Disclaimer:

This document is not designed to set out any commitments in relation to any intentions or plans for the activities of the Euro Banking Association (EBA).

The information contained in this document is provided for information purposes only and should not be construed as professional advice. The views expressed are those of the authors and not necessarily the views of the EBA. EBA or its affiliates do not accept any liability whatsoever arising from any alleged consequences or damages arising from the use or application of the information and give no warranties or any kind in relation to the information provided.
Authors

Charles Bryant

Charles Bryant is a consultant with a focus on e-invoicing and the financial supply chain. He was appointed as Senior Adviser to the Euro Banking Association in 2007. For the EBA community he has produced a number of reports on e-invoicing and is currently facilitating the association’s working group on supply chain finance.

He also works with OB10, the leading e-invoicing network. He was a member of the European Commission’s Expert Group on e-Invoicing, which reported in November 2009 and now represents the UK in the EU Multi-Stakeholder Forum on e-Invoicing. He co-founded the European e-Invoicing Service Providers Association and in 2011 was elected its Vice-Chair.

He was formerly Secretary General of the European Payments Council and played a major role in the design of the Single Euro Payments Area (SEPA) initiative, coming to that role after six years in the senior executive team at SWIFT, the financial messaging and standards organisation.

Prior to 1997, he had pursued a career in international banking with Chase, Midland (now HSBC) and NatWest with senior executive roles in trade finance, payments, investment and corporate banking. He has lived and worked in London, New York, Hong Kong, Sydney, and Brussels.
Enrico Camerinelli is a senior analyst at Aite Group specializing in wholesale banking, cash and trade finance, and payments. Based in Milan, he brings a strong European focus to Aite Group’s Wholesale Banking practice.

Mr. Camerinelli has been widely quoted by publications ranging from American Banker to Financial Times. He has contributed editorial content to publications such as Supply Chain Europe, and serves as a consulting editor with gtnews. He has spoken at leading trade shows and conferences in Europe, including Sibos and EuroFinance.

Mr. Camerinelli has extensive experience within his areas of coverage as well as in providing research and consulting services to clients. Most recently, he served as a senior analyst with Celent, focusing on the financial supply chain and Single Euro Payments Area (SEPA). Prior to that, he was the European director and chief analyst at the Supply Chain Council, a non-profit serving the logistics and supply-chain industry. In that capacity, Mr. Camerinelli provided independent research and advisory services as well as business development and budget control for the organization. Before that, he was a vice president and research leader at META Group’s Electronic Business Strategies service, tracking trends in supply chain management, product lifecycle management, e-procurement, and sourcing. He also spent 10 years working as a supply chain manager at various manufacturing and automotive companies.

Mr. Camerinelli graduated from Università degli Studi di Roma 'La Sapienza' with a degree in Business Engineering. He is a member of the Italian delegation at the United Nations Centre for Trade Facilitation and Electronic Business (UN/CEFACT), and speaks fluent Italian and English and is proficient in Spanish.
Contributors
The authors would like to thank all the contributors for their excellent work and commitment in putting together this valuable market guide, particularly the members of the EBA Supply Chain working group.
Abstract and Management Summary

The Euro Banking Association (EBA) is a country-neutral banking association for payment and transaction banking practitioners with a pan-European mindset and vision. In 2011 the EBA Board launched a new EBA Supply Chain Working Group (SCWG). The initial objective of the SCWG is to carry out a study of the Supply Chain Finance (SCF) market as represented by this Market Guide.

The intended audience for the Market Guide is the European transaction banking community, both specialist and those with a general interest in SCF.

In addition to providing a wide range of descriptive and explanatory materials, the Market Guide makes a number of recommendations and expresses a number of positions developed by the EBA SCWG.

The key focus areas elaborate on the layers of work specified in the SCWG Terms of Reference, and are as follow:

1. Describing the ecosystem for supply chain management and SCF and what drivers are propelling or constraining take-off and adoption.
2. Raising issues relating to market terminology and conceptual language. In describing the various instruments of SCF the Guide proposes a ‘holistic’ approach and discusses some key definitions that need to be aligned in common industry parlance.
3. Identifying and explaining the key risk and regulatory issues impacting SCF.
4. Linking SCF to the trend towards automated supply chain processes and describing how it is benefiting and could benefit further from the application of technology and business to business (B2B) platform capabilities.
5. Making recommendations on managing financial industry collaboration and partnerships at all levels.

A Market Guide of this nature must necessarily be focused as the topic is large and complex. The key categories of SCF instrument or enabler in focus are as follows:

– Accounts Payable or Buyer-centric – called ‘Approved Payables Finance’ or sometimes ‘Reverse Factoring’, ‘Supplier Finance’ or ‘Confirming’, and sometimes (confusingly) simply ‘Supply Chain Finance’, and based on the discounted payment of accounts payable in favour of suppliers by accessing a financial institution’s or a buyer’s own liquidity. Another related instrument is Dynamic Discounting, through which a buyer itself provides variable discounts for early payment of supplier invoices.

– Accounts Receivable or Supplier-centric – such as Receivables Finance (the category term used in this guide), Receivables Purchase and Invoice Discounting (all three being common names for similar financing instruments) and Factoring, which is a form of Receivables Finance but different in character from those previously mentioned.

– Inventory-centric (or ‘pre-shipment’) – such as Purchase Order (P.O.)-based finance and Inventory Finance.
Supply Chain Finance
European market guide

– **Bank Payment Obligation (BPO)** – an interbank instrument developed initially by SWIFT (as a development arising from its SWIFT Trade Services Utility) and now adopted by the International Chamber of Commerce (to be governed by ICC rules set out in Uniform Rules for the Bank Payment Obligation (URBPO) on the basis of which a variety of SCF transactional structures can be enabled).

– **Traditional documentary trade finance** – such as Letters of Credit, and documentary and related trade loans – summarised in an Annex.

– Complemented by other instruments and enablers e.g. other types of asset finance, longer term export and project finance, and hedging and payment instruments – not described in detail in this Guide.

**The Eco-System**

Following a short introduction, the Market Guide starts with an overview of corporate supply chain management and SCF trends and characteristics- the eco-system. A summary of the essential conclusions of the analysis of the ecosystem is provided in the chapter entitled ‘Description of the Market Eco-system’, which covers the rapid evolution of corporate supply chains and their mission-critical processes.

Working capital management is now an urgent and pressing issue and, with the availability of automation and Internet technology, practitioners are able to offer a rich array of supply chain management techniques and to trigger a range of ‘event-driven’ financings. Large buyers are often seeking to lengthen payment terms and suppliers are subject to liquidity pressures arising from this and general credit constraints.

On such a basis a new market for SCF is growing rapidly. The point is made that SCF is currently a ‘niche’ activity (outside the traditional domains of factoring and documentary trade finance). This niche largely engages larger buyers and suppliers, but has yet to apply its potential to the SME segment, where there is considerable demand for new sources of finance and liquidity generation.

Further analysis is provided in the four main chapters that follow, which address the four key issues of: **Definition, Risk and Regulation, Automation and Collaboration**.

**Definitions- more clarity is needed on definitions of Supply Chain Finance and its components**

There is a need to take great care with the language used by practitioners and drive towards much greater clarity of definitions, conceptual language and commonly used terms. This is illustrated by the definition of SCF itself, which sometimes is an umbrella term for a whole range of financial instruments and sometimes denotes a specific technique or component of the SCF portfolio as mentioned already above.

Supply Chain Finance (SCF) is most commonly described as “a portfolio or series of financial practices and technologies that support the trade flows and financial processes of end-to-end business supply chains”. This is emphatically a holistic definition including a broad range of traditional and evolving financial techniques. The EBA SCWG supports this description and further proposes that:
Supply Chain Finance is defined as “the use of financial instruments, practices and technologies to optimize the management of the working capital and liquidity tied up in supply chain processes for collaborating business partners. SCF is largely ‘event-driven’. Each intervention (finance, risk mitigation or payment) in the financial supply chain is driven by an event in the physical supply chain. The development of advanced technologies to track and control events in the physical supply chain creates opportunities to automate the initiation of SCF interventions.”

Whereas the categories of SCF and trade finance set out above are generally well accepted, the market for SCF is still evolving and the next levels of definition for SCF structures and components are not well established.

In response, banking associations and other organisations have already started to build glossaries and bodies of knowledge to support their membership and associates in adopting common definitions and terms. The most noteworthy and active is the Bankers’ Association for Finance and Trade-International Financial Services Association (BAFT-IFSA), the US-based global association for organizations actively engaged in international transaction banking.

The EBA SCWG has concluded that with the exceptions set out in Chapter 3, the terms and definitions elaborated by BAFT-IFSA for trade finance and supply chain finance instruments are worthy of support and do indeed reflect the experience and acceptance of a large community of organizations actively engaged in international transaction banking and finance.

The International Chamber of Commerce (ICC) has created the industry standards for definitions of traditional documentary trade finance instruments, which command universal respect and adoption. ICC has recently been working with SWIFT on the definition of Bank Payment Obligation and this is to be welcomed. For other open account based supply chain finance areas, ICC has not yet embarked on any further official work programs and it may be a helpful step forward if it did engage further in the process based on its recognised rule-making capabilities.

Other bodies in the Factoring and Forfaiting markets employ other terminologies and there is a plethora of proprietary language in use. At a working level there appears to be a real need for more consensus on definitions and the development of a cogent market terminology, which can evolve over time.

It is recommended that a representative international stakeholder group or Round Table be formed to develop further convergence in definitions and terminology. EBA SCWG members are willing to support this process.

Risk and regulation - a number of issues need to be addressed

There are four issues that deserve discussion within the headings of risk and regulation as summarised below:
1. Internal risk management for SCF: in order to aid understanding and assist the thought process, the section provides a full discussion of the risk characteristics of SCF and its essentially short term self-liquidating nature. Measures are proposed to adequately manage SCF business lines and risks, together with a number of searching questions that bankers could usefully ask themselves. In structuring financing transactions, there is a discussion of the difference between credit and performance risk and the relative value of transaction controls and collateral security.

2. Regulation and Basel III impacts on SCF: It is a common view of bankers that the perceived level of risk arising from trade and SCF as seen by regulators does not always match economic reality. Basel III and its European counterpart, the Capital Requirements Directive IV and related Regulations, propose tighter risk and capital allocations than its predecessor Basel II, and many concerns have been expressed as to the possible impact on the availability of finance to underpin growth in world trade.

