis, with one quarter of all processed milk and one in every two litres of beer run through its systems.

GEA runs a payables finance programme as part of a broad mix of working capital optimisation techniques, with the technique helping improve its DPO and bolster stability across the company's supply chain. At the same time, it helps GEA strengthen relationships with key suppliers, who have the chance to improve their DSO, drive down funding costs, secure preferred supplier status and even increase their volume of sales to GEA (since the default risk on the payment is transferred to Deutsche Bank).

Partnering up

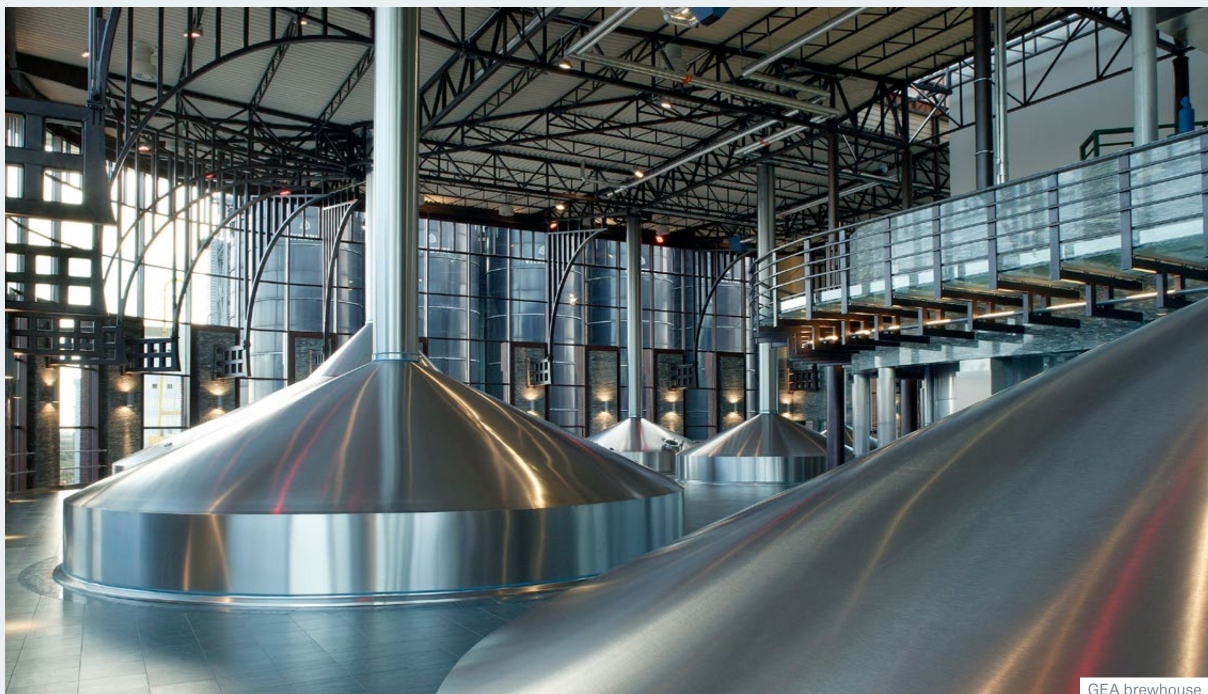
GEA's programme is also notable for being based on a clear vision of what is required from a payables finance provider, each of which is deemed essential:

1. Cost-efficiency;

2. Strong IT integration;

3. A high-performance platform; and

4. Funding capacity.



GEA brewhouse

> "This was a global programme and what we see is that there's no cookie-cutter solution for setting up an SCF programme. Every programme throws up surprises, even if you've already set up hundreds of programmes"

Anil Walia,
EMEA Head of Supply Chain Finance – Payables at Deutsche Bank

On top of this, GEA was keen to find a provider that would serve as a long-term partner. This meant one with a global presence that could cover the full supply chain, and also conduct face-to-face meetings and training sessions with suppliers in their own language and time zone.

IT and onboarding

GEA runs 70 different enterprise resource planning (ERP) systems – a considerable IT challenge that required colleagues across finance, business and IT teams to work together to reduce the overall number of ERPs and harmonise those that remained.

Onboarding suppliers is another perennial challenge. In particular, GEA was keen to strike the right balance between onboarding as many suppliers as possible as fast as possible, while also making sure those suppliers were the right fit for the programme. From GEA's pool of 25,000 suppliers, Deutsche Bank helped build out a picture of the company's supplier structure before selecting those with high spend volume to help GEA gain a working capital effect fast.

The keys to success

Having selected the right suppliers, it was also important to onboard them correctly. "The key to successful onboarding is ensuring good training sessions for the procurement colleagues," comments Oliver Triebsees, Senior Manager, Corporate Finance, at GEA. "Better training leads to better negotiations that will, in turn, produce better results."

Triebsees sees the success of this payables finance programme as a combination of several factors. Commitment and support from the executive board and senior management helped to push the organisation forward when there were obstacles, while regular and clear communication with Deutsche Bank as the programme provider ensured all parties were thinking and acting as one team with common goals.

Finally, planning out the implementation in a measured way kept the programme under control. "I think it was important that we took our time to get this right," explains Triebsees. "There was no big bang approach – implementation of an SCF project like this a is marathon not a sprint and it helps to do your implementation in waves, breaking it down into manageable steps."

2

Demand for payables finance

Demand for payables finance has been driven by a number of factors that have changed and evolved over time. This section outlines those that have contributed to this rise of the technique. They start with the initial impetus, driven by a desire to improve working capital metrics for large corporate buyers, and running through to more modern drivers such as the need for greater stability and sustainability within supply chains.

2.1 Early drivers of growth

Although payables finance has existed since the 1990s, the global financial crisis of 2008-2009 highlighted this method of financing, and its value with respect to effective working capital management.

The crisis put many manufacturers, retailers, and suppliers at risk of insolvency. As money from traditional bank-supplied credit lines dried up, companies increasingly looked to working capital management as an important tool to unlock previously idle pools of liquidity in their supply chains. Procurement teams began to scrutinise their supplier payment terms with more rigour and worked on lengthening them, thereby putting pressure on smaller businesses.

In addition, supplier disruptions grew as a concern for many large corporates during the crisis. Recognising the negative impact that the bankruptcy of a strategic supplier could have on their own production lines, many companies began to think more seriously about the stability of the entire supply base and looked for new ways to aid selected suppliers as needed.

It was in this context that demand for bank-funded payables finance programmes surged. Using payables finance, large corporate buyers can extend or maintain existing supply payment terms, without threatening supply chain stability, and suppliers can access financing at a rate that reflects the risk of the better-rated entity in the supply chain.

2.2 Drivers of continued growth

Adoption of payables finance is accelerating in response to a convergence of factors. In the wake of the pandemic FX volatility has increased (see *Section 4.3*) and the focus on working capital is on the rise, coupled with a steep change in digital adoption. Cross-border payment flows have been severely affected by Covid-19. PwC's Working Capital Survey 2020/2021 found that its impact has been significant. A comparison between Q2 2020 and Q2 2019 shows that revenue decreased by 16%. Meanwhile, cash tied up in outstanding invoices reduced by only 6%, with a sluggish trading environment leading to a five-day increase in net working capital (NWC) days – that is, the amount of time it takes for businesses to convert their available working capital into revenue.[17]

As economies come out of lockdown, the strain on working capital is likely to get worse before it gets better.

Across sectors, there has been a rapid shift in working capital requirements, driven by disruptions to both supply and demand. Normal lead times and replenishment frequencies have lengthened even for regional supply chains (further aggravated by difficulties sourcing lorry drivers), meaning inventory policies need to be adapted. As a result, early payments from trusted buyers are more important than ever for suppliers, while the stability of these suppliers is essential for anchor buyers.

Payables finance has also emerged as one of the flagship techniques for corporates to integrate ESG considerations are into their operations – driving further demand (see *Section 5: Environmental, social and governance considerations*).

2.2.1 The global cash opportunity

For banks, SCF represents a huge cash opportunity. In theory, the potential market for supply chain finance encompasses every invoice and receipt issued by corporates – up to US$17trn globally.[18] In practice, however, the market is a little more limited, but a useful reference point is the oft-quoted trade finance gap. There have been several high-profile estimates aimed at quantifying this shortfall. The most recent of these, released by the International Chamber of Commerce (ICC) in May 2020, put this figure at between US$1.9trn and US$5trn; representing a dramatic increase from the Asian Development Bank's (ADB's) 2019, pre-pandemic estimate of US$1.5trn.[19]

Payables finance helps to bridge this gap, in providing support to businesses that might otherwise be turned down for financing by tying their debt to the confirmed receivables of a trusted or highly-rated company.

It should come as no surprise, then, that demand for payables finance extends beyond the traditional developed markets of Europe and North America. According to the ADB, 40% of this deficit originates in the Asia-Pacific region, with 74% accounted for by small and medium enterprises (SMEs) and mid-cap companies.[20] And according to an IFC/McKinsey study, emerging markets account for the vast majority of the world's 420 to 510 million micro, small and medium-sized enterprises – meaning the onboarding of the long tail of SME suppliers will be central to any reduction in the trade finance gap.[21] Though bridging the gap is a huge undertaking – and one that payables finance cannot hope to fill entirely – the technique has an important role to play here.

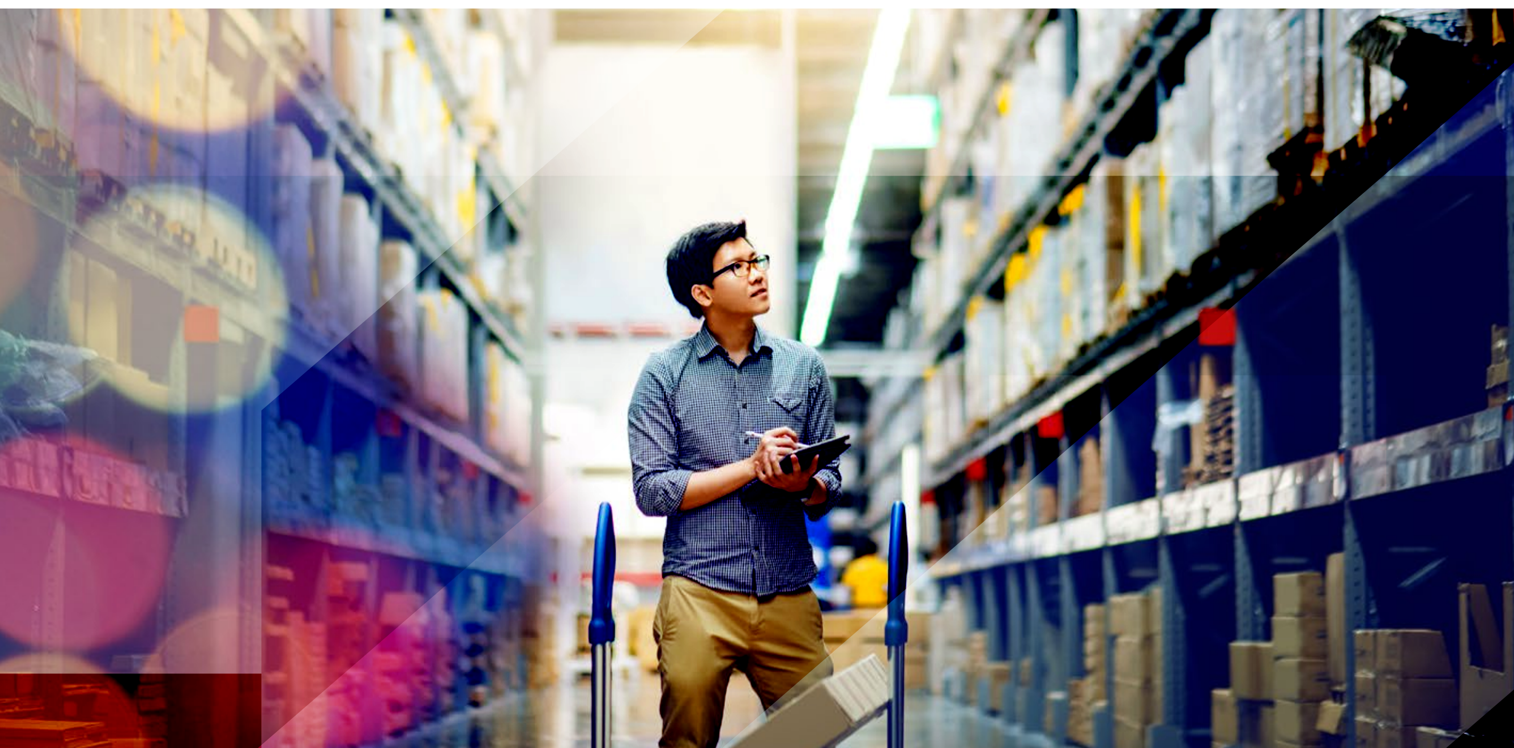
2.2.2 The need for supply chain stability

The need for supply chain stability has been underlined by the pandemic (see *Sections 1.4.1: SCF as a resilience tool* and *3.1.2: Focus shifts from cost-efficiency to resilience*). While the optimisation of working capital management continues to be the primary objective of many payables finance programmes, corporates are increasingly motivated by their ability to strengthen trading relationships and shore up points of vulnerability in the supply chain. For a while now, protecting the supply chain has been the number one priority, above even extending payment terms, for many businesses – a trend that has been accelerated by recent macroeconomic headwinds, such as Brexit, US-China trade tensions and the pandemic.

