

SCF Capital Delivers New Industry Procurement Utility Approach to Supply Chain Finance

Key Finding

Companies are increasingly realizing the power of supply chain finance to improve working capital. A new “industry procurement utility” approach by SCF Capital is the next evolution, enabling earnings growth as well as improved liquidity. Companies in industries with financially weaker tiers or undergoing power shifts, such as distributors in the electronics supply chain, should pay special attention.

Research Results and Recommendations

In the past 12 months, there has been a surge of interest from U.S. and European manufacturers, distributors, and retailers in how to use trade finance innovations to create a “cost-advantaged” supply chain. To date, most supply chain finance programs have revolved around large buyers and their immediate suppliers. Many of these programs enable the buyer to extend DPOs while also offering early payment discounts to suppliers, funded either by the buyer’s own cash reserves or a third-party financing institution.

SCF Capital is delivering a new “industry procurement utility” model that supports the “large buyer and its suppliers” model, but also introduces two new programs that help companies achieve off-balance sheet financing for receivables, payables, and inventory.

SCF Capital’s Industry Procurement Utility Innovation

SCF Capital is a boutique merchant bank focused on helping multiple tiers of companies in an industry take advantage of supply chain finance innovations. Its goal is to do this by:

- (1) Harnessing the strength of capital market and supply chain participants for its clients such as banks, credit insurers, private equity firms, hedge funds, logistics service providers, and business process outsourcers to provide lower-cost funding.
- (2) Using its financing expertise in industries like high tech and electronics combined with its own procure-to-pay transaction platform to design, automate, and execute the programs.

This platform is what SCF Capital calls the “SCFCAP.com Procurement Utility,” which has been launched for electronics and print industries, and is anticipated to be launched for other industries as shown in Table 1.

SCF Capital is run by an experienced set of executives who have held key finance positions at companies like HP and Dell. The company is still in its early stages; its concept is sound, though extremely ambitious. The key will be how well it can gain volume and participation across multiple tiers. Gaining this type of market usage will be a multi-year endeavor. Companies considering SCF Capital services should be aware of both the benefits and the maturity stage of the organization.

Announcement

[Benchmark your supply chain finance technology](#) – how are you automating payment processes with suppliers or customers?

Table 1: Rollout Plan for SCFCAP.com Procurement Utilities

Procurement Utility	Planned Go-Live Date
Electronics Industry Procurement Utility	Live (Q1 2007)
Print Industry Procurement Utility	Live (Q1 2007)
Oil and Gas Industry Procurement Utility	Q2 2007
Pharmaceutical Industry Procurement Utility	Q3 2007
Consumer Goods/Retail Industry Procurement Utility	Q4 2007

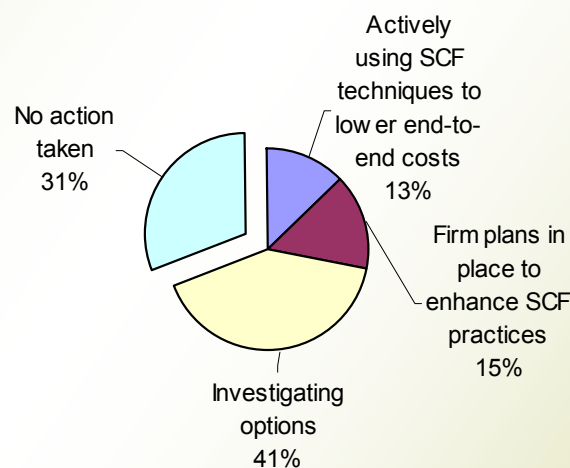
Source: SCF Capital, February 2007

Supply Chain Finance: The Next Competitive Frontier

The intersection of trade finance with today’s Internet-based technology is enabling a whole new way of thinking about multi-tier buy-sell processes. The gap is growing between those companies leveraging technology and financial services innovations and those sticking with traditional AP/AR methods.

Aberdeen has conducted two recent benchmark studies on supply chain finance across a total of more than 250 organizations. The first study found that 69% of respondents are investigating or putting supply chain finance programs in place to lower end-to-end supply chain costs (Figure 1). These programs are enabling companies to extend days payables outstanding (DPOs), reduce days sales outstanding (DSOs), and create a lower supply chain-wide cost of capital.

Figure 1: Current Strategies for Supply Chain Finance



Source: AberdeenGroup, February 2007

Table 2 shows Aberdeen survey results of “Best in Class” companies – the 20% of enterprises that have been able to extend their DPOs and lower their trade financing rate since 2004. Their financial performance advantage over all other respondents is striking.

Table 2: Best in Class Advantage Over All Other Respondents

Metric	Best in Class Advantage Against All Others
DPOs (all suppliers)	13.6 days longer
DPOs (Asian suppliers)	15 days longer
Annualized trade financing rate	2.86 percentage points lower

Source: AberdeenGroup, February 2007

Typically, for a company sourcing US\$500 million from China, the annualized savings of extending DPOs with its Chinese suppliers could be \$3.84 million. (This sample calculation assumes a 1.5% cost of short-term financing for a buyer, and that a buyer would have to finance its working capital if unable to extend payment terms to Best in Class levels.) Using an early payment discount program with terms of 2/10 Net 30, the annualized savings for such a buyer could be as much as \$10 million. For full descriptions of sample calculations of these and other savings opportunities, see [The New Strategies for Financial Supply Chain Optimization Report](#).

The example above shows how much an average company could save by moving to Best in Class metrics averages. A number of innovators have achieved an order of magnitude greater working capital improvement. Others report lowering their unit costs from suppliers by 5-10% by helping cash- and credit-constrained suppliers get paid faster but at a much lower rate than a traditional bank advance. These “Best of the Best” companies typically use a specialist supply chain finance provider that leverages an electronic flow of transaction data and access to capital markets in order to drive lower funding costs and propel greater payment program flexibility.