A continuing dialogue involving a number of bodies representing the financial industry and corporate users have expressed these concerns and remain in a continuing dialogue with regulators. Some concessions have been achieved and further suggestions have been made in particular to relieve balance sheet trade-related contingent obligations from the full force of the capital allocation rules for leverage and other aspects of the emerging framework. Without constituting a complete explanation of a complex subject the main regulatory approaches now under review are briefly described.

The EBA SCWG proposes no role for itself in relation to Basel III other than to monitor the issue. There is clearly a need for the financial industry and its customers to document in a transparent way its representations and back this up with evidence of loss experience and credit quality indicators, an initiative that is in train at the ICC.

3. Compliance and Anti-Money Laundering in relation to SCF: Reference is made to a set of proposed guidelines in relation to Anti-Money Laundering, Terrorist Financing and Sanctions compliance under discussion within the BAFT-IFSA community.

4. Accounting aspects of SCF: Issues arising in relation to accounting treatment are discussed. Achieving the correct balance sheet treatment in particular for the Approved Payable Finance structure is important to avoid the re-classification of trade indebtedness as bank debt on the balance sheet under certain transactional structures.

These four areas are discussed in Chapter 4.

Automation enables Supply Chain Finance and e-invoicing automation is a ‘game-changer’

Automation refers to the range of IT-based and business tools that support the management of Supply Chains and SCF. Several categories of automation tool are identified and explained.
With the increasing use of fully automated end-to-end solutions, the transmission of dematerialized business documents over a B2B network can now mean that SCF offerings can be substantially automated. A key aspect is the ability to accelerate cycle times especially invoice, payment and other approvals in order to trigger event-driven SCF interventions. The growing popularity of business-to-business networks, which support e-invoicing and supply chain automation, is bringing to bear capabilities and benefits to end-users and other intermediaries such as financial institutions. Through its dematerialization and the acceleration effects, e-invoicing is clearly demonstrating its potential as a ‘game-changer’ for the SCF business.

The development of platforms and networks that directly support the provision of SCF itself is also accelerating. Some of these are proprietary and potentially quite limited in scope; on-boarding of suppliers is a particular challenge. Collaborative platforms have the potential to create substantial value.

Collaboration and Competition- there is a collaboration space in SCF

In a networked industry, a debate usually takes place about the relevant roles of competition and collaboration between market participants. Up to now, outside the framework of traditional trade finance and the areas of payments and financial trading (foreign exchange and derivatives), SCF has largely been conducted as a purely competitive activity with industry cooperation limited to syndication/asset distribution and the activities of some successful collaborative finance platforms.

Industry collaboration is recognised as a growing need and the EBA SCWG has identified or confirmed numerous areas of potential collaboration among financial institutions and other stakeholders.

The following breakdown of relevant spaces is identified:

1. Competitive space, where collaboration has no role. This will certainly cover the value propositions of individual competitors, pricing and customer specific information,

2. Collaboration between business entities undertaken on a bilateral basis through partnerships or commercial contracts, covering areas such as geographic coverage, four corner models, technical outsourcing and cooperation with B2B networks and SCF-enabling platforms.

3. Collaboration on a collective basis between market participants in areas defined in advance as being non-competitive, non-infringing of competition law and having the effect of creating the basis of overall market development to the benefit of individual competitors. This section covers governance and joint industry initiatives promoting collaboration on areas such as regulation, standards and infrastructural development.
Summary of the specific recommendations and ideas for the future role of EBA in relation to SCF mentioned in this Market Guide

The following propositions have been broken out of the body of the Market Guide, where they are developed as part of the fact-based discussion of the issues involved. At this stage they represent an initial list of action areas, which EBA and its member community will take forward in a manner and at a pace developed by the membership:

- EBA will actively contribute to the clarification of definitions and market terminology in cooperation with other stakeholders
- EBA will reach out to other stakeholder organisations with an interest in SCF
- EBA will participate in any emerging SCF ‘Round Table’ or similar initiatives at a European level
- EBA will monitor the evolving risk and regulatory framework and provide its members with information and updates.
- EBA will keep abreast of automation and technological developments and continue to participate in the EU Multi-Stakeholder Forum on e-Invoicing.
- EBA will continue to undertake further research and analysis of SCF topics on a phased basis.
- EBA will bring its skills and experience to bear in the collaborative space and supporting its members to develop the SCF component of the transaction banking business together with its related payment, liquidity and transactional elements.
- EBA will support the above activities with its education and communication activities
# TABLE OF CONTENTS

**AUTHORS** ..................................................................................................................... 3

**CONTRIBUTORS** .......................................................................................................... 5

**ABSTRACT AND MANAGEMENT SUMMARY** ............................................................ 6

## 1 PURPOSE OF THIS MARKET GUIDE ............................................................. 16

### 1.1 Introduction .................................................................................................... 16

### 1.2 The SCF instruments in focus in this Market Guide ................................... 17

### 1.3 Why Supply Chain Finance is important to banks and why should transaction bankers take an interest? ................................................................. 18

## 2 DESCRIPTION OF THE MARKET ECO-SYSTEM ............................................. 20

### 2.1 Description of the ecosystem of physical and financial supply chains ... 20

### 2.2 The impact of the physical supply chain on the components of working capital at a detailed level .......................................................... 22

### 2.3 How the physical and the financial chains connect ........................................ 24

### 2.4 How supply chain management is changing ................................................. 27

### 2.5 From SCM to SCF- trends and drivers ............................................................ 28

### 2.6 SCF key statistical indicators ......................................................................... 30

### 2.7 Factors driving SCF adoption ......................................................................... 31

### 2.8 There are some constraints and challenges for SCF growth, but they are not insurmountable ................................................................. 32

### 2.9 Impact of SCF for SMEs .................................................................................. 33

### 2.10 Stakeholder landscape .................................................................................. 33

## 3 TOWARDS A CLEAR CONCEPTUAL LANGUAGE AND COMMON SET OF DEFINITIONS FOR SUPPLY CHAIN FINANCE ........................................... 41

### 3.1 Definitions- More clarity needed on definitions of supply chain finance and its components ................................................................. 41
Supply Chain Finance
European market guide

3.2 Approved Payable Finance ................................................................. 44
3.3 Dynamic Discounting........................................................................... 50
3.4 Receivables Finance.............................................................................. 52
3.5 Pre-shipment or Purchase Order-based finance................................. 57
3.6 Inventory finance................................................................................ 60
3.7 The Bank Payment Obligation (BPO) .................................................. 61

4 RISK AND REGULATION- A NUMBER OF ISSUES NEED ADDRESSING ...... 65
4.1 Internal risk management for SCF.......................................................... 65
4.2 Regulation and Basel III......................................................................... 72
4.3 Compliance and Anti-Money Laundering................................................. 74
4.4 Accounting issues .............................................................................. 75

5 AUTOMATION UNLEASHES SCF AND E-INVOICING IS A ‘GAME-CHANGER’ 76
5.1 Automation tools.................................................................................. 76
5.2 Challenges and constraints................................................................. 77
5.3 The role of e-invoicing......................................................................... 78

6 COLLABORATION AND COMPETITION- IDENTIFYING THE COLLABORATION SPACE IN SCF ................................................................. 82
6.1 Bilateral collaboration........................................................................... 82
6.2 Collective collaboration........................................................................ 84

7 ANNEX 1 - GLOSSARY OF TERMS.......................................................... 87

8 ANNEX 2 - BAFT-IFSA DEFINITIONS OF SCF INSTRUMENTS ................. 91

9 ANNEX 3 – EBA SCWG: TERMS OF REFERENCE, MEMBERSHIP AND METHODOLOGY................................................................. 97
9.1 Terms of Reference ........................................................................... 97
9.2 Membership of the EBA SCWG........................................................ 100
9.3 Methodology of the EBA SCWG................................................................. 101
9.4 Relevant quotes and answers to the questionnaire ............................... 103

10 ANNEX 4 – TRADITIONAL TRADE FINANCE AND PAYMENTS .............. 109

11 ANNEX 5 – REFERENCE & SOURCES DOCUMENTARY AND OTHER BANK SERVICES FOR TRADE ........................................................................................................... 112
# TABLE OF FIGURES

Figure 1: "Source-to-Pay", "Fulfil-to-Service" and "Order-to-Cash" macro-processes . 21  
Figure 2: The Cash-to-Cash Cycle Time Illustrated ..................................................... 24  
Figure 3: The Flow of the Physical Supply Chain Processes ........................................... 25  
Figure 4: Supply Chain Finance “Trigger Points” (examples) ........................................... 26  
Figure 5: Distribution of SCF Instruments ....................................................................... 29  
Figure 6: The Complete Supply Chain Finance Portfolio ................................................ 43  
Figure 7: Approved Payables Finance Flow ....................................................................... 48  
Figure 8: Dynamic Discounting ..................................................................................... 51  
Figure 9: Dynamic Discounting Process Flows ............................................................... 52  
Figure 10: Receivables Purchase Process Flows ............................................................. 55  
Figure 11: PO-Based Finance Process Flows .................................................................... 58  
Figure 12: Illustration of the BPO Process Flows ........................................................... 64  
Figure 13: Perceived and Real Risk Profile of a Shipment ............................................. 67  
Figure 14: Breaking Down Supply Chain Processes ......................................................... 67  
Figure 15: Further Breaking Down Supply Chain Processes ........................................... 68  
Figure 16: E-invoicing expands the “Window of opportunity” ......................................... 79  
Figure 17: Three-Corner vs. Four-Corner Model ........................................................... 83
1 Purpose of this Market Guide

1.1 Introduction

The Euro Banking Association (EBA) plays an important role in the European financial industry as a forum established to discuss and drive pan-European payment-related initiatives. As a country-neutral banking association for payment and transaction banking practitioners with a pan-European mindset and vision, EBA is well positioned to support banks in their continuing migration to the Single Euro Payments Area (SEPA) and in other bank-driven initiatives requiring hands-on co-operation at a pan-European level.

Since 2006 the EBA Board actively supported its new EBA E-Invoicing Working Group in assessing the market opportunities for banks. The Group worked on analysing the potential role of banks in activating customer engagement, the linkage to Internet Banking and on the development of concepts for a pan-European network model for the delivery and processing of e-invoices based on exchanges between banks and non-bank service providers.

As part of its market monitoring activities, two market guides on e-invoicing were published in conjunction with Innopay in 2008 and 2010, and a service description and draft rulebook proposal was released in 2011. Externally EBA made a significant contribution to the European Commission’s Expert Group on E-Invoicing and has recently been invited to participate in the EU Multi-Stakeholder Forum on E-Invoicing.