2.2.3 Reaching out to the "long tail"

Suppliers of any size can form a critical element in a global supply chain. A small technology enterprise, which provides a very innovative solution, may need to receive money more quickly in order to fund development, while the producer of a small automotive part can bring the whole production line to a halt if they close down. Yet, SCF demand has historically been dominated by the huge anchor suppliers, which provide high-impact, low-risk opportunities for funders. As a result, the so-called "long tail" of suppliers, which is made up of numerous SMEs, has relied on less competitive credit card, overdraft and loan rates as sources of external finance.

A 2020/2021 PwC survey highlights the liquidity challenge faced by SMEs. The survey uses data gathered by Previse (an SCF fintech focused on helping suppliers get faster payment), which shows that more than 70% of all suppliers are paid late.[22] This is a perennial problem – and one that has been exacerbated by the pandemic. It's also one that primarily affects SMEs. A June 2018 study from the UK's Federation of Small Businesses (FSB) with data from more than 4,000 SMEs in the UK showed that 61% of respondents have seen late payments worsen since the start of the pandemic, with many experiencing frozen payments, while, according to Previse's data, payment times for smaller suppliers increased by up to 20% following the coronavirus outbreak, while purchasing decreased by 20% or was postponed.



> "One of the historical limitations of payables finance is that it has traditionally touched only the most privileged suppliers of the largest anchor buyers. With supply-chain stability being a key concern, especially in the wake of the Covid-19 pandemic, the desire to extend this support to a wider range of suppliers is fuelling further demand for these programmes"
>
> Christian Hausherr,
> Head of Product Management EMEA, Payables Finance, Deutsche Bank and Chair, Global Supply Chain Finance Forum

This is a particular challenge for these smaller businesses because working capital solutions such as factoring and overdraft products simply do not address their needs: they are either unavailable or too expensive. Some large corporates have taken temporary steps to support their SME suppliers during the Covid-19 crisis by making payments earlier than their terms dictate. However, the problem of slow payments is returning. Payables finance represents one way of addressing this issue – and banks continue to refine onboarding processes to make it easier to include larger numbers of suppliers in these programmes.

The primary challenge is ensuring that the long tail is onboarded smoothly. A vast array of participants, such as those working in the production and distribution sectors, may be unfamiliar with payables finance, its processes, or its benefits. As such, educating the entire chain of the value of a payables programme – including improved working capital, financing at competitive rates and a more predictable cash flow – will prove a vital next step (see *Section 4.5.2: Communicating the benefits to suppliers*).

At a certain point, buyers will hit a limit in terms of the number of suppliers they can sustainably support via a payables finance programme, but this won't necessarily be enough to cover all their suppliers. One solution to this dilemma is dynamic discounting (see *Section 7.2: Dynamic discounting*) where a buyer and a supplier agree flexible payment terms, where payment for goods or services can be accelerated in return for a reduced price or discount.

2.2.4 ESG drivers

As explained elsewhere in this paper (see *Section 5: Environmental, social and governance considerations*), payables finance can also be used to enhance sustainability across the supply chain. Increasingly, consumers and investors alike expect companies to have strong ESG credentials. Through payables finance, companies can financially incentivise their suppliers to become more sustainable, while also boosting their own sustainability credentials. It is no longer enough for a company as an individual entity to be sustainable – it must also source its supplies and services from businesses with similarly strong ESG credentials.

Case study

need credit

2.3 Jumbo Supermarkten

Jumbo Supermarkten (Jumbo) had its beginnings in 1921 with the entrepreneurial Van Eerd family – a wholesaler in colonial goods. The first shops were set up in the 1970s, and the number of shops grew until father Karel and his children Colette, Frits and Monique opened a new, unique store in 1996 (in the belief that business could be done more efficiently).

Jumbo's unique store was a resounding success. It made possible what appeared impossible: a store that combines the largest selection, lowest prices and best service. Jumbo decided to expand what it saw as a winning formula.

Now, some 21 years after the first store opened, Jumbo has become the second largest supermarket chain in the Netherlands. It has acquired two major competitors: Super de Boer in 2009, and C1000 in 2012. Moreover, with the acquisition of the La Pace restaurant business (announced at the end of January 2016), Jumbo has expanded its reach beyond the Netherlands – into the markets of Belgium, Indonesia, Germany and the US.

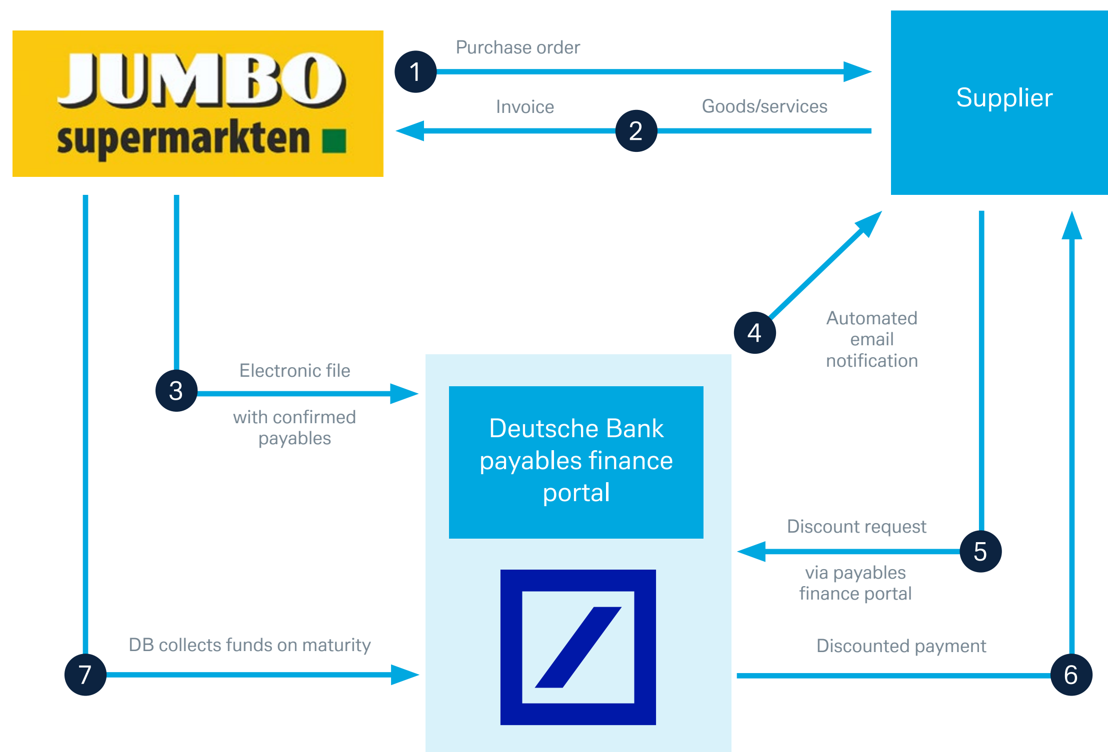
Managing high volumes, maintaining a steady flow of goods

Retail business models are characterised by high-volume, low-ticket transactions in a business-to-consumer market – something very different from, say, the aviation industry. Everything happens fast, and so to ensure a steady flow of goods, customer satisfaction and, in turn, a healthy bottom line, Jumbo needs a healthy supply chain.

While inventory optimisation, cost and quality control, and end-to-end visibility are all invaluable management disciplines, Jumbo also wanted a solution that helped its suppliers reduce their dependence on traditional bank financing (since bank credit is often expensive or unavailable to these companies).

The Deutsche Bank/Jumbo partnership

Deutsche Bank won the mandate to provide the finance – working closely with Jumbo's own technical teams to design a tailored solution that allows the supermarket giant to process up to 40,000 invoices in a week (without sacrificing any richness of data or required information).



Step 1-2: Upon receipt of Jumbo purchase order, supplier delivers goods and invoice to Jumbo

Step 3-4: Jumbo uploads approved invoices on to Deutsche Bank's payables finance portal, which automatically notifies the supplier

Step 5: Supplier submits an online request to discount the invoice

Step 6: Deutsche Bank pays the supplier in an automated process

Step 7: Jumbo repays the invoice on maturity. If necessary, Deutsche Bank, acting as a fronting bank for the syndicated programme, forwards the payment to the relevant financier

Source: Deutsche Bank

Once a suitable platform had been designed, clear targets, and a personal approach (with the help of Deutsche Bank's programme managers on the ground), resulted in the swift onboarding of all Jumbo's target suppliers within 12 months. For example, to ensure Jumbo's suppliers were fully engaged in the onboarding process, and understood the value of off-balance sheet liquidity, Deutsche Bank held a series of 'on the ground' meetings with Jumbo's suppliers in the run-up to programme launch. In addition, Deutsche Bank worked with Jumbo's procurement staff to ensure they too understood the programme's role in the management of the supply chain.

Today, 35,000 invoices approved by Jumbo are discounted every week on the Deutsche Bank platform. Jumbo has met its working capital objectives, and hundreds of its suppliers have access to quick, efficient liquidity.

In February 2017, the partnership between Deutsche Bank and Jumbo won a Global Finance Award for the 'Best Customer Implementation of a Supply Chain Financing Solution'.

3

Understanding the role of finance within the supply chain

Payables finance is a technique that provides support during a particular stage of the long and complex process that is the supply chain. To fully understand it – and the role it plays today –means understanding how supply chains work, how they have evolved and are evolving, and how banks have adapted to lend support at key stages of the process. This starts with understanding the physical supply chain.

3.1 The physical supply chain

"Even in the recovery from Covid the physical side of the supply chain has continued to draw storm clouds – the Ever Given blocking the Suez Canal, the rumblings of more on-shoring, 3D printing, shortages of shipping and containers leading to increases in freight costs and so on. So far physical problems appear temporary and far from fatal, certainly not serious enough to overcome the comparative advantage of manufacturing in lower cost countries. Longer term there will be further efficiencies from digitisation; the likely drivers of long-term change seem more strategic and political"

Sean Edwards,
Chairman, International Trade & Forfaiting Association (IFTA)

As defined in *Section 1.1 Definition of supply chain finance*, the physical supply chain is the mechanism through which goods and services are purchased, transformed, and delivered – and incorporates suppliers of all types and sizes, as well as their respective suppliers and so on. Payables finance owes much of its popularity to the fact that it gives greater financial flexibility to these suppliers – and therefore greater security to the anchor buyers that rely on them. The security provided, in guaranteeing the reliable provision of goods and services from suppliers, is an essential part of the production cycle – making it critical for a business's ongoing operation. Although he was commenting on purchase order finance in the Trade Information Network, the point made by Jens Noffke, Working Capital Lead, Global Procurement at Roche, sums up the timing issues for critical suppliers when fulfilling orders for their buyers. "The purchase order that we place initially means a cash outflow for the supplier, so having something on the table at favourable rates that helps is very attractive."[23]

> "Leading analysts are looking at important characteristics of supply chains, including the role of strategic suppliers whose contribution is so critical that any disruption in their ability to assure supply can cause the entire production process to grind to a halt. Similarly, service providers and others that support a supply chain and enable its activities can be critical to its ongoing operation, and as such, ought to be considered strategically important"[24]
>
> Alexander Malaket,
> President, OPUS Advisory Services International, quoted from *Financing Trade and International Supply Chains*

3.1.1 The integration and globalisation of supply chains

Supply chains are not static entities, however, and, over the past decade or more, they have undergone two main changes – becoming at once more integrated and more global.

In 2008, following the financial crisis, global economic growth slowed and reduced the volumes and values of trade. This started a race to begin streamlining supply chains by eliminating inefficiencies and costs wherever possible. Supply chain integration has played an important role in carving out these efficiencies. The process of integrating a supply chain involves bringing together numerous links in the chain, across each of the procurement, manufacturing, distribution and settlement phases, into a close, holistic relationship – enabling the supply chain to work seamlessly from end to end. The value-added services sector is becoming increasingly embedded in this broader supply chain, too; with closer connections reducing production administration periods, costs and waste across the entire chain.

This determined drive for optimisation has helped to create a more global supply chain. Large corporates need to ensure that their products meet high standards and will look to utilise the best possible expertise, at the best possible price, across a series of different fields – necessitating a global outlook. For instance, a single core part of a specific machine will likely cross borders several times during the production phase. The raw materials may be procured in Germany, manufactured in China, and receive specialist refinement in the U.K – all before the product is distributed. An integrated supply chain ensures this global process is lean, for both the largest and smallest suppliers.