One of SCF Capital’s goals is to use its utility model to increase the magnitude of P&L impact that companies and their supply chain partners can achieve.

Value Example: Electronics Industry

An example of SCF Capital’s industry approach is its electronics procurement utility, which aims to support the end-to-end electronics supply chain including retailers, VARs, distributors, contract manufacturers, OEMs, and their suppliers. The electronics industry is a supply chain with financially weaker tiers, (e.g., the contract manufacturers) undergoing a significant power shift toward the large big box retailers and mass merchants. Companies in industries with these types of dynamics have the opportunity to drive a significant improvement in working capital and earnings, even on low-margin business (e.g., less than 10% margins). Table 3 shows the benefits that SCF Capital proposes are attainable for a \$1 billion electronics company.

Table 3: Electronics Industry Hypothetical Benefits Table

Approach	Working Capital Improvement (millions per \$1 billion in sales)	Earnings Improvement (millions per \$1 billion in sales)
Company Receivables Program	\$50 million-\$150 million	none
Industry Receivables Program	\$50 million-\$150 million	\$1 million-\$2 million
Industry Inventory Program	\$20 million-\$50 million	\$1 million-\$3 million
TOTAL Industry Receivables & Inventory Financing	\$70 million-\$200 million	\$2 million-\$5 million

Source: SCF Capital, February 2007

The Importance of GAAP Compliance

A critical issue to consider with supply chain finance programs is how they are accounted. In particular, there have been concerns over U.S. GAAP interpretations on discount management and inventory financing programs; some corporate programs have been classified as short-term debt on the balance sheet versus being off-balance sheet.

One reason that SCF Capital believes it can be GAAP compliant and offer off-balance sheet programs is because of its “industry procurement utility” approach. This approach is based on the established principles of merchant trade finance where contracting parties engage a third party, such as SCF Capital, to manage a particular activity. Although the underlying business and contractual relationships between the various participants (e.g., OEMs, contract manufacturers, suppliers, and distributors) do not change, the utility assumes a procurement role on behalf of the originating transaction party.

Understanding the Three Program Options on SCF Capital’s Industry Procurement Utility

Even though the financial improvement opportunity is very large, SCF Capital’s industry procurement utility approach is designed to release this value for multiple levels of the supply chain through minimal business process change and simplified technology integration to corporate ERP systems and financials.

The three off-balance sheet programs that SCF Capital’s industry procurement utilities are being designed for are listed below. A company can choose to use one or multiple of these programs.

- **Synthetic early payment/early receivables programs:** This comprises a synthetic early payment program for end buyers with optional extended DPO terms/synthetic early receivables program for multiple tiers of the supply chain. In return for end buyers confirming non-disputed invoices, the industry procurement utility can provide cost benefits between 0.5-2.0% per annum on the volume of goods administered through the utility. The supply chain is also strengthened through earlier payment of receivables significantly below suppliers’ cost of capital.
- **Toll manufacturing and netting program:** In the electronics industry, for example, contract manufacturers procure some of their components through the OEMs on commercial terms and subsequently sell back the finished goods to the OEMs. This creates a significant working capital requirement for contract manufacturers that they must bear at a capital cost significantly higher than the OEMs’. SCF Capital’s industry procurement utility approach enables off-balance sheet inventory financing to ease this pain. The solution also supports being able to net off trade positions between OEMs and contract manufacturers, reducing credit risks and lowering transaction taxes.
- **Inventory financing program:** By outsourcing procurement finance and administration to the utility, SCF Capital says that participants should be able to achieve GAAP-compliant off-balance sheet inventory financing. By using the consignment method to hold inventory title within the utility at all stages of the manufacturing process, a contract manufacturer would not have to carry inventory on its balance sheet. A key to the GAAP compliance is that SCF Capital’s industry procurement utility also creates a liquid market for surplus inventory, demonstrating an arms-length commercial relationship among participants.

Who Should Consider Using SCF Capital

Aberdeen benchmark research clearly shows that those companies taking an end-to-end approach to supply chain finance are gaining significant working capital and supply chain reliability advantages. However, these companies are still the minority. Too many companies are taking a silo-based, tactical approach to their payment processes.

If your company is considering an e-invoicing project, looking to extend payables, thinking of outsourcing procurement, or searching for greater visibility into its multi-tiered supply chain, you may want to take a look at the additional liquidity and earnings advantages that could be gained from a more advanced supply chain finance approach.

Companies in SCF Capital's target industries (see Table 1) should investigate the benefits of using the industry procurement utility. Look at the funding dynamics in your end-to-end supply chain and evaluate how you can free working capital while strengthening the health and reliability of your supply chain.

Based on our benchmark findings, we strongly believe that **supply chain finance is emerging as the next frontier that companies are focusing on to drive financial advantage over their competitors**. Companies in industries with financially weaker tiers or undergoing power shifts should evaluate supply chain finance opportunities to drive working capital and earnings improvements. For minimal business process change, companies are rewarded with cost-advantaged supply chains that are more reliable and agile. Because only a small fraction of companies are executing these programs today, the opportunity is at hand to obtain true market advantage.

Related Research

[*New Strategies for Financial Supply Chain Optimization Benchmark Report*](#), November 2006

[*Supply Chain Finance Benchmark Report*](#), September 2006

[*Supply Chain Financing and Technology Innovations May Help Extend LCCS Benefits*](#), November 2006

[*Get Ahead with Supply Chain Finance*](#), July 2006

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