In 2011, the EBA decided to enlarge the scope of its e-invoicing initiative to encompass related supply chain processes and launched a new EBA Supply Chain Working Group (SCWG). The initial objectives of the SCWG are to carry out a study of the Supply Chain Finance (SCF) market and its opportunities, based on four layers of work:

1. provide a common basis for the EBA community to understand the ecosystem of supply chains (physical and financial) and provide a picture of the market and opportunities for related SCF services;

2. analyse and make recommendations for common definitions, terminology and conceptual language related to the financial supply chain and SCF;

3. explore the explicit link between e-invoicing and SCF and how dematerialization in general supports the process of better working capital management, optimal financing structures, and the control of payables/liquidity;

4. describe possible model(s) for the integration of SCF related messaging in a 4-corner service context, and on the assumption that a cooperative space for market development is identified and supported.

The Terms of Reference of the EBA Supply Chain Working Group are attached in Annex 3.

This Market Guide is the first deliverable of this work program and is intended to be a 'living' document that will evolve. It is certainly not a manual of procedures, practices and detailed product descriptions. Reference is made to convenient sources of information for these areas where these are readily identifiable. Nor is the work based...
on a systematic data collection of transaction volumes, country differences or forecasts of future developments. It simply reflects the aggregation of general research, the views of members of the EBA SCWG, the perspective of guest speakers and external sources and the current body of written materials on the subject. In addition to providing a wide range of descriptive and explanatory materials, the Guide makes a number of recommendations and expresses a number of positions developed by the EBA SCWG. It is recognised that this brief description is the beginning of a process in contributing to better understanding of the practical issues and may raise more questions than answers in the mind of the reader. If that is the result and further discussion and solution-finding is encouraged then its objectives will have been achieved.

The key focus areas of the Guide elaborate on the layers of work specified in the Terms of Reference, and are as follows:

1. Describing the ecosystem for supply chain management and SCF and the drivers that are propelling or constraining take-off and adoption.

2. Raising issues relating to market terminology and conceptual language. In describing the various instruments of SCF the Guide proposes a ‘holistic’ approach and discusses some key definitions that are mainly aligned with common industry parlance.

3. Identifying and explaining the key risk and regulatory issues impacting SCF.

4. Linking SCF to the trend towards automated supply chain processes and describing how it is benefiting and could benefit further from the application of technology and business to business (B2B) platform capabilities.

5. Making recommendations on managing industry collaboration and partnerships at all levels.

The intended audience for the Guide is the European transaction banking community, both specialist and those with a general interest in SCF.

1.2 The SCF instruments in focus in this Market Guide

A Market Guide of this nature must necessarily be focused as the topic is large and complex. The key categories of SCF instrument or enabler in focus are as follows:

- **Accounts Payable or Buyer-centric** – called ‘Approved Payables Finance’ or sometimes ‘Reverse Factoring’, ‘Supplier Finance’ or ‘Confirming’, and sometimes (confusingly) simply ‘Supply Chain Finance’, and based on the discounted payment of accounts payable in favour of suppliers by accessing a financial institution’s or a buyer’s own liquidity. Another related instrument is Dynamic Discounting, through which a buyer itself provides variable discounts for early payment of supplier invoices.

- **Accounts Receivable or Supplier-centric** – such as Receivables Finance (the category term used in this guide), Receivables Purchase and Invoice Discounting (all three being common names for similar financing instruments) and Factoring, which is a form of Receivables Finance but different in character from those previously mentioned.
Supply Chain Finance
European market guide

– Inventory-centric (or ‘pre-shipment’) – such as Purchase Order (P.O.)-based finance and Inventory Finance.

– Bank Payment Obligation (BPO) – an interbank instrument developed initially by SWIFT (as a development arising from its SWIFT Trade Services Utility) and now adopted by the International Chamber of Commerce (to be governed by ICC rules set out in Uniform Rules for the Bank Payment Obligation (URBPO) on the basis of which a variety of SCF transactional structures can be enabled).

– Traditional documentary trade finance – such as Letters of Credit, and documentary and related trade loans – summarised in an Annex.

– Complemented by other instruments and enablers e.g. other types of asset finance, longer term export and project finance, and hedging and payment instruments – not described in detail in this Guide.

1.3 Why Supply Chain Finance is important to banks and why should transaction bankers take an interest?

There are a number of key strategic reasons and imperatives that are today driving the interest by banks in SCF:

1. Meeting essential customer needs is recognised to be vital in the ‘post-crisis’ financial markets and customers expect banks to be more ‘customer-centric’ in the supply of core working capital finance.

2. Payments, cash management and traditional lending services are maturing and represent challenges in terms of the development of new sources of value-added. For example the development of SEPA, the squeeze on payment fees and the pressures on Risk Weighted Assets are impelling bankers to engage in new ways of supporting customer working capital processes.

3. Corporate customers are managing the risk in their supply chains holistically as a source of enhanced efficiency and liquidity and expect their banks to engage in an area of real importance to them.

4. One of the benefits of SCF is its close and meaningful alignment with the actual movement of goods and payments throughout the supply chain, based on the introduction of improved and automated supply chain management monitoring and event-driven processes. An additional benefit of the close alignment between supply chain finance interventions and events in the physical supply chain is that there is greater visibility and control of bank exposure and earlier warning of potential repayment problems.

5. There is therefore an opportunity for banks to profitably intermediate or re-intermediate themselves using tried and tested techniques in the core working capital arena even as traditional trade finance products are apparently in relative decline. The increasing automation and de-materialisation of supply chains are creating new attractive financing opportunities that are short-term ‘self-liquidating’, open account-based, and triggered by identifiable supply chain events.

6. In a tough economic and credit environment it is less easy for customers to access funds through traditional channels; SCF provides a new opportunity to
unlock new sources of finance and liquidity for many corporate segments including SMEs.

7. There is a requirement and an opportunity to partner with vendors and B2B platforms, which bring new solutions and sources of value.

A recent EBA questionnaire demonstrated that a large number of banks have a strong interest in Supply Chain Finance (SCF) service offerings and such findings were very consistent with the above points.
2 Description of the market eco-system

This chapter explores some important themes in the development of SCF within the context of rapidly evolving supply chain management (SCM) practices. Supply chain management can be described as a disciplined blend of practices, information, organization and technologies that support users in the design, planning, sourcing, manufacturing, delivery, and return of goods and information delivered to customers in the global market. The rationale is to perform such activities in a way that contributes tangibly to profitability.

The physical supply chain is defined as the series of business processes by which goods and services are purchased, transformed, and delivered, whereas the financial supply chain covers the series of financial processes that support the physical supply chain such as credit assessment and control, deployment of financing and risk mitigation instruments, and payments.

The material in this chapter is primarily descriptive and details how the physical and the financial supply chains interplay with each other. A critical role is identified for a range of physical supply chain ‘events and triggers’ in activating responses in the financial supply chain. This builds the case for SCF. The part played by various stakeholders engaged in SCF is discussed.

2.1 Description of the ecosystem of physical and financial supply chains

Globalization has created internationally dispersed supply chains as production has been re-located to emerging markets, logistics have become more cost effective and global communications easier and pervasive. The recent downturn is not likely to do long term damage to the growth in global trade, although protectionism is always a downside risk. Global trade tends to grow faster than aggregate GDP.

Supply Chain Management techniques and proactively managed procurement have become key disciplines of effective corporate management. Larger buying organisations are much more sensitive to the inherent risk and resilience of their supply chains, as mission-critical product components are frequently dependent on third party suppliers.

In this interconnected global environment the following factors are driving concerted supply chain management practices:

1. The demands of operating in global markets are transformational and businesses have major incentives to identify and better utilise sources of precious liquidity within their own operational processes.

2. It is widely acknowledged that strong SCM practices will reduce operating costs and help organizations control their logistics expenses. Managers of the physical supply chain have responded by taking the lead in delivering billions of dollars of savings in inventories, freight costs, procurement and other costs associated with supply chain logistics.
3. For Chief Executive Officers’ (CEO) focused on profitable growth, working capital control has become a key metric. Working capital represents the amount of day-by-day operating liquidity available to a business. In numerical terms, working capital is calculated as:

\[ WC = (AR) + (Inv) - (AP) + (Cash) \]

(AR) stands for Accounts Receivable, the amount that customers owe a business. (Inv) is the Inventory value calculated as the total amount of inventory held by the business in raw materials, work in progress, and finished goods. (AP) is Accounts Payable, payments due to suppliers for goods and services purchased. (Cash) is self-explanatory.

4. Significant value can be derived from the optimal use of management processes in the physical supply chain: Source-to-Pay, Fulfil-to-Service, and Order-to-Cash process flows (Figure 1), with banks supporting working capital management and the improvement of their clients’ cash utilization.

Figure 1: "Source-to-Pay", “Fulfil-to-Service” and "Order-to-Cash" macro-processes

Source: Camerinelli

5. Many executives are beginning to understand the intrinsic connection between competency in physical supply chain management and corporate performance measured in financial terms. For that reason supply chain professionals must be ready to deliver value through their own local initiatives in order to support their companies’ strategic vision and overall performance. Collaboration between procurement and treasury professionals is essential.
2.2 The impact of the physical supply chain on the components of working capital at a detailed level

It is relevant to examine the financial components of working capital and analyse how they are affected – positively or negatively – by management practices in the physical side of the supply chain.

1. First let’s take the receivables element (i.e., AR). To more accurately assess the impact of SCM operations on receivables, it is useful to use the time-related figure for Day Sales Outstanding (DSO). This figure represents the average time interval required to collect an outstanding receivable and, therefore, measures the speed with which customers are invoiced and payment is received. The crucial control responsibility sits with the sales and credit control functions in terms of interpreting changes in DSO and its relationship to sales.

An obvious problem that may arise in the physical supply chain arises when the product is not delivered, or it is delivered in the wrong quantity, with the wrong specifications or in the wrong package, or is damaged and is eventually returned in full. Attention must also be paid to the activities of distributors in linking with the end-customer, delivering product and receiving/remitting funds. Additionally, poor performance in the invoicing process due to incorrect information will extend the time period between sales and the collection of funds. Ultimately AR is affected by the ability or willingness of a buyer to pay on time or at all (credit risk). Customer relationship management and credit control procedures are keys to this process.

A good way to illustrate this is to differentiate between the ‘can’t pay’ scenario and the ‘can pay/won’t pay’ scenario. The former is all about credit risk whilst the latter is about performance risk. An effective credit control process should mitigate the first and will provide early warning of the second. Credit control and effective management of collection of receivables can significantly speed up the process, shortening DSO and reducing finance costs.