But what do global supply chains look like today? Rising protectionist sentiment, reaching a peak during the Trump presidency in the US and pre/post-Brexit negotiations in Europe, combined with the impact of the coronavirus pandemic have caused the globalisation of supply chains to stall somewhat.

3.1.2 Focus shifts from cost-efficiency to resilience

The financial effects of Covid-19 have been similar to those of the 2008 financial crisis, though the stresses now extend across every sector of the economy. Previously healthy businesses have been placed under acute financial pressure, which in turn is compromising the commercial and operational resilience of supply chains. In light of this, many businesses have looked to retool their supply chains, moving away from the previous model of 'just-in-time' delivery across multiple borders. Sourcing goods and services more locally and maintaining reserves of inventory in case of supply shocks has become an increasingly popular alternative, helping build a supply chain that is more resilient.

Before the pandemic, just-in-time (JIT) supply chains were embraced by companies in many industries, particularly in the automotive, manufacturing and technology sectors. They enabled companies to reduce working capital tied up in inventory and to respond flexibly to changing customer demand.

However, on 10 March 2020 – the day Italy experienced the first European lockdown – an Institute for Supply Chain Management (IoSCM) Survey found that 75% of respondents reported disruption to their supply chains.[25] Some 62% experienced order delays and more than half struggled to communicate with supply-chain partners in China, with lead times having doubled on average since December 2019.

"While it seems unlikely that the crisis will spell the end of JIT manufacturing, it could – and should – mark the end of poor implementation," says Helen Sanders, independent treasury and transaction banking specialist and Director of Education at the Association of Corporate Treasurers (ACT).[26] Sanders explains that, while building supply chains based solely on lowest-cost principles might create a short-term competitive advantage, squeezing suppliers on cost and building transactional relationships rather than longer-term ones creates significant supply-chain vulnerability.

It also brings environmental and social costs and risks, which have major reputational implications. Moves to increase supply chain resilience have been hastened by the Brexit deal, which came into effect on 1 January 2021 but has created complexities and compliance issues, injecting considerable uncertainty into supply chains. This uncertainty will not be short-lived: it is likely to persist for a decade or more and will add to existing volatility and vulnerability in the supply chains of many industries.[27]

The uneasy trade relationship between the UK and the EU is not the only one threatening supply chains – the China-United States trade war is ongoing. The last major development was the 'Phase One' agreement of January 2020, with little subsequent progress in improving the Washington/Beijing entente, despite the change in administration at the White House.

3.1.3 Globalisation on hold

All of these developments feed into a wider trend towards rapid deglobalisation. Businesses are reassessing China's role in global supply chains; in a February 2020 survey by the American Chamber of Commerce in Singapore, 28% of those polled said that they are setting up, or using, alternative supply chains to reduce their dependence on China.[28] Increasingly, mutual dependency is becoming a source of fear. The pandemic has shown that just-in-time networks are as fragile as they are efficient.

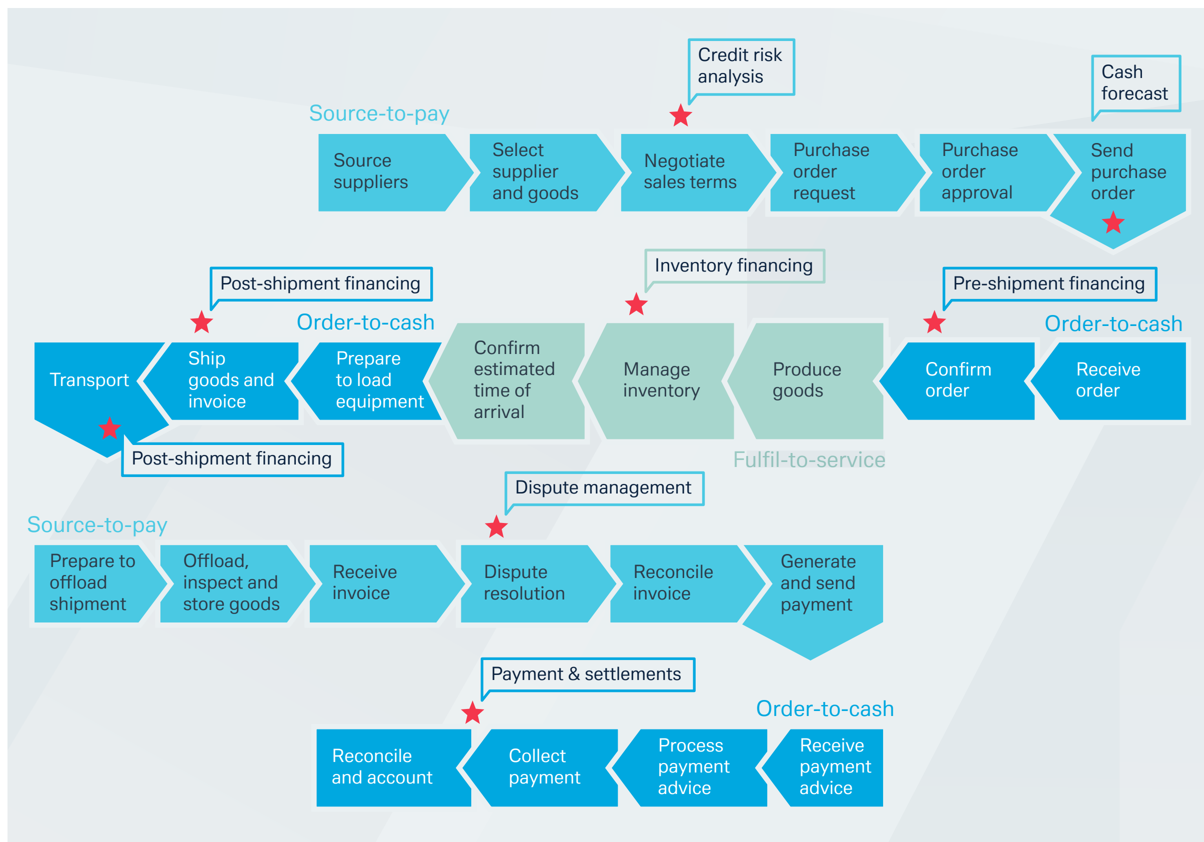
“If businesses do not include financing in any trade facilitation programme, they are missing out on a key opportunity to bolster its global trade flows, trade relationships, and international supply chains”

Enrico Camerinelli,
Senior Analyst, Aite Group

3.2 The financial supply chain

As defined in *Section 1.1: Definition of supply chain finance*, the financial supply chain looks to facilitate the workings of the physical supply chain by providing financial support at key strategic points (see Figure 3) or flexible support that can be drawn upon at any point in the process.

Figure 3: Linking the physical and the financial supply chains



Source: Enrico Camerinelli

3.3 How do banks support the financial supply chain?

Banks take a comprehensive approach to providing support to the financial supply chain (see *Section 1.2: The supply chain finance universe*), but many gravitate towards buyer-led finance because of the lower risk associated with the financial strength of multinational corporation (MNC) buyers.

3.3.1 What is a payables finance platform?

Many banks run payables finance platforms to centralise numerous supply chain offerings through a single digital portal integrated using application programme interface technology (APIs) with the buyer's enterprise resource planning (ERP) system. This helps to facilitate the process of confirming and discounting payables contracts in a seamless, user-friendly manner.

In recent years, the number of supply chain offerings have grown (see Figure 4) – with many third-party providers (TPPs) offering their own platform-based solutions. Generally, TPP solutions separate the funding from the platform architecture and add specific fees related to the use of the platform.

However, a bank will have a wider dialogue with their clients beyond just payables finance, and successful programmes are often anchored in a comprehensive banking relationship – enabling the bank to stabilise pricing.

3.3.2 Beyond digital platforms

SCF platforms represent just one aspect of the broader payables finance proposition. The full proposition includes putting in careful thought to structure and set-up a tailored payables programme, as well as thorough Know Your Customer (KYC) and Anti Money Laundering (AML) checks on all participants in the chain.

Perhaps surprisingly, one of the most challenging aspects of setting up a payables finance programme is onboarding the suppliers (see *Section 4.5: Onboarding suppliers*). In this respect, one of the key roles of banks and other participants in the financial supply chain is communicating the benefits, simplicity and security of joining a payables programme. This is a marketing exercise, and the strategy varies not just according to the type, size and industry of the supplier in question, but also by geography – making a local presence and an in-depth knowledge of a region's culture and languages a crucial part of a comprehensive service.

Figure 4: A short developmental history of the technology behind payables finance solutions

Buyer-led platforms

During the early 1990s, German retail giant Metro Group was one of the first innovators to set up a supplier financing platform with its in-house financing entity MIAG in Switzerland, still operating today.[29]

French retail group, Carrefour, soon followed their lead by setting up a similar platform connected to its in-house financing entity, FINIFAC, in 2000.[30]

Bank-led proprietary platforms

By the early 2000s, a number of leading banks had established their own proprietary payables finance platforms, often sold to clients as part of a wider portfolio of banking solutions.

These platforms are integrated with the buyer's ERP system through host-to-host connectivity solutions, with File Transfer Protocol (FTP) servers commonly used as a means of secure data transmission.

Increased competition, third-party platforms and platform refinements

Starting in 2005 and over the next 15 years, the payables finance market has been flooded with technology platforms, driven by growing interest from leading corporates looking for ways to improve their working capital. With increased competition came a number of platform innovations and refinements. These include:

1. Plug-and-play technology

Several providers, including banks, offer a "plug and play" model, where the payables finance platform is connected to the buyer's ERP system, significantly reducing the time and effort required by a corporate buyer to initiate a programme.

2. Digitalisation

To simplify the onboarding process, many platforms now offer suppliers the option to upload or fill in the required documentation online. The onset of the pandemic early in 2020 accelerated this process considerably, driving demand and prompting regulators to update their legal frameworks to incorporate digital signatures. The introduction of blockchain-enabled platforms has further increased the push towards digitalisation, though it's still to be seen if live, large-scale transactions can gain traction in the coming years.

3. Shifting to the cloud

Many buyers are moving their ERP systems into the cloud. Several ERP software applications, including Microsoft Dynamics, SAP and Oracle Netsuite, now allow access to receivables finance apps and work is underway to bring in support for payables finance as well.

4. Single access

Until recently, some companies could be included on 20 different payables finance platforms, depending on their buyers and scope of geographical operations. This meant different integrations, solutions and access points. Today, however, there is a greater focus on rationalisation and efficiency. For example, suppliers signed up to several financing programmes run by Deutsche Bank are able to access all their programmes through single access point.