2. Inventory (i.e., Inv) is the second component of working capital. We can take a similar time-based approach as with DSO to measure SCM’s impact on inventory value using the Days in Inventory indicator (DII).

There are many events that can occur in the physical supply chain processes that will increase inventory, in particular time required to receive inward supplies, factory movements, processing time for order processing, preparing goods for shipment, and poor performance of the distribution channel. Further issues can arise from failures in management processes such as forecasting and requirement sizing, order cycles being commenced too early in the cycle and purchasing based on price factors rather than paying attention to what is really required.
There may, of course, be legitimate reasons why a buyer might need to hold inventories in greater quantity than might be required using a ‘just in time’ principle: for example, a factory might need to gear-up/set-up machinery to make a production run efficient. A series of low volume product runs might be impractical and excessively expensive. A single large run might be the only viable option, resulting in a build-up of inventory either with the supplier or with the buyer.

Transit costs might be such that a low volume shipment is far more expensive at unit level than a high volume shipment. The practical impact of logistics might mean that there is a minimum practical size of consignment (e.g. one container-load or one tanker). A significant unit price advantage may be possible with a larger consignment, although this would have to be offset against the higher finance requirement and associated cost and the practical implications of holding, securing and insuring physical stock.

Some types of stock are subject to urgent call-off demands (e.g. aerospace spare parts) so stock levels will tend to be disproportionately high. Incidentally, a possible remedy here in the physical supply chain space is the collaborative inventory-holding model, in which the trading parties agree to share inventory holding and which has certain parallels with the collaborative approach to SCF.

3. The contribution of supply chain practices to working capital in its third component, **Accounts Payable (AP)**, can be appreciated- as in the previous cases- by focusing on its time-based equivalent - Days Payables Outstanding (DPO) and by applying concrete measures to the management of the supplier base and flow of in-bound goods and services. In the following paragraphs the tension between imposing longer payment terms by buyers to maximize DPO and the need to ensure stability and liquidity within the critical supplier base is discussed.

By focusing on the practices in the physical supply chain that impact DPO we can also compute a further metric for the financial supply chain— **cash-to-cash cycle time** – that has already become a significant ingredient of successful SCM.

Cash-to-cash cycle time = [(DSO + DII) – DPO] represents the interval between payment for raw materials and the receipt of cash generated by selling final goods.

If the cash-to-cash cycle time is short then a company can reasonably consider itself to be managing its working capital well. If the cycle time is long a company must conclude that it could have too much working capital tied up in its business operations, which means it cannot be used for other purposes such as investing in growth projects.

This is another way of saying the aim of efficient SCM is to shorten DSO and extend DPO whilst minimizing DII. Figure 2 graphically illustrates the cash-to-cash cycle components and their correlation.
The link between SCM operations and cash-to-cash cycle time becomes clear when a company realises that the longer its cash remains tied up in inventories (DII) the greater the time required for its production process and consequently the longer the delay in receiving payment from customers. A common response is to increase the value of DPO to counterbalance the increased combination of (DSO + DII).

Leaning on suppliers to increase their payment terms is not usually a valid or advisable long-term strategy and will create a natural tension between trading parties. Suppliers will suffer if they are forced to wait for payment as a result of decisions taken on a unilateral basis and this particularly impacts smaller or more vulnerable suppliers with limited bargaining power. The key point here is that by extending DPO a company can indeed reduce the cash to cash cycle time, but this merely passes the problem onto the suppliers unless there is also a commensurate improvement in the efficiency of the SCM process.

Longer payment terms of payment can be reasonably negotiated only if there is an appealing counter-offer to the supplier, such as certainty of payment date or an SCF facility with the support of financial institution (FI) releasing cash on behalf of the buyer.

2.3 How the physical and the financial chains connect

It should now be clear that there are many ways in which businesses can influence the values of working capital with its time-based components of DSO, DII, and DPO utilising pro-active management of the physical supply chain.

- It is important to recognize that supply chain management is much more than purchase orders, logistics, and inventory management. While these are, indeed, a key part of the scope of supply chain management, there are many more additional activities (Figure 3) such as production and procurement planning, the management of suppliers, inventory control, sales and
distribution planning, and the pro-active management of the receivables portfolio.

**Figure 3: The Flow of the Physical Supply Chain Processes**

A forward-looking perspective for a bank’s SCF offering should be based on *event-driven* process mindset. As soon as the bank is able to pinpoint when a financially significant event is triggered by the physical supply chain process (see “Trigger Points” in Figure 4), it will be in a position to offer a rich range of value-added services well beyond the domain of traditional trade finance and in a way that fully engages with open-account trade.
As can be noted from the illustration, there are many “trigger points” that may activate these value-added SCF services. The bank can detect them – and therefore increase its value-added offer – by learning to integrate its SCF value proposition with its customers’ physical supply chain.

Examples of these triggers are as follows:

1. The evaluation of counterparties for supply and sales requires credit analysis and due diligence. From the “trigger point” of ‘negotiate sales terms’ support of credit risk analysis by the bank could be activated.

2. ‘Send purchase order’ can be supplemented with a financing proposition based on the purchase order.

3. ‘Supplier management’ triggers a financial supply chain response such as improved cash forecasting for future cash outflows and optimal management of DPO referred to above. Assistance with cash forecasting could be a bank service triggered by the whole SCM process.

4. ‘Inventory planning, purchasing and tracking’ demands an ability to manage purchase order and inventory financing and, perhaps, letters of credit, or forward foreign exchange (FX) transactions.
Supply Chain Finance
European market guide

5. ‘Production planning’ may trigger an analysis of available capital equipment finance and asset-based lending services.

6. Post-shipment finance may be offered once the goods have been shipped. Electronic invoicing and management of residual or related paper documents are all services that could be offered.

7. Supply chain management creates the context for the use of a wide range of payments and cash management services.

- In addressing the above it is important to recognize the necessity to deploy both business and technological capabilities in order to exploit the value of event-driven SCF. An example of this is the use of developing technologies such as RFID tags. These might include monitoring of: raw materials on site, production in progress (tracked against key stages), independent/buyer inspection pre-shipment, goods loaded on vessel, unloaded, in warehouse or delivered to buyer.

2.4 How supply chain management is changing

It is likely that collaboration will become an even more intense feature of SCM touching all aspects of manufacturing, procurement, logistics, finance functions and related enterprise information and automated applications at every level. As competition in international markets becomes progressively more dependent upon the reliability and quality of deliveries, this collaboration between suppliers and buyers has become an important characteristic of the supply chain. It has become more important to have knowledge of the availability of products (i.e., inventory levels), price fluctuations (i.e., tendering) and existing contracts (i.e., orders) than the mere information about the physical shipment of goods.

The benefits of a collaborative perspective can be further appreciated given the current situation of liberalized and globalized international trade: the analysis of the processes underpinning production, and sourcing consumer products from across the globe are enhancing the interdependence between producers and wholesalers in globalised supply chains. The distribution of competitiveness in physical exchanges with the rest of the world is now crucial for economic prosperity, and has given rise to new forms of electronic transactions and methods of collaboration.

Electrically-based manufacturing supply chains have created digital business ecosystems which deliver collaboration and transparency. The adoption of communication standards (e.g. RosettaNet) further improves the opportunities for success. These electronic chains transform the supply chain from the buyer sending orders and the supplier fulfilling the request into integrated supply chains, in which

---

1 Radio-frequency identification (RFID) is the use of a wireless non-contact system that uses radio-frequency electromagnetic fields to transfer data from a tag attached to an object, for the purposes of automatic identification and tracking.

2 With the kind collaboration of Usva Kuusiholma, Aalto University - School of Science
buyers and suppliers continuously exchange many types of information regarding forecasts, production plans, capacity constraints, and performance objectives. Thus, they have evolved from traditional supply-side concerns (i.e., supply chain) to demand creation by providing attractive features, which support the generation of demand (i.e., demand-supply chain). These processes are managed by cross-functional teams, including participants from logistics, production, purchasing, marketing, and research & development. The benefits made possible by reviewing supply chain management activities under the process-focused lens can be replicated and transferred to the financial flows that constitute the financial supply chain. This requires new concepts for the management of the instruments that make up the SCF portfolio and enable a shift from financing order-to-cash activities to financing a more information-intensive and event-based collaboration.

2.5 From SCM to SCF - trends and drivers

It is important to understand the key trends and drivers in the SCF market:

1. SCF practices initially focused on cross-border east-west trade where the relationship between buyers and suppliers was typically characterised by a balance of power in favor of the former. Large international buyers offered financial support to their small suppliers in exchange for a better purchase price. The application of supply chain finance instruments is now more widely used including at domestic and regional level with the main objective of securing business continuity and flows of supplies as well as financing sales growth on the side of the supplier.

2. Order to cash cycles are have lengthened in many cases and large buyers have sought to squeeze suppliers by increasing payment terms. SME and emerging market suppliers are consequently vulnerable to constraints in the availability of finance and working capital through traditional channels.

3. The SCF market is still evolving - it is a competitive business and business undertaken is covered by customer confidentiality and therefore sources of information are constrained and not widely in the public domain.

The receivables financing segment including factoring, invoice discounting and receivables finance in all its forms remains the largest segment with an estimated 60-70% market share (Figure 5). It is primarily domestic (although there is a growing cross-border segment), and is likely to experience steady growth. Banks, bank owned subsidiaries and a variety of non-bank financial institutions are the main providers. Country practices vary widely.

---

3 Estimates derive from results collected through email survey, the views of the EBA SCWG and the authors’ experience
5. Buyer-centric SCF techniques, such as Reverse Factoring or Approved Payables Finance, represent less than 15-20% (estimates vary) of the market but have strong growth potential. Global banks are today mainly concentrated on the large buyer side of the trade equation and this is the heritage of the cleverly structured solutions engineered and provided by banks for large international trading companies. It will need a ‘tipping point’ to see these instruments take-off on a broad scale and eventually encompass SMEs. In particular the value of this SCF technique in stabilising the supply chain, directing liquidity to where it is needed, and creating a win-win situation for buyers and their suppliers is increasingly recognised.

6. Inventory and pre-shipment finance are more specialised and not widely practiced outside certain industries and the commodity markets. These practices hold perhaps a 5-10% share in market size.

7. The development of ‘four corner’ models may enable a further acceleration of volumes of SCF transactions as providers cooperate to extend reach into new populations of potential users.

8. International trade finance based on classical documentary instruments is in relative decline, but should not be under-estimated in terms of importance in Asian and emerging markets. LCs still have a key role to play in respect of ‘big ticket’ transactions especially where control of goods as collateral is critical to the acceptability of the risk. The LC business has benefited from greater automation and the use of electronic processes.
9. Banks provide funding and payment/transactional support, although liquid
customers and non-bank financial institutions also provide financing services
and create market liquidity- a secondary market is strongly developing.

10. Collaboration services, e-invoicing service providers, automation platforms,
software and ERP vendors are proving themselves to be a valuable
complement in supporting market growth. Partnering is common.

11. It has been already demonstrated that there are many opportunities stemming
from supply chain management activities such as production planning,
forecasting customer demand, inventory management, and distribution
planning, that can expand the reach of the supply chain manager’s
responsibilities and which can trigger opportunities for SCF.

12. Banks are increasingly motivated to investigate SCF based on a contraction of
traditional payment fees arising, the need to optimise the use of Risk Weighted
Assets and identify additional sources of revenue in the working capital cycle.

2.6 SCF key statistical indicators

According to market research⁴, the aggregated European invoice finance market,
including factoring and invoice discounting, supply chain finance (equating to approved
payables finance as defined herein) and trade receivables securitisation, as well as
other techniques such as forfaiting, and distributor finance, was worth over EUR 1
trillion in 2011.

This represents some 8% of EU GDP and more than 8% of total bank lending. It is five
times the volume of leasing transactions. Growth of the market has been over 10%
p.a. since 2009, and this growth is expected to continue.

Another market research publication refers to the recognition of the importance of
optimum liquidity management and estimates that SCF (approved payables finance)
growth rates in developed countries could be from 10 to 30% and in developing
countries from 20 to 25% p.a. (source: Aite Group).

In a presentation to the ICC Supply Chain Finance Conference in October 2012, a
speaker noted the consistently low impairment rates experienced with invoice-based
finance compared with conventional corporate loans. At the same event Factors Chain
International reported that its Import ‘Two-Factor’ (cross-border) business grew
strongly in 2011 in the USA and Europe (except in the UK and Spain, which are
already mature factoring markets). Looking at Export Two- Factor activity, Asia shows
huge growth especially in Turkey, Taiwan, Hong Kong and China (the latter at over
200% in the first half of 2012, as China increasingly adopted the factoring model).

⁴ Demica Reports- Issues n.15,16, May-October 2012
2.7 Factors driving SCF adoption

A large number of drivers are encouraging the growth of SCF:

1. Open account trading and lengthened supply chain cycles are promoting SCF demand as are often quoted constraints on traditional bank finance such as overdraft. These two factors are highlighting the need for alternative sources of finance and efficient credit structures.

2. As credit spreads have widened there is more scope to develop new approaches to pricing these alternative structures. On both the supplier and buyer side, the availability of working capital throughout the supply chain is a key issue. Manufacturers and retailers operating towards the end of the physical supply chain are able to act as a catalyst for enhancing financial supply chain efficiency for upstream supply chain participants involved in raw material sourcing, processing and refining functions. Dynamic markets especially in emerging countries in Asia and Latin America represent further opportunities for SCF adoption given their trade focus, especially those in high interest rate environments. Indeed it will be a litmus test for open account based SCF instruments that they find favour in Asian markets in particular, but also across the spectrum of emerging economies.

3. Receivables finance is already well-established and growing- some mature markets such as USA, UK and Italy being ahead, of markets such as Germany, where other forms of finance are more common and many developing economies where capability is not evolved. There are opportunities for technology transfers to new markets.

4. Buyer-centric SCF supports the objective of de-risking the supply chain and relieves suppliers, many of whom are SMEs, of the complexity of arranging their own SCF solution. Leveraging the credit strength of highly rated buyers seems a sensible and untapped opportunity.

5. Pre-shipment finance can be facilitated through SCF, although this is largely an aspiration at this stage outside specialised commodity finance structures.

6. Although traditional documentary trade finance is in relative decline, the benefits of its related globally standardized risk mitigation, finance and settlement infrastructure remain valid. This infrastructure can be leveraged and further developed in the open account space through the emergence of SCF enablers such as the Bank Payment Obligation.

7. Supply chain automation techniques, transparency and routine data availability can be transformed into valuable information or ‘triggers’ for SCF offerings.

8. Many of the institutional ingredients are in place, well-connected supply chains, willing financial institutions and other essentials such as B2B automation platforms and networks. The latter are capable of supporting a widening out from a niche business based on large value transactions to a widespread SME support based on automation, especially e-invoicing.
2.8 There are some constraints and challenges for SCF growth, but they are not insurmountable

The potential constraints and challenges is a long list, but provided they are actively managed they are not insurmountable:

1. Most businesses are still attached to core banking relationships and to traditional forms of credit, which dwarf SCF transaction volumes. Gauging the real and feasible demand for alternatives such as SCF remains elusive, although growth trends are encouraging.

2. There is lack of a clear market terminology and standards for key concepts and definitions needs to be addressed. There is confusion as to what SCF encompasses making widespread SCF adoption difficult to measure. There is no well-articulated generic value proposition for SCF in a highly fragmented market.

3. Leaders in a growing field are less likely to support moves to integrate ‘laggards’ through market cooperation, even if overall market enlargement would benefit them. There is a trade-off to be made between tailored solutions and standard market products.

4. Risk, regulatory, tax, VAT, and accounting issues need to be understood and managed so as to remove uncertainty. The risk- based capital allocation rules applicable to SCF are still evolving. Accounting treatments need to be carefully planned to avoid reclassification of trade obligations into bank debt.

5. There is a challenge to on-board suppliers onto automation platforms and to meet KYC requirements. There is a danger inherent in too many proprietary platforms and more attention could be paid to the collaborative space and open models, so as to save users the complexity of managing too many platform connections. This raises an issue of scalability of SCF solutions based on so many existing platforms.

6. Credit availability and balance sheet capacity remain key requirements and are subject to uncertainty. Confidence in continuing credit availability needs to be built if SCF is to attract regular users.

7. There is a complexity factor with many individuals needing to collaborate and coordinate the ‘moving parts’ within financial institutions; various product silos, and management relationship groups need to be coordinated- a challenge in large and complex organisations especially with the global dimension demanded by SCF. Customer education, long sales cycles and systems integration are demanding areas especially if short term profit goals inhibit investment.

8. Corporate buyers and suppliers need to work together and share the benefits- in so doing they must try to eliminate the tension often present in supplier/buyer relationships; this is a pre-condition for success. Both supplier and buyer need to perceive a tangible benefit from such interactions.
9. Industry collaboration and governance is presently quite fragmented and requires improvement to address non-competitive issues such as standards, infrastructure, and market rules.

10. There is not as yet a deep secondary market for SCF assets that are generally heterogeneous, unrated and not well understood by potential institutional investors. There is clearly growing activity and there is a growing appetite for such assets. Most secondary market activity is bilateral or accomplished through specialist intermediaries, both evidence of an ‘early stage’ market.

2.9 Impact of SCF for SMEs

Small and Medium-sized enterprises (SMEs) are facing tough credit constraints and yet require sources of credit and liquidity. Recent developments such as the latest Late Payments Directive (2011/7/EU) and measures taken at country level to accelerate supplier payments testify to the seriousness with which this problem is regarded. SCF has a potential role to play.

1. SMEs credit risk is typically more challenging to assess than that of larger businesses. Consequently many have struggled to gain the access to traditional forms of finance.

2. Banks’ appetite to lend to small businesses has diminished, as a result of deteriorating credit quality caused by the economic downturn. This has had a fundamental impact on the ability of small businesses to grow.

3. Through supply chain finance, logistics, it is possible to achieve ‘win-win’ situation between core enterprises and their SME partners.

4. SCF enables banks to support SMEs at a level that is more commensurate with their trading activity. By contrast, traditional forms of bank finance are primarily dependent on the SME’s balance sheet strength, security values and the value of supporting guarantees. Finance availability is, therefore, constrained by factors that are unconnected with an SME’s trading activity.

2.10 Stakeholder landscape

The objective of the following brief description of the main market segments involved in SCF is to frame the market in terms of what solutions are currently available, what players are involved, and what roles each plays. An illustrative listing of the most active players in the SCF ecosystem is provided. The firms quoted are assigned to the category where major activities are undertaken, although they may also carry out other functions. The lists are illustrative and non-exhaustive.

2.10.1 Banks

SCF instruments are not new to banks as the vast majority have been inherited from trade finance practices.

1. The added value of financial institutions is not so much in creating new product structures, but in understanding how can they be best combined and offered in
2. Financial institutions are evidently the most advanced and mature players in the SCF arena. The analysis of how they are shaping their SCF strategy proves that SCF requires continuous improvement in three specific ways:
   a. Technology (e.g., the portal and supporting platforms)
   b. Activities (i.e., the processes of the physical and financial supply chains being impacted)
   c. Organization (i.e., the role and functions, and the performance criteria of the people involved).

The following is a (non-exhaustive) list of globally active banks in the SCF market:

- ANZ
- Bank of China
- Bank of Tokyo-Mitsubishi
- Barclays
- BNP Paribas
- Citi
- Deutsche Bank
- HSBC
- ING
- J.P. Morgan,
- RBS
- Santander
- Scotia Bank
- SEB
- Standard Chartered
- Unicredit

These institutions are complemented by a large number of local and regional banks who provide SCF solutions on a stand-alone basis or in partnership with other banks and non-bank providers. Among these, examples are Nordea, KBC Bank and Commerzbank.

2.10.2 Non-bank financial providers

A number of multinational groups have financial arms active in the SCF space e.g.:

- GE Capital
- Siemens Financial

Other active players are:
Factoring companies, such as Bibby Financial Services, and CIT, although the vast majority of Factors are bank-owned or affiliated.

Insurance companies, mainly as secondary lenders and investors

Credit Card providers based on the Purchasing Card and related services

There is a new breed of “peer-to-peer” lending operators. These new providers allow their clients—especially small businesses—to obtain access to finance through a web-portal.

- Funding Circle
- Market Invoice
- RiverRock
- The Receivables Exchange

2.10.3 Solution Providers

These players are generally known as software application and IT vendors, with experience in payments, cash management, workflow automation, and systems integration.

Vendors are close to the pulse of the market and are automation-centric by nature. For this reason, financial institutions seek their advice and partnership to address market opportunities, such as paper-to-digital transformation.