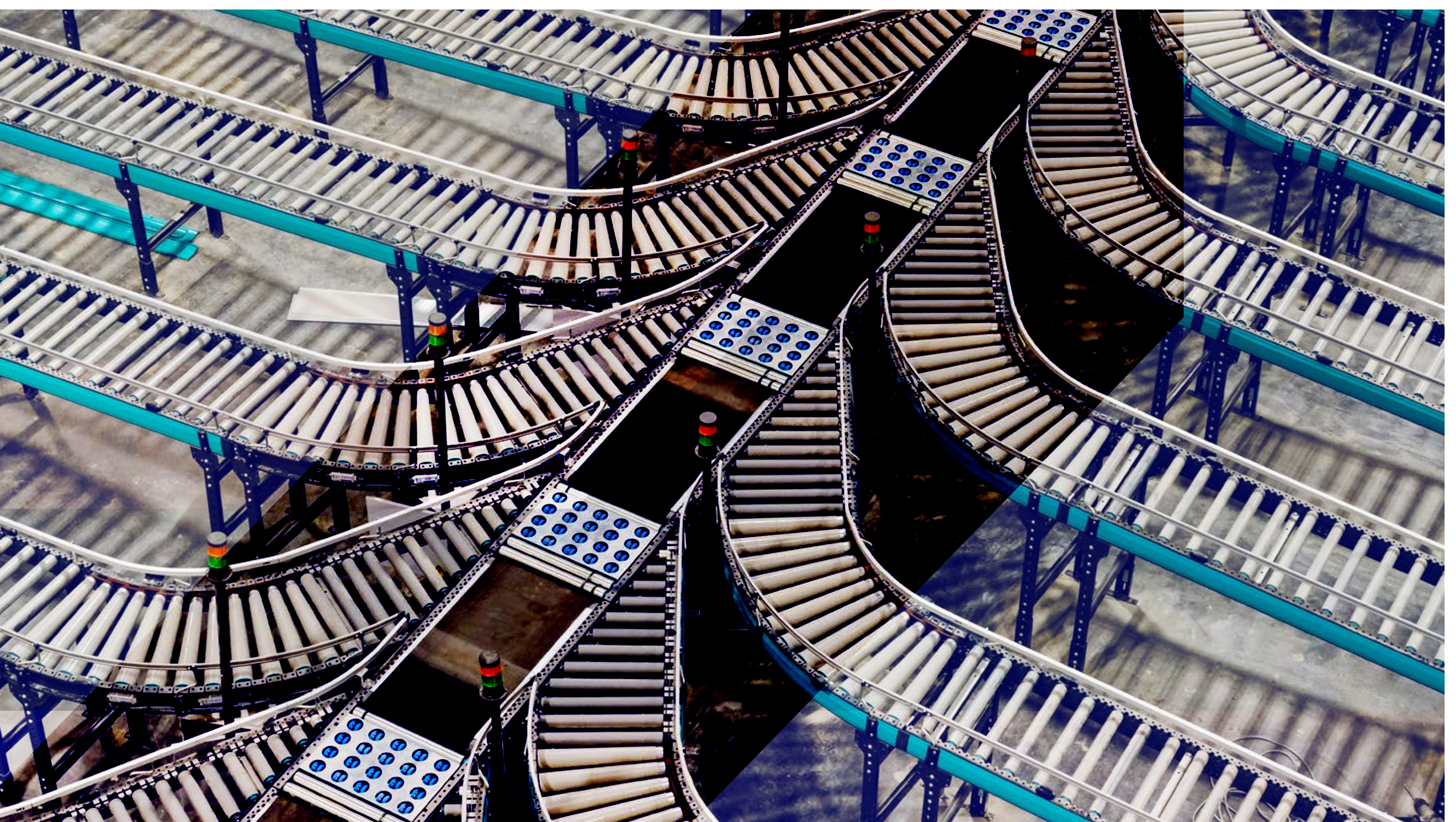
5. Artificial intelligence

Artificial intelligence (AI) has great potential in the payables finance space, particularly when it comes to deciding the specifics of a programme, such as the overall size and payment terms. After over 20 years of supply chain finance, there are a vast number of data points available that can be used to feed advanced algorithms to generate new insights. For example, during the pandemic, buyers have been keen to improve payment terms. AI can help them determine the optimum terms by analysing supplier cash flows, payment behaviours and other factors. It can also help buyers decide the size of the programme by analysing historical behaviour patterns to estimate how many invoices will ultimately be sold and how many suppliers will simply accept longer terms and decline the option of favourable financing.

Source: Oliver Belin, Founder of Calculum.ai and author of the book: *Uncovering Supply Chain Finance: How to plan, implement and manage Supply Chain Finance solutions successfully* and Anil Walia, EMEA Head of Supply Chain Finance – Payables, Deutsche Bank

While recent advancements have done much to simplify and streamline the payables finance process, another challenge that remains is scalability. Even for suppliers with a liquidity shortage, the onboarding process for a programme can sometimes be too complex to be worthwhile. For example, if a supplier needs US$1m in liquidity to cover its production cycle and its payables finance-related invoices only cover US$100,000, the value of financing this at a better rate doesn't necessarily justify the effort involved, when the majority of its liquidity will have to be sourced through more expensive factoring arrangements. However, the administrative challenges involved could be eased with the creation of a "network of networks", connecting all participants across the value chain.

> "A highly efficient virtual platform that connects multiple payables finance participants – running the gamut across banks, buyers and suppliers – has the potential to make it far quicker and easier for suppliers to be onboarded onto multiple programmes – helping a much broader range of businesses to realise the benefits"
>
> Philipp Wetzel,
> Ph.D. HSG in Supply Chain Financing, University of St. Gallen



4

Setting up a successful payables finance programme

A successful payables finance programme offers a host of benefits to both suppliers and buyers. However, it takes time and commitment to ensure that a programme reaches its full potential. This section will cover five key steps the buyer will need to take once it has decided to start a payables finance programme.

4.1 Finding a provider

4.1.1 Main requirements

Getting a payables finance programme right starts with finding the right provider. This involves some preliminary homework to find a bank, fintech or third-party financier with plenty of experience, strong credentials – you don't want to suddenly find they have closed down the programme – and good references from its current clients (good reputations can last longer than good service).

From a buyer's perspective, working capital optimisation is key, although as already explained in this paper, greater control of the supply chain and oversight of suppliers' ESG alignment is also very important now. A good programme will not require the buyer to set up a whole supporting infrastructure to manage it, because this will detract from its optimisation of working capital. The programme should not interfere with the buyer's existing processes, including the approval of invoices, management of invoices, management of suppliers, management of credit notes, and reconciliation.

Supplier acceptability is the make-or-break factor of a payables finance programme. Suppliers want early, easy access to their money, but they also want to be treated as the provider's client. So, the best banks and fintechs will provide suppliers with a proper contact, easily reachable by email or phone, rather than forcing them to make contact through a call centre.

4.1.2 Global coverage

As supply chains become increasingly global, payables finance providers must also offer capabilities that reflect the global nature of their client's business and supplier relationships. To do so, there are additional layers of complexity involved – in terms of regulatory, legal and operational challenges – if a buyer and its suppliers are located across national and regional borders.

As such, a successful global provider will need to have people on the ground who understand the local environment – in particular the regulatory requirements– and who can respond to the supplier in the same time zone and the same language. In addition, a successful provider will need a global-friendly platform, and a cross-border funding model that can deal with the inherent FX risk.

"Foreign currency exposure, or FX risk, is inherent for at least one or both trading partners in the majority of international transactions, and may extend to impact a whole group of trading partners in the context of an international supply chain," notes Alexander Malaket, President, OPUS Advisory Services International. He adds, "Buyers have noted the significant impact on cost, and have opted, as part of the SCF programmes offered through their trade bankers, to provide suppliers with the option to settle invoices in local currency. The banks, in effect, 'bundle' a trade or SCF solution with some form of currency hedge, be it spot conversion to the currency of the supplier at the time of settlement, or conversion on the basis of an FX contract, assuring settlement in local currency on the due date."[31]

4.1.3 Diversified funding sources

As the market has grown, so has the size of payables finance deals demanded by corporates. Some programmes (particularly those of the largest MNCs) have become so enormous that they now outstrip the funding capacity of a single bank.

Leading banks have created capacity for these enormous programmes by forming syndicates with other banks – usually the clients' other relationship banks.

However, managing a multi-bank payables finance solution introduces a number of new challenges – including technical and data compatibility issues, reporting requirements, and risk and compliance needs across all participants. As a result, only a handful of players currently have the capabilities and expertise to lead such syndicates.

4.2 Legal issues

4.2.1 Trade payables status

Documentation and general internal processes are fundamental to the smooth running of a payables finance programme. A programme is only functional if the buyer's trade payables can remain trade payables, and this depends on how the documentation and processes within the programme are structured.

Currently, the industry uses accounting standards that are adaptable to a multitude of different business models. As a result, the standards are necessarily left open to interpretation and make it uncertain how auditors will classify trade payables.

Although in pure cash terms there is no difference between having a trade payable due in 90 days and having a bank debt due in 90 days, the perceived differences between the two are significant. Reclassification of trade payables to bank loans from the bank to the buyer gives the impression that the buyer had to borrow money in order to pay the supplier; especially if the majority of suppliers are covered by payables programmes. As such, the amount of financial debt held by a buyer on its balance sheet increases – leading to negative implications for a corporate buyer's loan covenants, its leverage, and its access to additional credit.

Geoffrey Wynne of law firm Sullivan & Worcester explains, "The reclassification of trade payables as debt on the balance sheet matters. It can have serious implications for corporate buyers' loan covenants".

Ensuring that payment terms are aligned with commercial terms and industry norms, that the supplier is able to freely choose whether or not to join the programme, and that the buyer is not held responsible for any finance costs, remains a central element of any sound payables finance programme. However, rating agencies have begun to place heightened levels of scrutiny on the trade payables sector.

4.2.2 Disclosure

An ongoing discussion about the disclosure of payables finance in annual reports dates back to 2015, when Moody's reported that "Reverse-Factoring has debt-like features",[32] while in 2018 it stated that there were "flaws in accounting for supply chain finance arrangements".[33] In January 2018, these concerns were confirmed by the collapse of UK multinational construction firm Carillion, the warning signs of which were partly obscured by its use of payables finance in the form of its "early payments facility". As reported in the *Financial Times*, from 2011 to 2016 Carillion's published net debt increased by only £11m, while its trade payable liability increased by almost £500m.[34]

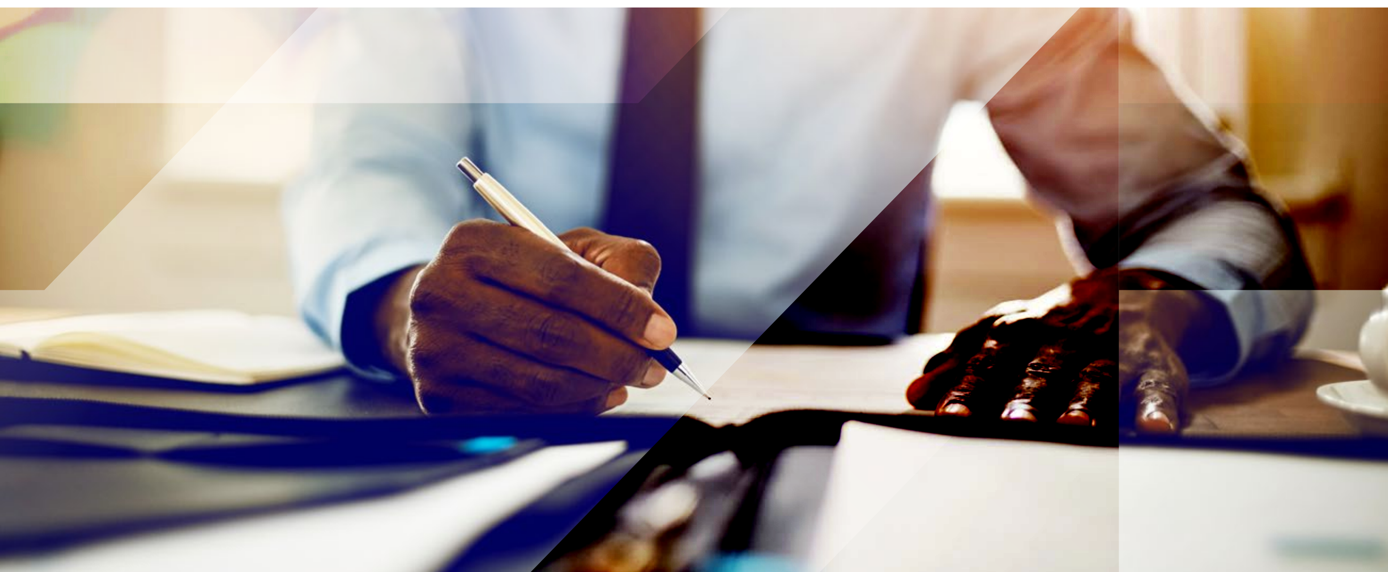
Carillion's fate gave rise to a lively discussion as to whether its trade payables should have been reclassified as bank debt. Anil Walia, EMEA Head of Supply Chain Finance – Payables at Deutsche Bank, says the banking industry should sit down with ratings agencies, regulators and accounting bodies to agree on how SCF should be treated in company accounts. Trade payables still have to be paid, even if they are not bank debt. Further clarity on the product offering and structure is needed to avert the danger of "a negative watershed event for the SCF business", adds Walia.

Measures include ensuring that the financier obtains the exact same rights to receive payment that the supplier had. This means that the bank does not, for example, have any greater certainty of being paid, and paid on time, than the vendor had. Likewise, corporate guarantees or additional security from the buyer – elements a buyer would not agree to in an ordinary vendor relationship – can risk contributing to a case for reclassification.

The proportion of suppliers that are onboarded to their payables programme also plays a role. If your entire chain buys into a programme, it gives the impression you cannot pay suppliers without heavy financing; thus risking reclassification. The challenge, therefore, is to strike a balance between providing comprehensive coverage for the greatest risks and maintaining an uncompromised balance sheet. Putting in place these kinds of measures will be essential for corporates looking to avoid reclassification. But while different views have been exchanged over the years, there is no consistent interpretation available that is shared among the relevant stakeholders.

Progress is nonetheless being made. Industry organisations such as the Global Supply Chain Finance Forum (GSCFF) are interacting with accounting standard bodies to help improve their understanding of the matter (see *Section 8: Industry frameworks*).