A few selected company names of these solution providers are provided below:

- ACI Worldwide
- Bottomline Technologies
- CGI/Logica
- Fundtech
- IBM
- Misys
- Oracle
- Polaris
- Premium Technology
- SAP
- SIA / RA Computer
- SunGard
- Taulia
- Tieto

2.10.4 B2B networks and e-invoicing service providers

Collaboration is a key aspect in the success of SCF programs. The possibility to exchange electronically purchase orders and invoices dramatically enhances the opportunity. These operators may offer solutions in their own right but more commonly in partnership with banks and financial institutions.
A short (non-exhaustive) list of players in this space is provided below:

- Ariba/SAP/ B-Process
- Basware
- GXS
- Itella
- OB10

2.10.5 Marketplaces and hubs

Some vendors go beyond the development of enterprise applications and deploy platforms that enable collaboration among all players in the SCF eco-system: users, buy-side and sell-side financial providers, and other supportive actors. The platforms provide the necessary “hub” that interconnects the systems of the various constituents in a “plug-and-play” fashion (even though such ease of connectivity is yet to be fully accomplished).

A few names of players in this domain:

- Asyx
- Bolero
- Corporate Linx
- Demica
- GSCF
- Lighthouse BCS
- Orbian
- Prime Revenue
- Syncada
- TradeCard

2.10.6 Consultants and analysts

Historically, this family of players has been involved in consulting and implementation services in relation to strategy, market research, business models, marketing and systems development. They include:

- Aite Group
- Bain
- Capco
- CapGemini
- Gartner
- McKinsey
- Oliver Wyman-Celent
- Tower Group
2.10.7 Logistics services providers (LSP)

These players have visibility of the goods in the physical supply chain, which can dramatically reduce the risk associated with their financing. This permits tracking, transparency and visibility, and collateral evaluation. As effective operators they are sometimes seen as having the potential to disintermediate banks, although in most instances they are seen as valuable partners. In particular they can be the source of the triggers that enable SCF to be ‘event-driven’.

2.10.8 Industry associations

In traditional trade, rules and practices have evolved over many years, providing an established framework (e.g., UCP600\(^5\)) for banks to work with one another, and helping to reduce the risk of fraud and dispute. Industry and trade associations provide a shared cooperative infrastructure for market participants to exchange information, and develop standards and market practices. In open account, which constitutes the usual trade exchange condition for SCF, the market has so far lacked established rules, practices, infrastructure, and standards or at least these have been fragmented and inconsistent. There is a recognised market need for more formal rules and market practices, technical specifications and exchange standards for various business messages.

Leading industry associations in SCF are:

**ICC**

The Banking Commission of the International Chamber of Commerce (ICC-\[http://www.iccwbo.org/\]) is a global rule-making body for commerce and the banking industry and has become a worldwide forum for trade finance experts whose common goal is to facilitate international trade finance.

ICC and SWIFT signed a cooperation agreement in September 2011 that will enable industry-wide adoption of the Bank Payment Obligation (BPO). A first output of the cooperation between the two association bodies is a series of common financial product definitions adopted by corporations in their trade operations. The objective is to provide standard rules and market practices for open-account products.

**BAFT-IFSA**

The Bankers’ Association for Finance and Trade-International Financial Services Association (BAFT-IFSA- \[www.baft-ifsa.com\]) was formed by the merger of The Bankers’ Association for Finance and Trade (BAFT) and the International Financial Services Association (IFSA). It operates under the umbrella of the American Bankers Association. BAFT-IFSA is a global financial services association providing advocacy, education, and community-building opportunities for financial services institutions and

\(^5\) UCP 600 is the latest revision of the Uniform Customs and Practice that governs the operation of letters of credit.
suppliers around the globe. In December 2010\textsuperscript{6} the association published two
documents: BAFT-IFSA Product Definitions for Traditional Trade Finance, 2010 and
BAFT-IFSA Product Definitions for Open Account Trade Processing and Open Account
Trade Finance, 2010. The purpose of the papers was to build a framework of
definitions that provided structure and common terminology for key processing and
financing services. The association also conducts a Global Trade Council, various
regional groupings and organises conferences and seminars.

**SWIFT**

The Society for Worldwide Interbank Financial Telecommunication (SWIFT-
\url{http://www.swift.com}) is a member-owned cooperative through which the financial
world conducts its business operations with speed, certainty and confidence. More
than 10,000 financial institutions and corporations in 212 countries trust SWIFT every
day to exchange millions of standardised financial messages. This activity involves the
secure exchange of proprietary data while ensuring its confidentiality and integrity.

It provides the proprietary communications platform, products and services that allow
its users to connect and exchange financial information securely and reliably. It also
acts as a catalyst that brings the financial community together to work collaboratively
to shape market practice, define standards and consider solutions to issues of mutual
interest.

Aside from handling messages for the execution of traditional trade transactions Swift
has created the TSU, a matching and workflow engine for open account transaction
data. Since March 2009, it includes the BPO, an irrevocable conditional undertaking to
pay given by one bank to another.

**INTERNATIONAL FACTORS GROUP**

The International Factors Group (in short: IFG or IF-Group- \url{http://www.ifgroup.com})
was founded in 1963 as the first international association of factoring companies. The
original mission of IFG was to help factoring companies to conduct cross-border
business acting as correspondents for each other. This is still the core activity of IFG
today, which acts primarily as the representative trade association for the factoring and
the asset based finance industry, with an important focus on education and events,
industry information and regular news and newsletters. Both IFG and Factors Chain
International below have developed a set of rules (GRIF), which govern international
factoring.

**FACTORS CHAIN INTERNATIONAL**

\textsuperscript{6} Subsequently revised in May 2011.
Factors Chain International (http://www.fci.nl) is a global network of leading factoring companies, whose common aim is to facilitate international trade through factoring and related financial services. Currently the FCI network counts 264 factors in 72 countries, actively engaged in more than 80% of the world's cross-border factoring volume.

EU FEDERATION FOR THE FACTORING AND COMMERCIAL FINANCE INDUSTRY

The EUF (http://www.euf.eu.com) is the representative body for the Factoring and Commercial Finance Industry in the EU. It comprises national and international industry associations that are active in the EU. The EUF seeks to engage with Government and legislators to enhance the availability of finance to business, with a particular emphasis on the SME community. The EUF acts as a platform between the factoring and commercial finance industry and key legislative decision makers across Europe bringing together national experts to speak with one voice. It publishes glossaries of relevant terms and concepts.

INTERNATIONAL FORFAITING ASSOCIATION

The International Forfaiting Association (IFA- http://www.forfaiters.org), is the worldwide trade association for commercial companies, financial institutions and intermediaries engaged in forfaiting. Founded in August 1999 and with more than 140 members the IFA aims to foster business relationships and enable best practice among those engaged in the ever-expanding, global forfaiting community.

OTHER ASSOCIATIONS AND INITIATIVES

Other noteworthy industry organisations and associations that contribute to the development and awareness of SCF-related matters are:

- ACT (http://www.treasurers.org)
- EACT (http://www.eact.eu/)
- EBA (https://www.abe-eba.eu/)
- EESPA (http://www.eespa.eu/)
- ISCFC (http://www.scfcommunity.org)

2.10.9 Role of governments and public sector in SCF

Governments in both developed and emerging economies often take specific policy actions to support SCF development. The availability of bank credit to support businesses has become a political issue and the techniques of supply chain finance have been mentioned in that connection.
Public authorities may intervene to meet the challenge faced by many small and midsize enterprises in raising working capital finance for example based on their accounts receivables from creditworthy customers or other qualifying assets. Bank loans secured by accounts receivable (a primary source of SME financing in the United States and Europe) is often unavailable in emerging markets as the latter may lack the necessary infrastructure or access to commercial credit information. Encouraging developments are happening.

Governments often take a lead by improving liquidity in the corporate credit market through special funding programs or acting to enhance credit quality or by making purchases of high-quality, private-sector assets. These securities could be transaction-specific under export/import programs and may be evidenced by a variety of underlying instruments, such as letters of credit, trade-related promissory notes, and bills of exchange. Suppliers can develop confidence that businesses that sign up for these programs will be more likely to pay within clearly defined terms, and that there is a proper process for dealing with any payments that are in dispute.

Special local and state initiatives support trade credit insurance at rates of premium that are normally available only to companies with significant trade volumes. This provides additional capacity for short-term trade credit insurance against a buyers' default in order to promote trade flows.

Governments are also active in promoting automation such as e-invoicing both in general and for public procurement and taking measures to encourage prompt payment and remove late payment especially to smaller suppliers.

The most noteworthy examples of constituents of this segment of SCF players are:

- Central and regional government authorities
- Export Credit agencies
- Small business guarantee programs
- Government e-procurement and e-invoicing projects
3 Towards a clear conceptual language and common set of definitions for Supply Chain Finance

This chapter describes and evaluates the main categories of SCF instrument and makes a number of recommendations for improvement of the common conceptual language and definitions.

3.1 Definitions- More clarity needed on definitions of supply chain finance and its components

There is a need to take care with the language and terms used by practitioners and drive a move towards much greater clarity. Clear terminology and a common conceptual language remain elusive starting with the definition of SCF itself:

1. One variant describes SCF as simply the “interaction” of physical supply chains for goods and services with the financial supply chain of decisions and financial processes such as credit, invoicing and payments

2. Another talks about optimising “working capital management, cost and transactional efficiency” along the supply chain.

3. Others talk about the “portfolio” of transactional supply chain finance structures

More recently others refer specifically to buyer-led programs to provide liquidity to their critical supply chain partners as being the sole definition of SCF.

Supply Chain Finance is usually described as “a portfolio or series of financial practices and technologies that support the trade flows and financial processes of end-to-end business supply chains”.

The EBA SCWG supports this description and further proposes that Supply Chain Finance is defined as “the use of financial instruments, practices and technologies to optimize the management of the working capital and liquidity tied up in supply chain processes for collaborating business partners. SCF is largely ‘event-driven’. Each intervention (finance, risk mitigation or payment) in the financial supply chain is driven by an event in the physical supply chain. The development of advanced technologies to track and control events in the physical supply chain creates opportunities to automate the initiation of SCF interventions.”

Within this definition of the SCF, the following financial instruments are included:

- Accounts Payable or Buyer-centric – called ‘Approved Payables Finance’ or sometimes ‘Reverse Factoring’, ‘Supplier Finance’ or ‘Confirming’, and sometimes (confusingly) simply ‘Supply Chain Finance’, and based on the discounted payment of accounts payable in favour of suppliers by accessing a financial institution's or a buyer’s own liquidity. Another related instrument is
Dynamic Discounting, through which a buyer itself provides variable discounts for early payment of supplier invoices.