> "It is worth noting that the recommendations made by the accounting bodies, FASB and IASB, in June 2021 are related to the question of how to report a payables finance programme, rather than how to account for it. Generally, both accounting bodies advocate and recommend transparency on the usage of a payables finance programme – this is fully supported by the industry"
>
> Christian Hausherr,
> Head of Product Management EMEA, Payables Finance, Deutsche Bank
> and Chair, Global Supply Chain Finance Forum



Regulators are also taking a closer look the subject. In October 2020, the US-based Financial Accounting Standards Board (FASB) decided to undertake a project to "develop disclosure requirements that enhance transparency about the use of supplier finance programs involving trade payables."[35] The FASB also met with the International Accounting Standards Board (IASB) in November 2020 to discuss the issues raised.[36]

In June 2021, the IASB published its recommendation that standards be set for new accounting disclosure requirements in annual statements for SCF arrangements. The IASB has chosen not to undertake a standard-setting exercise for the balance-sheet treatment of payables finance as either bank debt or trade payables.[37]

4.3 True sale and assignment

On the supplier side, it is imperative that the discounting is done on the basis of the true sale of the receivable from the supplier to the bank. If the receivable is not assigned (if the title is not transferred to the funding party), there are serious risks in terms of balance-sheet treatment and rating agency assessment. And, if the supplier is illiquid, the buyer may even have to pay the invoice twice.

Contractually, before an early payment can be made under a payables finance programme, the supplier and financier must sign a Receivables Purchase Agreement (RPA) under which the supplier agrees to transfer all their rights (or title) to the trade receivable to the financier.

> "Perfecting the title to the receivable is important. We have to ensure we take over the receivable exactly as it was originally committed. Shortcuts create risk"
>
> Anil Walia,
> EMEA Head of Supply Chain Finance – Payables, Deutsche Bank

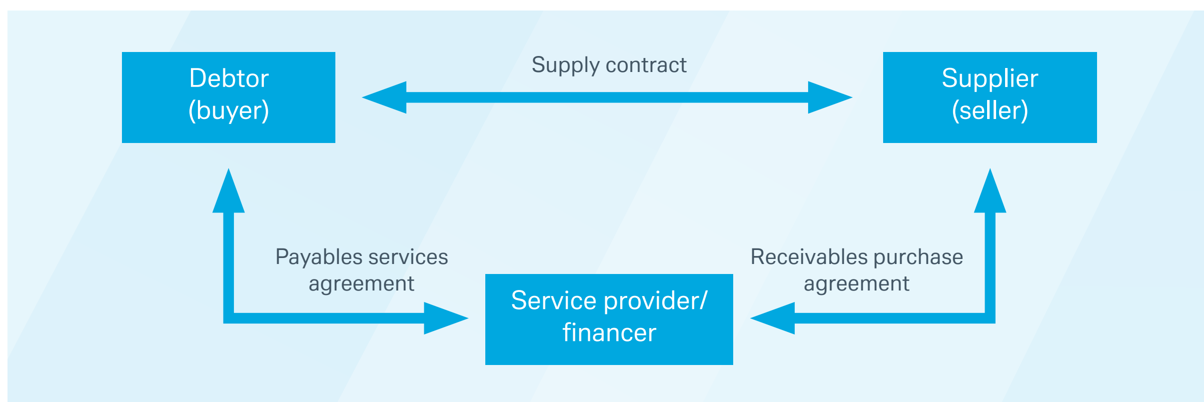
"If a German supplier is selling to a French buyer – and I am a UK SCF provider – theoretically every time I buy a trade receivable, I must make sure it was validly sold to me under German law, French law and English law"

Geoffrey Wynne,
Partner, Head of Trade and Export Finance, Sullivan & Worcester UK LLP

When drafting this document, providers and also their lawyers must take care to ensure the assignment of receivables is "perfected" according to jurisdictional requirements. This means ensuring it will be recognised by the relevant local transaction courts as a "true sale", which is essential in the case of a default. Failure to achieve this can result in an interpretation that it is a loan secured by the receivable instead. In the event of a supplier's insolvency, if the liquidators do not accept that a true sale has been achieved, the buyer could find themselves in a situation where they have to pay the same invoice twice or the financier could have no valid claim on the receivable. The supplier would still have a claim against the buyer under the original invoice, and the financier (often protected by some form of irrevocable payment undertaking) could theoretically still claim the value underlying the discounted receivable from a buyer.

Reaching perfection is not always easy. And even within the EU, the rules relating to perfection of the assignment vary from country to country and are far from simple.

Figure 4: The legal structure of a payables finance programme



Source: Sullivan & Worcester UK LLP

"It is important to understand both the accounting and legal aspects of any sale. Getting it wrong may leave you exposed or, if you are a buyer, leave you with different rights from those you were expecting"

Sean Edwards,
Chairman, International Trade & Forfaiting Association (IFTA)

4.4 Implementation

4.4.1 Coordination and adoption

Implementation occurs in parallel with documentation. It involves connecting the corporate buyer and the SCF provider's IT systems. The technology should be advanced enough that there is just one platform globally, with users able to log in with the same technology and credentials from anywhere in the world. A straight-through process from front to back is also essential. A successful payables finance programme is all about the level of adoption, so it has failed if suppliers do not use it.

Implementation includes the supplier-facing side of the technology as well as the buyer-facing side; there is flow from the buyer to the provider to the supplier and vice versa. In most cases, the supplier accesses the platform online.

During implementation the buyer and the finance provider should work together to ensure coordination between internal accounting, treasury, procurement and IT teams; all of whom are important stakeholders in the payables finance process. These departments will not necessarily have worked together closely before, however, so should understand the purpose and value of the payables finance programme. And, to perform their respective roles, each will need to receive specific training. The strategy for supplier onboarding should also be discussed at the implementation stage.

4.4.2 Working with procurement

In recent years – and particularly since early 2020, treasuries have become increasingly cognisant of the need to work closely with their company's procurement teams. From managing FX exposures to monitoring the cash conversion cycle, processes typically run better when they are approached in tandem with procurement. Payables finance is no different. In fact, given the scope and complexity of these programmes, the pitfalls are often more plentiful and the stakes higher.

"Given how large payables finance programmes can be and the diversity of suppliers that fall within them, procurement teams that understand these suppliers are an essential partner to treasury. If a treasury team arranges a payables finance programme without close alignment with procurement, the programme will, at best, fall short of reaching its full potential and, at worst, could fail entirely"

Claudia Villasis-Wallraff,
Head of Cash Management Structuring APAC at Deutsche Bank

It should be confirmed that new terms under a programme are viable for suppliers and that each of them buys into the programme. For this to happen requires treasury to work well with the client's main contacts on the procurement side, who will understand the client's needs and how to support them and will therefore be central to establishing their buy-in to the programme.

Work on this type of project is best carried out as part of an existing close relationship between treasury and procurement, rather than treating it as a one-off collaboration. This provides a strong foundation for reaching out to suppliers and reaching amenable terms for all parties, as well as selling the benefits of the programme.

As businesses become increasingly aware of the need for close relationships, many recognise the value of establishing an ongoing two-way dialogue, with treasury teams responsible for providing options to procurement for managing risk. Procurement teams, on the other hand, can provide the business case for taking on additional risk. This regular communication reduces the risks intrinsic to commercial negotiations.

4.4.3 Managing FX risk

When setting up a payables finance programme, a company will need to decide how to manage the risk of contracts denominated in a foreign currency.

"Foreign currency exposure, or FX risk, is inherent for at least one or both trading partners in the majority of international transactions, and may extend to impact a whole group of trading partners in the context of an international supply chain," notes Alexander Malaket, President, OPUS Advisory Services International.[38]

The main decision to make will be whether or not to hedge the exposure long-term. If the company decides to hedge, it will then need to manage the hedging programme. This will involve choosing whether the hedging is going to be handled separately by the corporate buyer or built into the payables finance programme on the bank side.

If the company decides not to hedge the exposure, prices will necessarily fluctuate, and the company will need to consider how to get the money to where it needs to be. Some key, high-level FX considerations are:

- How do the accounts payable combine with the company's other FX risks? Do they broadly match equivalent accounts receivable or other exposures?
- How material are the net risks relative to the size of the overall balance sheet and net income?
- What is the client's risk appetite for FX gains and losses on the balance sheet? Can they pass those on via pricing power or another way?
- Will payment at maturity require a cross-border payment (in which case, hedging can help ensure transparency over the conversion rate) or will it fund out of existing foreign currency liquidity?
- Will payment be going into or out of restricted markets, such as Brazil or China, where the government controls the exchange rate of its domestic currency? This can increase documentary requirements but will likely be less complicated procedurally than if the company is looking to hedge a restricted currency. The approach will also depend on the direction of the payable; that is, whether the payment is leaving or entering a restricted market.

Malaket comments, "Buyers have noted the significant impact [of FX risk] on cost, and have opted, as part of the SCF programmes offered through their trade bankers, to provide suppliers with the option to settle invoices in local currency. The banks, in effect, 'bundle' a trade or SCF solution with some form of currency hedge, be it spot conversion to the currency of the supplier at the time of settlement, or conversion on the basis of an FX contract, assuring settlement in local currency on the due date."[39]

A payables finance programme should not create much additional risk beyond that imposed by the supply chain. The main change is timing: the company will likely incur a longer duration of FX risk (and technically interest rate risk) if extending its payment terms. If the buyer is already hedging, it will simply change the tenor of its hedge.

Integrating the hedging of FX risk into a payables finance programme affords the opportunity to streamline workflows for both suppliers and buyers. The simplest integration is likely to be the capability for a supplier to be paid in their preferred currency and the achievement of greater transparency than if a foreign currency was simply sent to their bank. More advanced integrations could allow buyers to automatically hedge their FX exposures. In addition to benefiting suppliers through local currency invoicing and transparent FX execution, tight integration of a hedging programme can reduce the treasury overhead for the buyer of managing a hedging or cross-currency payment programme, particularly if its payables form a large part of its foreign-currency exposure.

Where the buyer is a very large entity with a sophisticated FX risk management programme already in place, they may prefer to manage the risk on a portfolio basis across their entire business, rather than on a granular "per transaction" basis. Depending on the relative strengths of the buyer's banking relationships and total volume, they may also wish to separate their FX and trade finance business.

4.5 Onboarding suppliers

4.5.1 Efficiency and priorities

Onboarding suppliers is the stage at which companies are most likely to encounter difficulties because it is necessary to approach the process in a particular way. Onboarding has a far longer-term impact than the earlier stages discussed above: it involves hundreds of suppliers and the process will be ongoing for approximately five years, so it needs to be efficient.

Because onboarding is such a sizeable process, it is important to consider a variety of procurement relationships. Suppliers range from MNCs to SMEs and from global to strategic. As a result, the approach to onboarding will be dependent on the type of supplier. This flexibility of approach necessitates supplier segmentation, whereby suppliers are categorised into groups with different onboarding processes. The segment determines the method of communication, such as in-person visits or phone calls, and the level of discounting.

The segment with which the buyer starts the onboarding process will depend on the buyer's priorities. Some buyers will want the biggest financial impact as quickly as possible, so will approach the largest suppliers first. Others will want to begin with the smaller, more strategic suppliers.

Best practice involves discussion and due diligence with the procurement department. Integral to this is understanding procurement's structure and strategy and making decisions based on their priorities, as well as heeding the advice offered by providers.

4.5.2 Communicating the benefits to suppliers

Perception of payables finance among suppliers is not always positive. Those who don't fully understand the benefits or have been subjected to poorly structured programmes can even conclude that large companies are forcing their suppliers into programmes in order to extend their payment terms.[40]

The key to avoiding such suspicions is to ensure that participation is always optional and that the programme is structured in a way that maximises the benefits for suppliers. In the same vein, buyers should ensure their suppliers understand the benefits afforded by a payables programme.

If the benefits of the programme are poorly articulated to the supplier, the latter's attention may be limited to the extended payment terms that may come with a payables finance programme. However, payments terms are just one component of a successful payables finance programme; another is enhanced financing conditions. What ultimately matters is the final outcome and financial benefits that are created for the supplier, which can be substantial depending on the supplier's individual financial situation.

When holding these discussions, it is often useful to think in terms of the cost of capital.[41] Often, and almost certainly with SMEs, the supplier will have a lower credit rating than the buyer; meaning the cost of funding under a payables programme is less than the supplier could obtain on their own. On this basis, it would often cost the supplier more to wait 100 days to be paid in full, than to get paid 99% of the total by the bank in just 10 days.

Payables finance can also be useful in facilitating transactions that might otherwise be tricky to execute due to conflicting production cycles. An SME may sell relatively simple parts, the buyer combines these materials and components to build complex machinery, which is a high-margin, low-volume business. In such a scenario, the supplier might need payment long before the buyer is able to convert its investment into liquidity. For many SMEs, the delay in payment can be detrimental to its cash flow. A payables finance programme can offset such a situation by allowing buyers to improve their payment terms and the liquidity of their suppliers simultaneously.

It is also worth noting that the costs to the supplier of implementing a payables programme are negligible. Some small one-off costs may arise from the technical implementation effort and the analysis of the benefits of participation, but otherwise the primary cost is the discount agreed in exchange for an early payment.