- **Accounts Receivable or Supplier-centric** – such as Receivables Finance (the category term used in this guide), Receivables Purchase and Invoice Discounting (all three being common names for similar financing instruments) and Factoring, which is a form of Receivables Finance but different in character from those previously mentioned.

- **Inventory-centric (or ‘pre-shipment’)** – such as Purchase Order (P.O.)-based finance and Inventory Finance.

- **Bank Payment Obligation (BPO)** – an interbank instrument developed initially by SWIFT (as a development arising from its SWIFT Trade Services Utility) and now adopted by the International Chamber of Commerce (to be governed by ICC rules set out in Uniform Rules for the Bank Payment Obligation (URBPO) on the basis of which a variety of SCF transactional structures can be enabled).

- **Traditional documentary trade finance** – such as Letters of Credit, and documentary and related trade loans – summarised in an Annex.

- **Complemented by other instruments and enablers** e.g. other types of asset finance, longer term export and project finance, and hedging and payment instruments – not described in detail in this Guide.

All of the above instruments are illustrated by means of the umbrella diagram below.
Figure 6: The Complete Supply Chain Finance Portfolio

Supply Chain Finance

Accounts Payable-centric
- Approved Payables Finance (also known as Reverse Factoring or Confirming)
- Dynamic Discounting

“Other SCF”
- Pre-shipment or Purchase Order-based finance
- Inventory Finance (including Warehouse Finance)

Accounts Receivable-centric
- Receivables Finance
  - Receivables Purchase
  - Invoice Discounting
  - Factoring
  - Forfaiting

“Related”
- Documentary Trade Finance
- Bank Payment Obligation
- Asset-based Lending
- Payments and Foreign Exchange

Source: Bryant, Camerinelli

Whereas the categories of SCF and trade finance set out above are generally well accepted, the market for SCF is still evolving and the next levels of definition for SCF structures and components are not well established with the following consequences:

1. Even though similar solution structures are offered by leading banks, a truly common market terminology and joint understanding of their essential product features is an important requirement if SCF is to become widely adopted.

2. The lack of a generally accepted and consistent nomenclature complicates the understanding of the offered solutions by users and creates confusion among potential customers.

3. There must also be sufficient room to allow individual competitors to create differentiated products within a common market terminology; both are necessary.

In response, banking associations and organisations have already started to build glossaries and bodies of knowledge to support their membership and associates in adopting a common language. The most noteworthy and active is BAFT-IFSA, the US-based global association for organizations actively engaged in international transaction banking.
Supply Chain Finance  
European market guide

The EBA SCWG has concluded that, with the exceptions set out below, the terms and definitions elaborated by BAFT-IFSA for trade finance and supply chain finance instruments are worthy of support and do indeed reflect the experience and acceptance of a large community of organizations actively engaged in international transaction banking. Therefore the EBA proposes the adoption as far as possible of the existing terms and references developed by the BAFT-IFSA community members. A glossary of the most common terms used developed by BAFT-IFSA for SCF is set out in ANNEX 2 - BAFT-IFSA Definitions of SCF Instruments.

At a second level of detail, there is scope for a more precise convergence between the BAFT-IFSA definitions and the way this Market Guide has described the relevant financial instruments and the way other market participants use the terms. An important example is the European use of the expression Reverse Factoring to the exclusion of the term Approved Payables Finance; the latter is clearly a preferable description but it is not well known. Reverse Factoring is a common expression but not very accurate or descriptive of the real context. Approved Payables Finance should become the favoured terminology.

The International Chamber of Commerce Banking Commission (ICC) has created the industry standards for definitions of traditional documentary trade finance instruments, which command universal respect and adoption. ICC has recently been working with SWIFT on the definition of Bank Payment Obligation and a set of Uniform Rules for the Bank Payment Obligation and this is to be welcomed. For other open account based supply chain finance areas, ICC could no doubt apply its recognised rule-making capabilities to further areas of opportunity; a by-product could be greater ‘portability’ of solutions without impinging on competitive aspects.

For Factoring, the International Factors Group (IFG or IF-Group) body provides definitions and common terms, as does the Factors Chain International Group and the EU Factoring Federation. The EBA SCWG accepts the terminology of these organisations as industry standard. There may be some scope however for the convergence with other industry strands as different parts of the finance industry delivers SCF solutions.

Value exists in describing the various categories of SCF techniques and this Market Guide attempts to provide these descriptions at some length. The EBA SCWG believes that such descriptions will support the process of market convergence.

It is recommended that a representative international stakeholder group or Round Table be formed to develop further convergence in definitions and terminology. EBA SCWG members are willing to support this process.

There now follows a description of the main categories of SCF instrument, which are open account based and most particularly event and data driven:

3.2 Approved Payable Finance

3.2.1 Description

Approved Payables Finance (also called Reverse Factoring) allows a Supplier to receive a discounted payment of an invoice or account payable due to be paid by a supplier on

Towards a clear conceptual language and common set of definitions for SCF
Buyer. The Buyer approves the invoice for payment and separately finance is raised against the payable by the Supplier from a bank or other finance provider, who relies on the creditworthiness of the Buyer without recourse to the Supplier. The Buyer pays at the normal (or an agreed) invoice due date, although the Supplier has received a discounted payment through the financing facility.

The bank relies on the creditworthiness of the Buyer and the attraction to the Supplier is based on an ‘arbitrage’ between the higher credit rating of the Buyer and the typically higher cost of financing for the Supplier, as well as the attraction of the availability of the finance.

The Spanish market regards itself as the ‘home of Confirming’, which resembles Approved Payables Finance in all significant respects. In Spain, confirming transaction volume exceeds that for traditional factoring and is mainly carried out for domestic transactions. Its advantages are held to include simplicity, minimal documentation and no need to include whole turnover as is the case with traditional factoring. Given the exclusion of confirmed transactions from whole turnover factoring there can be some tension between providers of the two instruments.

3.2.2 How it works

There are two main models for the provision of Approved Payables Finance:

In the first model, a Buyer will establish an umbrella Approved Payables Finance program with a bank or other finance provider and agrees what payables will be eligible for financing and what payables information will trigger the process.

Invoices are presented either in paper or electronic form to the Buyer in the normal way. The Buyer approves the invoice for payment and creates the usual entries in the accounts payable ledger. The Buyer then provides the bank with a schedule of accounts payable due and approved. In the latter connection either the Buyer establishes a specific list of approved payables/future payments due, or makes available its accounts payable invoice database in a web-portal. At this stage the Suppliers who are the creditors for the invoices due may be offered finance (often through an automated SCF platform - either built in-house or white-labelled) and the Supplier identifies the accounts payable it would like the bank to finance. Suppliers may be given discretion as to which individual approved payables to be financed or to elect an automatic finance option for all its approved payables (subject to an availability control).

The bank then purchases the payable on a sale (or assignment) basis without recourse to the Supplier. The bank becomes the trade creditor to the Buyer and relies on the Buyer’s responsibility to settle with the bank at maturity. The Buyer is not a party to the financing arrangement. The bank agrees the discounted amount to be paid, makes the payment to the Supplier and arranges for its settlement by the Buyer on the agreed due date of the payable.

A typical Buyer requirement is that the Approved Payable Finance solution is structured from a legal and accounting perspective such that the treatment of trade creditors remains unaltered (i.e. the liability doesn’t become reclassified as ‘bank debt’). This is often referred to as being ‘balance sheet neutral’. It is usually important, therefore that the financing of the Supplier is at ‘arms-length’ from the Buyer. The
Supply Chain Finance
European market guide

finance usually has to be requested by the Supplier – hence the need for an on-boarding process to ensure that the eligible Suppliers are configured on the SCF platform and have been subject to an appropriate ‘Know Your Customer’ (KYC) check.

Whenever the financing value is particularly large the instrument may leverage the financing capacity of several banks/financiers to meet the overall funding requirement. Financings for the same ultimate obligor and conditions may be syndicated among a number of banks and finance providers. Such syndications are a growing feature of the market.

In this first model, banks are typically the main providers and work with a creditworthy buyer to identify a list of strategic suppliers falling within the top 10% or perhaps 20% of the supplier base. These suppliers are offered finance in the way described above and on-boarded onto the bank’s SCF platform. In so doing the bank meets the needs of the most critical suppliers, minimises on-boarding and KYC challenges, and undertakes transactions of sufficiently profitable size and quality. Among the main SCF providing banks this model appears to be gaining traction.

In a second model, the process is supported by an e-invoicing service provider or third party B2B platform, which provide services to the Buyer and Suppliers based on a service platform through which, following submission and safeguarding of suppliers’ financial data, approved invoices are displayed in the e-invoicing portal and appropriate messages are generated between the parties involved. Under such an arrangement the financing program is very much tied to the on-going invoicing process and the various information flows are ‘joined up’ and fully integrated in the e-invoicing portal. An attraction to the financier of this model is that large numbers of suppliers will already be on-boarded for the invoice process and be available for SCF subject to any additional KYC process. By basing the process on an e-invoicing service creates some advantage in that the invoices are likely to be approved on an accelerated basis thus offering an enlarged ‘window of opportunity’ for a longer tenor financing.

Under this second model, proponents see the potential to extend it to support the liquidity needs of a much broader base of SME suppliers including the ‘long tail’ of small suppliers. This has the advantage of supplying credit to a sector where credit capacity remains constrained, and where political demands for the supply of increased lending is called for repeatedly, and where lengthened credit terms are ‘squeezing’ the suppliers concerned. Despite issues of on-boarding, KYC, sub-scale transaction size, unknown demand (many SME’s saying ‘we just want to be paid not pay a discount for money that is legitimately ours already’), suggests a more complex environment, but based on the use of automation, there are those who are beginning to offer this service. There have been recent announcements from e-invoicing networks, such as OB10, and from the UK arm of Santander, and it is also of interest to the factoring industry, which is much more geared to the provision of finance to this segment. Clearly where interest rates for core lending products are already high, the room for manoeuvre is greater and in addition the increasing availability of official funding schemes for SME lending may also stimulate growth of this market.
3.2.3 Operational processes

To support this market enlargement, the importance of having an automated accounts payable process at the Buyer is a key success factor, as is the integration and scaled-up on-boarding of suppliers. The latter includes the on-boarding onto the platform that is used to communicate details of approved invoices/payables, and which enables the supplier to select which to finance and instruct the financing bank accordingly (including the perfection of the security).