Buyers have begun to take these messages on board. The ongoing shift away from DPO-driven payables finance (see *Section 2.2.2: The need for supply chain stability*) demonstrates how corporates are increasingly structuring their programmes to maximise supply chain benefits and promoting health and stability across their supplier bases. Leading the way in this respect, some buyers even look to pay the interest for their suppliers, though accounting implications mean that this approach is not yet widespread.

4.5.3 Balancing KYC with customer service

The onboarding stage also brings in a raft of KYC considerations, with due diligence required for each supplier brought onto the programme. Reconciling these complex and thorough operational requirements with client demand for a smooth experience is not always easy. “Onboarding represents the first customer interaction for the financial institution and will set the tone for the entire relationship,” noted a Deloitte report in 2017.[42] Profits are driven by good client experiences, and no financial institution can afford to impose a bad experience on the buyer or any of its suppliers.

The problem is that the supplier isn’t going to care that, relative to third-party competitors, banks are subject to a large number of regulatory requirements when onboarding suppliers to their programmes. KYC and supplier onboarding remain major pain points for banks, according to the 2020 ICC Global Survey.[43]

The emphasis moving forward should be on enhancing the efficiency of compliance processes through the use of new technology, such as artificial intelligence, and utilities such as the Global Legal Entity Identifier Foundation (GLEIF) project, SWIFT’s KYC Registry and IBM’s blockchain-based shared KYC solution.[44] Advocating solutions that are light on compliance, or providers that are willing to take shortcuts in the process, will simply add to the problem.

The Legal Entity Identifier (LEI) is a 20-character, alpha-numeric code that connects to key reference information, enabling clear and unique identification of legal entities participating in financial transactions.[45] According to GLEIF’s *Quarterly LEI System Business Report*, in Q2 2021, total Legal Entity Identifier (LEI) issuance grew by 3.3% and the total number of active LEIs now stands as 1.82 million.[46] This publicly available LEI data pool greatly enhances transparency in the global marketplace.

The KYC-related aspects of onboarding suppliers are outlined in the current edition of the Wolfsberg Trade Finance Principles, which elaborate on customer and counterparty due diligence in a newly added Appendix on Open Account.[47]

In short, the technology is steadily getting there, but where there are inevitable manual paper checks, financial institutions should take the opportunity provided by that client interaction to ensure the experience remains positive and consistent. “In a transaction-based business, profits are driven by good client experiences, a point made time and again in research and taught in professional marketing education,” notes Stefan Hoops, Head of Corporate Bank, Deutsche Bank in his flow article ‘Frontline economics’.[48]

5

Environmental, social and governance considerations

ESG considerations continue to rise up the business agenda, with senior management teams realising the benefits from both a brand and business perspective and so banks are now dealing with increasingly complex sustainability issues, from climate change risk to green financing opportunities.

This chapter summarises the background to financing sustainability and includes the Bridgestone EMIA/ EcoVadis case study as an example of an ESG-rated and aligned payables finance programme in action from J.P. Morgan and its fintech partner Taulia.

As the Head of Deutsche Bank's Corporate Bank, Stefan Hoops put it in his presentation at the Bank's Sustainability Deep Dive held on 20 May 2021, "Over the past few years, corporates have seen ESG shifting from a previously voluntary activity towards a strategic imperative, coupled with new disclosure requirements. Specifically, from 2022 onwards, European corporates with more than 500 employees will have to disclose the portion of revenues and capital expenditure aligned to the EU Taxonomy framework." He added, "Industry and regulatory discussions around sustainability have gained significant momentum across all industries and regions."[49]

Further information on the evolving regulatory ESG framework can be found in the *flow* summary article, Journey to Green in ESG transformation.[50]

To meet the needs of the new sustainability world order, banks are deploying financing structures aligned to sustainability key performance indicators to encourage sustainable practices right down the supply chain. These are found in a range of lending and FX products, including payables finance, and comprise more attractive financing costs for those meeting pre-agreed sustainability criteria (usually defined by a third-party environmental consultant).[51]

"The geopolitical context is increasingly focused on sustainable supply chains, including human rights and decent work as well as climate change. As financial disclosures around sustainability become more important during the coming year, trade itself will be more transparent and payables finance will be well-placed to serve this growing market"

Dr. Rebecca Harding,
CEO, Coriolis Technologies

5.1 The need for sustainable supply chains

The strategic and business need for sustainability is now widely acknowledged in the public and political sphere. In 2020, for the first time, the top five global risks in the World Economic Forum's global risk report were related to climate change. And while the precise timing, severity and economic ramifications of climate change are not yet known, there is a growing sense of urgency for businesses and their banks to start preparing now. An EY report published in 2020, for instance, found that 52% of banks view environmental and climate change as a key emerging risk over the next five years, against only 37% in the same survey in 2019.[52]

Much of the power – and therefore much of the responsibility – to drive mass change towards more sustainable global business practices lies in the hands of large international corporates, which exert considerable influence over the sustainable practices of their suppliers. In addition, investor appetite for company stocks in transition from brown to green is increasing; helpfully summarised by Nathan Fabian, Chief Responsible Investment Officer at Principles for Responsible Investment: "Investors are interested in who can transition, how fast they can transition and can they provide clear evidence about progress."[53]

> "Large corporates are in a unique position to drive meaningful global change and progressive supply chain management can play a huge role. Yet awareness among treasury teams remains limited – a knowledge gap that represents one of the major barriers to progressing the sustainability agenda. It underlines the importance of embedding sustainability into supply chains, as well as how companies can begin playing their part"
>
> Anil Walia,
> EMEA Head of Supply Chain Finance – Payables, Deutsche Bank

5.2 Drivers and opportunities for corporates

Sustainable practices make sense from a business perspective. Integrating ESG considerations into the business helps with stakeholder rebalancing and, as a new breed of environmentally and socially conscious customer comes to the fore, strong ESG credentials are required to secure buy-in to a company brand. At the same time, demonstrating a commitment to ESG can help secure buy-in from investors, who are increasingly aware that ESG factors represent material risks that must be managed. A strong ESG story will help companies meet and exceed investor expectations while improving access to finance in the capital markets (see *Section 1.4.3: SCF as an ESG financing tool* for more details)

Furthering the ESG cause is not just a business or a regulatory responsibility it is also a moral obligation. For younger generations, ESG has become personal; neglecting it threatens to affect their lives directly as well as those of their children in turn. And this goes beyond climate change to other areas, such as ensuring workers across the entire supply chain have satisfactory working conditions.[54] In 2013, for example, a poorly constructed and crowded garment factory in Dhaka, Bangladesh that served several major Western retailers collapsed, causing 1,134 deaths. Although this is an extreme example of the kind of issues at stake, it provides a wake-up call to buyers and acts as a reminder of the responsibility they hold for what goes on along their supply chains.

The pandemic emphasises the importance of supply chain resilience (see *Section 3.1.2: Focus shifts from cost-efficiency to resilience*). With the crisis triggering sharp shocks to supply chains across the globe, corporates recognise the importance of shifting from cost-focused to resilience-focused practices in their supply chains. ESG principles typically dovetail with this goal, with moves such as on-shoring and simplifying or shortening supply chains to be nearer to end markets. These changes all drive greater resilience and foster long-term success.

5.3 Practicalities of sustainable supply chain finance programmes

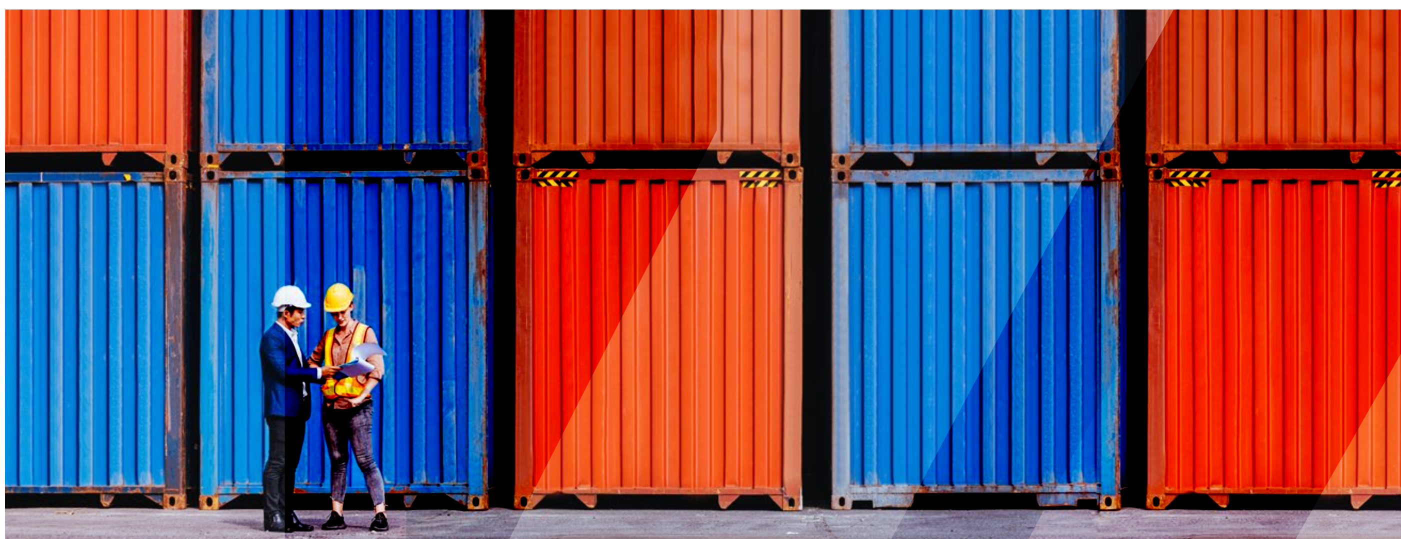
To make a sustainable supply chain programme workable and impactful, companies begin by actively managing the practices of their suppliers, identifying how sustainable they are and determining where sustainability can be improved. A supermarket, for instance, will want to ensure its fish suppliers source their produce in a responsible way by capping their hauls at a sustainable level to maintain stocks over the long term. Meanwhile a manufacturer of electronic goods will want to ensure that its factory workers benefit from acceptable working conditions.

5.3.1 Demonstrating sustainable practices

Though sustainable practices along the global supply chain are being more widely adopted, several barriers remain. A supply chain can be made up of hundreds of stakeholders, each with the ability to impact the chain's sustainable potential. Against this backdrop, providing proof of a supply chain's sustainability credentials can be incredibly difficult.

For instance, while a palm oil supplier may be able to demonstrate that its crop was sustainably grown, it might not know how it was harvested. Then, if the supplier could prove the crop was harvested via sustainable means, it may not be able to confirm that the workers who harvested the crop received a sustainable living wage. Given the number of participants in a single chain, tracing the sustainability of each link would require a colossal degree of oversight.

At the same time, even if a supplier could conceivably provide proof of their sustainability credentials, encouraging them to change their behaviour and processes can still be a challenge. For example, despite the concerted global efforts to combat climate change, many emerging markets remain heavily dependent on fossil fuels for heating and lighting. Small or medium-sized suppliers in emerging markets may have other more immediate issues to deal with and may object to the extra effort required for an environmental or social benefit they neither understand nor value.



> "Sustainable SCF programmes are set to change the paradigm for how business and trade are conducted and funded. They already help to drive the sustainability agenda and will continue to do so as we emerge from the pandemic"
>
> Björn Goedecke,
> EMEA Supply Chain Finance – Payables Sales at Deutsche Bank

5.3.2 Benchmarks and incentives

Once the need for greater sustainability is agreed, the next pivotal step will be to determine what metrics should be used as sustainability benchmarks. The key is to set achievable, yet impactful, ESG standards for suppliers to meet and, at the same time, help those who fall below requirements to improve. Companies can – and are – even setting minimum standards below which they will not work with a supplier. As filmmaker Huw Cordey put it in his interview at the 2020 *SCF Forum Global*, "Just asking suppliers to make changes without capital and liquidity is a fool's errand."[55]

Accordingly, the right mixture of support and incentives is essential and will likely vary from company to company and case to case. Compelling propositions include offering "approved supplier" status to those meeting the highest standards, which can be used as an impactful marketing tool for their business. Another option involves encouraging sustainable behaviour by offering a more favourable price for the sale of approved payables under an SCF programme to those suppliers who meet sustainable performance standards as compared to those who fall short.

This can be achieved through various means, such as highly individualised sustainability targets for an individual seller or standardised sustainability performance metrics for a group of suppliers. Another option could be to ring-fence green and sustainable transactions by committing 100% of the underlying exports/imports to a specified purpose. These can then be financed at favourable rates, provided the purpose clearly meets sustainability criteria outlined in internationally recognised taxonomies, such as the EU Taxonomy for Sustainable Activities, the Green Bond and the Green Loan Standard by the Loan Markets Associations (LMA).

Case study

Bridgestone tyre service

5.4 Bridgestone

In February 2018 the European arm of Bridgestone – a Japanese multinational tyre and diversified rubber products manufacturer – launched a sustainable payables finance programme based on assessments from external sustainable ratings agency EcoVadis.[56]

The programme, structured by JP Morgan and the US bank's fintech partner Taulia, is available to the top 20% of Bridgestone EMIA's direct suppliers, a group of around 45 firms that together represent around 80% of the division's total annual spend of US$1.6bn. The main financial incentives on offer through the programme are awarded for obtaining a rating from EcoVadis, highlighting Bridgestone's emphasis on visibility and transparency. Further benefits will be provided to suppliers that subsequently improve their ratings.

EcoVadis – a global provider of sustainability ratings for supply chains – is one of several companies aiming to solve a key challenge for sustainable payables finance programmes, determining and monitoring the sustainability metrics of suppliers. Underpinning these services are 21 sustainability criteria that EcoVadis has identified as impactful and measurable, each falling under one of four over-arching categories: environment; labour and human rights; ethics; and sustainable procurement.

EcoVadis requires companies to provide formal, recent and credible documentation as evidence of their sustainability management systems. This documentation can take the form of sustainability reports, policies, procedures, certificates or training materials, as well as site audits performed by third-party organisations.

EcoVadis also partners with specialist data providers, such as the Carbon Disclosure Project (now CDP Worldwide) for greenhouse gas emissions data and an external compliance database, to identify potential regulatory, commercial and reputational risks for companies. These serve as additional input for the analysis of every assessment. Factoring in all of this, the company provides a web-based platform on which procurement teams can monitor the ongoing sustainability performance of their trading partners.

"We believe the biggest gains in sustainability come through increased visibility and transparency throughout the supply chain," said Julle Pederson, Bridgestone's treasury director for Europe, the Middle East, India and Africa (EMIA) told *Euromoney* about the launch of the programme. "We want our suppliers to have an EcoVadis rating so that we can work together on sustainability with them."

"So far we have seen quite a good reception," says Alessandro Camporeale, Bridgestone EMIA's raw material procurement director. "Of course, it takes time to explain exactly what we're looking for, but besides the advantages of effectively allowing participants to discount invoices overnight, the sustainability element is also appealing to our suppliers."

According to the *Euromoney* report, the programme will be rolled out to the rest of Bridgestone EMIA's direct supply chain in late 2021, and then to indirect suppliers in industries such as transport, logistics and IT. There is also a secondary sustainability element to the programme. In addition to incentivising suppliers to improve their EcoVadis ratings, the pricing matrix will generate funds for sustainability projects selected by Bridgestone EMIA.

The programme is a "win-win-win-win" proposition, says Pederson. "The fourth win, beyond the direct stakeholders, is for society through the sustainable nature of the programme."

6

Payables finance and investors

The supply chain finance universe is large and provides various opportunities for risk participation and investment in the asset class once suitably packaged.

In this section we summarise how financial institutions and other institutional market participants work together to share payables finance risk (*Section 6.1*) and then how potential investors consider the asset class arising from the payables finance programmes from a portfolio management perspective (*Section 6.2*).

6.1 Distribution to financial institutions

Financial institutions originate and then distribute risk between trusted partners when transactions reach a size that is too large for one provider to cover entirely on their own balance sheet. Participation can take funded or unfunded forms and be made on a disclosed/open or silent basis.

"We have several ways of working," explains Kathrin Marks, Vice President, Distribution, Trade Finance & Lending at Deutsche Bank, "and this depends on the original transaction. For payables finance, we work on an open or disclosed basis as the participation is discussed before the mandate. Clients realise that for very large programmes they cannot keep it all on one bank's balance sheet and within the request for proposal (RFP) they enquire about how we would handle the financing and invite other relationship banks." Marks adds that banks would not want the concentration risk of a very large programme anyway and that the other reason banks prefer to participate in payables finance programmes on a disclosed basis is that they want the recognition and merit for having provided the balance sheet.

According to Kirstin Brozik, Team Head Distribution, Trade Finance & Lending at Deutsche Bank, while unfunded has been the main form of participation (see *Section 6.1.2*), funded is more dominant on a disclosed basis rather than an undisclosed basis. "The clients have evolved, and nowadays they are putting questions out in their RFPs saying we want to run a programme, so let us know your capabilities in adding other banks and investors".

6.1.1 Funded participation procedures

With transactions involving participating banks – which will usually have been agreed with the corporate at the outset – a master risk participation agreement will form the basis, such as the BAFT Master Risk Participation Agreement for Trade Transactions (2018) available in English law and New York law on the ITFA and BAFT websites to their members. However, given their references to Interbank Offered Rates (IBORs) now being phased out – such as LIBOR – as markets transition to alternatives, an update is widely anticipated.

Funded participation will typically happen on a recurring basis for weekly or biweekly payables finance programmes, so the agreement will cover these. Purchase offers to the prospective risk sharing institution are sent out, comprising full details of the payables finance programme. These are then accepted and the funds remitted.

Funded participation does not just come from other banks, but institutional investors such as insurance companies (where they act more as a financial institution rather than an insurer).

In addition, investors will include banks that are not part of the payables finance programme but are merely investing in the instrument, which at around 50 basis points (bps) or so is a more attractive proposition than paying the central bank to hold overnight money. Should interest rates rise from the ultra-low levels of recent years however, this could all change.

6.1.2 Unfunded participation

Insurance companies (except for their investment arms – see *Section 6.1.1*) do not come into funded programmes but are interested in unfunded participation. The originator pays the insurance provider a premium, which reduces the risk rating and capital allocation needed from the bank for the deal. “Our risk participation is a bilateral, silent agreement and represents an irrevocable, unconditional and on-demand obligation,” states Swiss Re Corporate Solutions on its website.

6.1.3 Managing the relationship

Larger corporates running payables finance programmes of €500m-plus rarely do this with just one relationship bank, but rather the use the opportunity of the programme to keep several relationship banks engaged. Some corporates will want to ensure that specific banks are included, so that the next time they need a syndicated loan or guarantee facility, nobody is left out.

Among the major advantages of a payables finance relationship, says Brozik, is that the programme keeps the corporate in constant contact with the funder, unlike a loan, and it runs for several years. True payables finance is a very safe product. Once suppliers are onboarded and the programme is up and running, the transactional visibility of the resulting supply chain makes it easier for the client – and its funders – to check the sustainability of the supply chain as well.

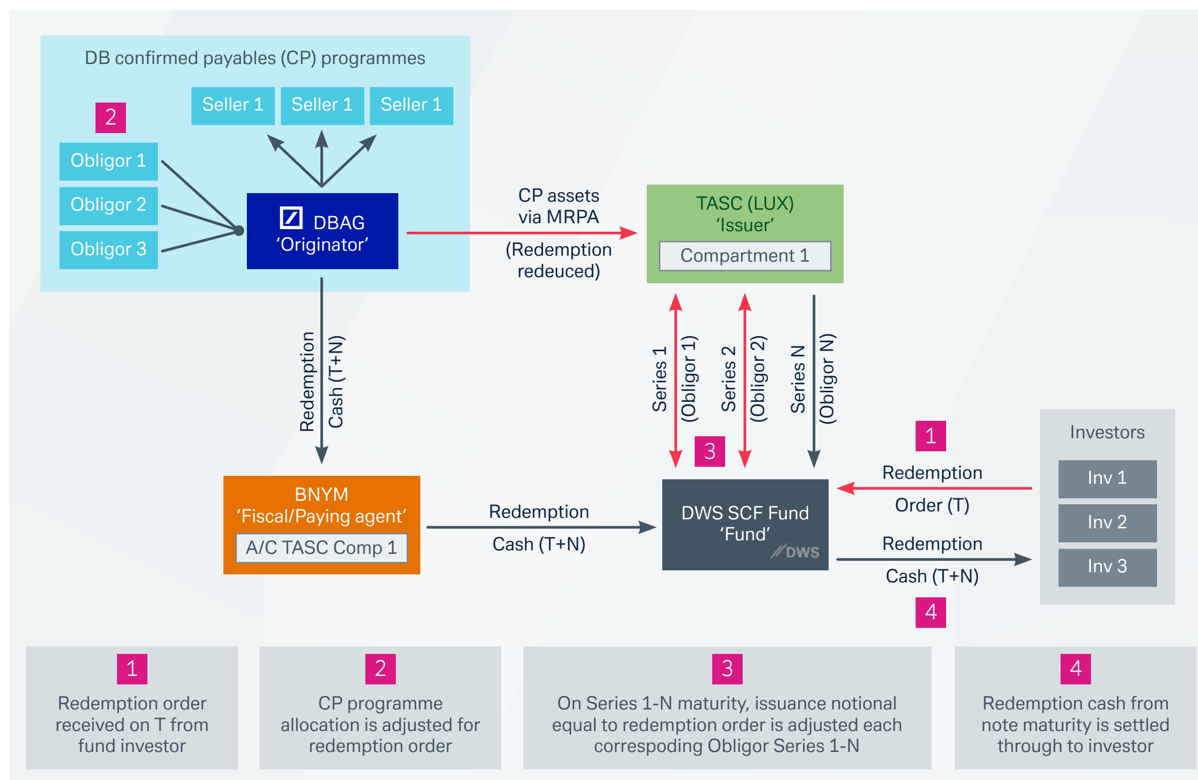
6.2 Distribution to institutional investors

6.2.1 Integrity of the buyer and risk profile

Payables finance as an asset class is increasingly catching the eye of portfolio managers, thanks to its attractive yield premium and short-term characteristics. However, the assets need to be packaged into a structure that makes them investible, as these are not bonds or loans. “Any kind of structuring or packaging increases complexity and, as a relatively new asset class, this requires more explanation,” explain Jens Witzke, Investment Specialist and Marcus Herbig, Head of Structured Income at DWS Group.

For insurance companies and pension funds, trade finance and payables finance represent a new asset class, but they need help in understanding it. With corporates looking for safe places to put their pockets of liquidity, trade finance assets seem an ideal solution with potential to balance yield and liquidity. Corporates, explain Witzke and Herbig, have large pockets of liquidity and may need to call on it in the short term – for example in around six months. Payables finance delivers an attractive yield premium, and they note that there are some good credit risk profiles in cases of confirmed payables (they know the integrity of the buyer through Deutsche Bank Research intelligence). In addition, the short-term nature of the asset matches the short-term expectations of these investors, and being bilateral in nature, they are less exposed to market-driven dislocations and should be more stable in terms of valuation. Such floored instruments with positive spreads are simply not available in this form elsewhere.

Figure 5: Structuring of Deutsche Bank confirmed payables programmes for investors



Source: Deutsche Bank

6.2.2 The investable universe

Once booked, the confirmed payables (denominated in EUR) are partly transferred, but the bank retains a proportion of the risk on the balance sheet and the fund has the right to invest up to a pre-agreed amount.

To make payables finance assets investible – (bonds and loans have relatively long-term maturity dates, whereas payables finance assets mature every 70–90 days) they are wrapped into a note that can be reported on, and it is the note that is transferred into the fund via a special purpose vehicle (SPV).

"This approach means we can show investors what is in the fund, not on a name-by-name basis but rather, for example, a German entity in a certain industry with a certain rating," explain Witzke and Herbig. "This should be sufficient for clients to understand the risk. Every time we have inflows of new payables, the corresponding notes are topped up."

While notes can be produced quickly, the difficulty comes with redemption, as the payable is not tradeable they add. "If an investor wants to leave, they have to give us notice of 80 days. We can then say via the note, please do not replenish but accrue the cash to fulfil the client's demand for redemption in 80 days."

6.2.3 Optimum characteristics

For the fund to work well, it needs to be well populated with payables assets from many different diverse companies and not just a handpicked few. In addition, funds have to take ESG ratings on board (see *Section 5: Environmental, social and governance considerations*) and remain with the ESG framework.

Case study

6.3 Ball Metalpack

The secondary market can be a useful resource for banks, affording them the opportunity to share the risk of a payables finance programme with an institutional investor. This proved a useful technique in the case of Ball Metalpack, the largest aerosol manufacturer in North America and a leading manufacturer of tinplate metal food and aerosol containers for food, household consumables, nutritional and other products.

Previously fully owned by Ball Corporation, Ball Metalpack then benefited from its parent company's successful payables finance programme. When, in July 2018, Platinum Equity acquired a majority stake in the company, leaving Ball Corporation 49% ownership, Ball Metalpack was keen to continue the programme, which its suppliers had come to rely on for early payment of their invoices; however, as a private-equity-held firm, rather than being part of an SEC-listed corporation, its financials were not widely available and it had no tangible credit history. As a result, it was suddenly difficult to gauge the company's creditworthiness, or to extend it credit as an anchor buyer for such a programme.

Working together with Deutsche Bank, Ball Metalpack was able to overcome this challenge using two strategies. First, Ball Corporation brought its credit profile to bear, supporting the transition by providing a guarantee for the first nine months after the spin-off. Second, Ball Metalpack recruited an institutional investor that it already knew well to share the risk with the bank. The institutional investor's knowledge of and relationship with Ball Metalpack made it easier for the bank to accept the risk. This collaboration enabled Deutsche Bank to set up a committed US$50m line of credit for the programme, selling on part of the debt to the investor.

This meant that Ball Metalpack's suppliers were able to maintain their access to payables financing, which was central to many of their liquidity plans. The support has proved particularly valuable during the pandemic, which followed shortly after the new programme was established, helping to stabilise supply chains and ensure that suppliers prioritised Ball Metalpack, rather than focusing on other buyers with better terms in cases of limited supply.

Ball Metalpack has weathered the pandemic and become a real success story from a liquidity perspective. Its capital ratio has increased from 1.75 in the first quarter of 2020 to 1.95 in Q1 2021, and its EBITDA has grown by more than US$7m. While it can't take credit for all of this impressive performance, payables finance has played its part as one of the tools helping Ball Metalpack to achieve these impressive numbers.

Ball Metalpack factory warehouse

7 Innovations related to payables finance

While payables finance plays a critical role in improving the flow of liquidity down supply chains, there is a limit to the reach and timeliness of the technique. Some suppliers, such as those with long productions cycles, require financing long before any invoice is issued, while others can find themselves deemed too marginal to the chain to fit into a payables finance programme that works best for the largest suppliers.

With support for the entire supply chain increasingly seen as critical to a resilient operational set-up, the industry continues to innovate, helping extend early payments to new beneficiaries. A number of solutions are emerging that serve this purpose, the most notable of which are explored in this section.

7.1 Purchase order financing

Payables finance helps bridge the gap between the issuance of an invoice and the ultimate collection of payment on the corresponding sale. What it doesn't address is the financing gap present in the early stages of many supply chains, from the issuing of the purchase order to approval of the invoice. When a seller receives an order from a large corporate, they have to put forward cash upfront to pay for the raw materials and/or labour for the final product or service.

This is where purchase order finance can help. Much like payables finance, purchase order financing enables suppliers to secure early payments for their goods or services at favourable rates, based on the guarantee of the buyer. The difference is that while payables finance is typically collateralised by an invoice issued by the seller and confirmed by the buyer, purchase order finance is instead collateralised by the purchase order issued by the buyer. This has traditionally been a difficult technique to execute because purchase orders can be forged, leading to fraudulent requests for finance.

> "One issue for suppliers is that payables financing comes very late in the financing cycle – even with early payment on the invoice, it still provides liquidity in arrears. What small suppliers need most is the money up front, so that they can buy their materials. This is what purchase order finance promises – and it's critical for many suppliers"
>
> Philipp Wetzel,
> Ph.D. HSG in Supply Chain Financing, University of St. Gallen

In 2018, Deutsche Bank and five other banks founded the Trade Information Network (TIN) as a response to the financing gap in the early stages of the supply chain. TIN enables companies to communicate their transaction data – such as purchase orders, invoices and shipment information – simply and securely, and to share this information with their banks when they request financing. Network members will have direct access to the trade information provided by clients of banks on the platform, thereby reducing the risk of double financing and fraudulent trade information across the industry. This will enable banks to better assess risks and to provide trade financing earlier in the supply chain, including for small and medium-sized businesses, which have traditionally found it difficult to access trade finance.

To encourage adoption by the industry, TIN has open architecture and standardised connectivity, based on a governance model similar to the SWIFT network. Companies will use a simple one-time registration process to connect with their partner banks on the network.

For a more detailed explanation of the TIN and how it works, please refer to the *flow* article '*Financing purchase orders – the best medicine*' (7 June 2021).[57]

7.2 Dynamic discounting

As payables finance has grown in prevalence, the demand to extend its benefits right down the supply chain to suppliers of all sizes has grown. This has huge benefits in terms of supply chain stability, but it also significantly increases the onboarding time in adding many more suppliers to the pipeline, which can lead to diminishing returns. For many businesses, it therefore makes sense to implement a more streamlined solution for smaller buyers.

Dynamic discounting – an SCF technique through which a buyer and a supplier agree flexible payment terms, so that payment for goods or services can be accelerated in return for a reduced price or discount – has emerged as a popular option in this regard. For suppliers, it represents straightforward access to favourable financing to cover their liquidity needs; for buyers, it offers not only the chance to shield suppliers from liquidity troubles, but also to earn an attractive risk-free return on their excess cash by realising a scaled discount in exchange for the early payment.

The solution typically allows both parties to view invoices through a web-based platform and select approved invoices for early payment. For instance, in July 2020, to support clients with this kind of programme, Deutsche Bank invested in TraxPay, a fintech specialist in the working capital space, becoming a shareholder and incorporating its dynamic discounting platform into the bank's client offering.

Case study

7.3 Roche

In 2021, F. Hoffmann-La Roche AG (Roche) – the world's largest biotech company, providing medicines in areas such as oncology, immunology, infectious diseases, ophthalmology and diseases of the central nervous system – became the first company to make a transaction using the TIN.

Building on an SCF relationship with Deutsche Bank stretching back over 10 years, Roche was looking to provide extra support for its ever-growing roster of suppliers. "We have a three-digit number of suppliers across the world focussing on larger suppliers and this number is increasing on a weekly basis," explains Martin Schlageter, the company's Head of Treasury Operations.

After receiving supplier feedback, Roche was determined to find a way of providing the liquidity currently offered through its payables finance programme at an earlier stage in its commercial transactions with suppliers, with many suppliers indicating that they needed money upfront. TIN was a natural solution here in offering, as Sudhir Dole, CEO of Trade Information Network Limited, notes, "the possibility to unlock additional financing opportunities along the entire supply chain".

The Roche logo outside one of its offices

> "The purchase order that we place initially means a cash outflow for the supplier, so having something on the table at favourable rates that helps is very attractive"
>
> Jens Noffke,
> Working Capital Lead, Global Procurement at Roche

Roche has hundreds of suppliers and while financing is quite simple for some; for example, those taking out a loan to produce lids for vaccine vials who then repay at the end of the month once the order has been shipped. For others the process is far more complex, with timelines protracted by clinical trials. Trials can stop and start for a number of reasons, including side effects, amendments to the drug or a sudden uptake or downfall in the market.

The inaugural transaction was in favour of Roche's supplier, Targos Molecular Pathology GmbH. Roche uploaded the purchase order data onto the TIN platform and gave Deutsche Bank permission to view this specific purchase order and any of its other purchase orders. Targos was notified by the platform that Roche had uploaded the purchase order so its team could review it and raise a financing request for this order with Deutsche Bank. The Bank could view the purchase order from Roche, along with Targos' response. In this case, Targos issued a financing request, which the bank was able to pick up and execute on its SCF platform, which was connected to TIN via application programming interface (API).

With the first successful purchase order financing completed through TIN, Targos approved a second purchase order immediately afterwards.

Reflecting on the process Roche and Targos agreed that TIN was easy to use, allowing them to amend process order data on the platform and that, with the help of the Roche procurement team, the onboarding process was very simple. The result was a straightforward transaction that solved a simple but longstanding challenge and strengthened Roche and Targos' 17-year business relationship.

8

Industry frameworks

In recent years, payables finance has benefited from a number of attempts to bring greater standardisation, structure and consistency to the industry. In particular, much work has been done by the Global Supply Chain Finance Forum (GSCFF) to provide clear definitions of the various techniques, as well as insights into common market practice. This section will outline the work of the GSCFF, provide the latest updates on its Standard Definitions and highlight some other interesting industry initiatives.

8.1 Work of the Global Supply Chain Finance Forum

Established in January 2014, the Global Supply Chain Finance Forum (GSCFF) is as an initiative formed by five industry associations that worked together on the development of *The Standard Definitions for Supply Chain Finance*.[58] These associations are:

— The ICC Banking Commission

— The Bankers Association for Finance and Trade

— Financial Conditions Index

— The International Trade and Forfaiting Association

— The Euro Banking Association

Since its formation, the GSCFF has continued to provide guidance documents for the industry and its partners in full consultation with its stakeholders – engaging with other industry initiatives such as the ICC Global Survey and the Wolfsberg Group to provide guidance on SCF in their particular fields of interest.

This includes guidance on KYC standards for SCF as well as plans to study the evolution of the market and develop reliable statistics on SCF. It also required expanding the reach and accessibility of the *Standard Definitions for Supply Chain Finance*, with the release of a Chinese translation of the document in January 2019.

On payables finance, the GSCFF has helped advocate for greater visibility and understanding of the technique. In the 2017 ICC Trade Register, Deputy Executive Committee Head Alexander Malaket stated that the Forum needed to expand its product coverage and data collection to include SCF. The GSCFF saw that this went on to be included in the scope of future Trade Register reports, a part of its continued role of providing crucial credit risk and default data in trade and export finance. This work has paid off – indeed, results reveal that "the probability of default for SCF is comparable to other short-term trade finance products."[59]

8.2 Updates to the Standard Definitions

In June 2019, the GSCFF published the first in a series of documents aimed at clarifying common market practices in risk management, documentation and operational handling for the techniques outlined in the Standard Definitions. *Market Practices in Supply Chain Finance – Receivables Discounting Technique* focuses on receivables discounting; a technique and form of receivables purchase, flexibly applied, in which sellers of goods and services sell individual or multiple receivables (represented by outstanding invoices) to a finance provider at a discount.[60]

The second in the series, *Market Practices in Supply Chain Finance – Payables Finance Technique*, was published in November 2020, complementing the GSCFF's existing work in this field and providing further detail on the mechanics of the technique.[61] Its release followed the publication of a Fact Sheet on Payables Finance in March 2020, as well as a Q&A report, *Ensuring Payables Finance Remains a Force for Good*, in August 2020. These reports were produced in response to growing concerns regarding the use and understanding of payables finance programmes, with the Q&A specifically aimed at addressing criticisms across three key areas: the potential adverse impact on suppliers, issues relating to financial reporting and transparency, and overall programme risk.[62]

In addition, the GSCFF has also been working towards a wider update to the Standard Definitions and to provide further clarity on the distinctions between the individual techniques. In January 2021, it was announced that alongside the existing Receivables Purchase and retitled Loan sub-categories, a newly created Advanced Payable sub-category would include three techniques: Corporate Payment Undertaking (CPU), Dynamic Discounting (DD) and Bank Payment Undertaking (BPU).[63] In turn, a first guidance document on the CPU technique was released concurrently, with those on DD and BPU to follow.

Speaking at the time of the announcement, Christian Hausherr, Chair of the GSCFF, and Head of Product Management EMEA, Payables Finance, at Deutsche Bank, explained that "at the time of publication, the Standard Definitions were deemed to be complete and widespread acceptance of the terminology confirms their benefit for the wider industry. [...] Adapting to current business practices, these updates will continue to encourage greater adoption of the Standard Definitions by market participants."[64]

8.3 Other industry initiatives

Alongside the work of the GSCFF, other industry initiatives and stakeholder engagement is underway to promote a better understanding of payables finance, and SCF more widely.

As part of this effort, BAFT's Global Trade Industry Council (GTIC) – formed of 19 heads of trade from some of the largest trade banks in the world – published its *Payables Finance Principles* in September 2020, to "codify a framework for articulating the essential criteria for the use and structuring of payables finance". These principles are not only aimed at those within the industry – who can utilise the framework for delivering and building payables finance programmes. They were also produced in order to provide greater clarity and specificity to rating agencies and other stakeholders, and mitigate any misunderstanding that can arise when confusing payables finance with other SCF techniques.[65]

Glossary of terms

AP (Accounts Payable)
An account that represents a company's obligation to pay off a short-term debt to its creditors or suppliers

APIs (Application programming interface)
A set of programming codes that queries data, parses responses, and sends instructions between one software platform and another

AR (Accounts receivable)
The balance of money due for goods or services delivered or used but not yet paid for by customers

CAGR (Compound annual growth rate)
The rate of return that would be required for an investment to grow from its beginning balance to its ending balance, assuming the profits were reinvested continually

CCC (Cash conversion cycle)
The time (in days) it takes for a company to convert its inventory investments into cash from sales

DSO (Days sales outstanding)
The number of days that it takes a company to collect payment for a sale

EBITDA (Earnings before interest, taxes, depreciation, and amortisation)
A measure of a company's overall financial performance

ESG (Environmental, social, and governance) criteria
A set of standards for a company's operations used by ethically conscious investors to screen potential investments

KYC (Know your customer)
A standard in the banking industry that ensures banks know that their customers are who they say they are and that they are suitable counterparties for the transaction in question

SCF (Supply chain finance)
A term describing a set of solutions that aim to improve efficiency and lower costs for buyers and sellers throughout a sales transaction

TIN (Trade Information Network)
A digital platform designed to enable suppliers to secure financing earlier in the cash conversion cycle, using a similar model to payables finance, but with an approved purchase order serving as collateral, instead of an approved invoice

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