There must also be an effective KYC process, as the financing bank will need to accept instructions from the supplier to undertake the discount, and such discounting will involve the assignment of the receivable, resulting in a need for a documented agreement between the supplier and the financing bank. The challenge here is that the supplier may not or will not usually have a banking relationship with the financing bank (other than by coincidence). From a compliance perspective, most banks will adopt a prudent stance and treat the supplier as the instructing party. In addition to executing appropriate documentation they will need to undertake a limited amount of company research (not full KYC) on each and every on-boarded supplier.

The following diagram illustrates an Approved Payables Finance flow:
The main source of information in Approved Payables Finance is an approved payable. As discussed above, the both models require that the Supplier to submit invoices to the Buyer. In the first model described above, the Buyer, provides a listing of amounts due to its Suppliers to the financing bank, who then independently assesses the transactions and makes an offer of finance to the Supplier.

The example illustrated in Figure 5 above is based on the second model described above and the use of an automated B2B platform, which could be provided directly by the financing bank or a third party or in combination. The processes described could support both the models described above. The basis for the approved payables finance is the underlying transaction between the Buyer and the Supplier (1). The invoice for the transaction is submitted to the Buyer by the Supplier (2), enabling the buying party to receive it into its enterprise resource planning (ERP) system (3). Electronic communication between the Supplier and Buyer is supported.

As soon as the Buyer has approved the invoice/account payable, the approval is communicated via the SCF platform (4), allowing the Supplier to see it. It is the up to the Supplier to either wait until the payment term expires and the Buyer pays the invoice, or to request finance from the bank (5). The bank receives this request via the SCF platform (6) and pays the Supplier for the invoices, withholding the agreed discount (7). When the agreed payment term expires, the Buyer makes a payment to the bank, after which all obligations have been met.
3.2.4 Benefits

The benefits of Approved Payables Finance to Suppliers can be summarised as:

1. Additional and flexible source of timely funding (liquidity)
2. Reduction of debt and Days Sales Outstanding (DSO)
3. Acceleration of accounts receivable at favourable rates
4. Cash flow optimization due to earlier receipt of funds (meeting Prompt Payment rules and expectations).
5. Improvement of liquidity planning due to transparency (Cash Forecast)
6. Existing Credit lines are not affected, although to the extent that receivables disappear from the balance sheet lenders may result in the adjustment of the level of facilities by lending bankers, especially as certain very credit worthy credits may disappear from the receivables portfolio.
7. Potential reduction in the overall cost of credit, since it is based on the credit risk of the Buyer.

The benefit to Buyers can be summarised as follows:

1. Strengthening of relationship with suppliers by ensuring certainty of supply (avoiding shortages of essential stock/components due to a supplier’s failure to deliver as a result of a lack of finding credit lines), and enabling the buyer to negotiate better terms, knowing that supplier has access to finance at favourable rates
2. Enhanced working capital effectiveness, integrated accounts payable, bundling payments and improved reconciliation processes
3. Incremental value creation from freeing up internal credit lines or internal risk limit.
4. The buyer can benefit from the savings possible by consolidating shipments. Using the available finance, the supplier can afford to ship larger consignments and the resulting savings may be shared with the buyer.
5. The trend towards even more intense globalization has meant that buyers have a strategic dependency on their suppliers and are now more inclined to treat them as partners. The provision of such a SCF solution supports such a partnership approach.

3.2.5 Important issues for consideration

To make an Approved Payables Finance program successful the following additional considerations need to be addresses:

1. The need for an international scalable platform(s) either deployed by banks directly or based on a partnership model to assure appropriate geographic coverage relevant to the location of the suppliers in scope
2. The need to clarify the accounting treatment of accounts payable financed (to avoid being re-classified as debt on the Buyer’s books) and therefore balance sheet neutral.

3. Legal clarification needed on the nature of the irrevocable payment instruction at maturity, the assignment of the invoices to a third party, confidentiality and tax issues.

4. Avoidance of the risk of “Double Finance”

5. A complex sales process is required in view of the multi-party nature

6. It is important to identify the value creation and arrive at a value distribution acceptable to the parties, who are collaborating

7. On-boarding as a key success factor needing careful management as described above.

8. The increasing prevalence of e-invoicing networks has far reaching implications for the supply chain finance market as there will be a critical mass of business transactions dematerialized and available in electronic form to feed SCF services supported by messaging and status/approval updates. E-invoicing is a ‘game changer’ and will permit more generalised use of Approved Payables Finance.

9. Similarly there is potential to integrate the process into electronic payment systems and take advantage of new platforms for SEPA payments (Single Euro Payments Area). In that sense SEPA is also a ‘game-changer’.

3.2.6 BAFT-IFSA definition

EBA SCWG accepts the BAFT-IFSA, definition of Approved Payables Finance and states a preference for this term, whilst recognising that the European market makes common use of the terms ‘Reverse Factoring’ and ‘Confirming’. It would be helpful for global market development if the single term Approved Payables Finance is used.

3.3 Dynamic Discounting

3.3.1 Description

Dynamic discounting offers suppliers the early receipt of accounts payable due from a buyer in return for a variable discount. Typically the funds are provided by the Buyer from its own liquid resources.

Discounts on invoices due offered by Buyers have usually been based on a “fixed” combination of discount value and payment date; the most frequently cited invoice discount scheme is “2/10, Net 30”: For an invoice due for payment in 30 days the supplier offers a 2% discount on the invoice face value, receiving in return an early payment in 10 days (i.e., 20 days earlier than contracted). The potential rewards for early supplier payments are great as the standard discount of 2% for payment within 10 days translates to an annual percentage rate of 36%. as a return to the Buyer. This
arrangement could be termed ‘static’ discounting and can be contrasted with ‘dynamic’
discounting discussed below.

Dynamic discounting eliminates the problem inherent in the cited 2/10, Net 30
arrangement where Buyers face the risk of not being entitled to a discount if the
invoice approval takes longer than 10 days. The alternative solution to static invoice
discount is dynamic discounting: This new form of invoice discount allows both buyers
and suppliers to propose terms by putting them on a sliding scale and opening them up
to negotiation, as shown in Figure 8 below. Buyers have the benefit of supporting and
stabilising their supply chain and achieving a return on liquidity that under current
market conditions will exceed returns on money market deposits.

Figure 8: Dynamic Discounting

Source: Camerinelli, adapted from Taulia,

At any point in time the Supplier and the Buyer may agree on the discount to be
applied to an applicable advance payment date- taking advantage of a range of
discounts depending on the interval selected. Clearly the addition of electronic
invoicing, which permits an acceleration of the invoice approval process, will allow the
Buyer to take advantage of the maximum discounts offered. The underlying IT system
takes care of providing visibility to the parties involved as well as ensuring the
contractual parameters (e.g., maximum discount allowed; minimum early payment
days) are met. This instrument requires a robust technology platform to run the
necessary calculations and negotiation process.

There are a number of technology providers that have created systems to support this
functionality which may also be integrated into ERP systems and e-invoicing platforms.
3.3.2 How it works

The main steps in a typical dynamic discounting arrangement are depicted below in Figure 9.

**Figure 9: Dynamic Discounting Process Flows**

Source: Taulia

Even though Dynamic Discounting is not a distinct SCF instrument offered by banks, the existence of the technique is of interest to them. For example, a bank might integrate into its cash management capabilities such as a dashboard for the management of dynamic discounting and the related liquidity, especially bearing in mind that a Buyer may have a seasonal trading pattern and require funding at some stage and being able to deploy its own liquidity at another.

3.3.3 Comparison with the definition from BAFT-IFSA

BAFT-IFSA does not provide any definition for this SCF instrument.

3.4 Receivables Finance
3.4.1 Description

Receivables Finance allows suppliers to raise finance on the basis of their receivables relating to one or many buyers and thereby receive early payment, usually at a discount to the face value although various pricing structures are used.

Receivables Finance arises in many forms and is subject to a wide variety of practices based on jurisdiction, country or industry practice and choice of instrument selected. The underlying receivables may variously be purchased, assigned, the subject of a security interest such as a pledge, discounted or otherwise structured as a financial transaction. The terms used by the industry are often overlapping and imprecisely defined.

Some key terms are:

**Receivables Purchase** is an instrument in which a bank enters into a financial agreement to purchase or discount receivables from a supplier typically without recourse to the latter. The purchase may or may not be disclosed to the obligor depending on circumstances. The supplier may remain responsible for collecting the proceeds at maturity. Such purchases may be made on a ‘silent’ basis or disclosed to the obligor, and there are a variety of pricing mechanisms.

With the receivables purchase model, the financing bank is usually dealing with one supplier (the bank’s customer) and one or multiple buyers. The financing bank purchases or takes an assignment of the receivables when the supplier’s invoices are created. Receivables purchase programs are typically structured on a ‘true sale’ basis to ensure off-balance sheet treatment for the supplier (i.e. the receivable is extinguished when the bank purchases the receivable, avoiding the recording of bank debt on the supplier’s balance sheet). In view of the performance risk issues, however, most receivables purchase programmes involve limited recourse to the supplier for example in the event of contractual dispute or insurance invalidity.

Many obligations are covered by bank guarantees, credit insurance or represent investment grade corporate risk, thereby permitting a 100% non-recourse transaction. Other transactions are based on a margin such as 80 to 90% of the invoice face value. There is often a focus on international or big-ticket business (>EUR 100,000) with maturities varying from 30 days to 7 years. New non-bank players are addressing a ‘small ticket’ market.

**Forfaiting** is invariably an internationally orientated activity, whereby a financing party purchases Promissory Notes, Drafts, Bills of Exchange or other paper claims on a Buyer and offered by a Supplier to a financier for discounting on a non-recourse basis. There is a secondary market for such claims and a quoted pricing system. Clearly since the receivables are ‘unapproved’ at the time of discount, considerable skill is needed to ensure the validity and provenance of such obligations in terms of risk of non-payment at maturity.

**Invoice Discounting** is often applied to a financing facility whereby a supplier offers receivables evidenced by an invoice for discounting by a bank or factor. The receivables concerned remain under the control of the supplier who collects the proceeds at maturity, and the arrangement is therefore undisclosed to the Buyer. The bank obtains title to the receivables and will usually advance a proportion of the face value.
value (75-90%). Discounts are calculated with reference to the current level of interest rates plus a margin. Invoice Discounting may be a term applied to the above described Receivable Finance/Purchase transactions, or may be used to describe business of a repetitive nature, which has some commonality with factoring (see below) and often provided by the same financing entity

**Factoring.** varies in scope but in its commonest form involves the factoring of the ‘Whole Turnover’ or at least a significant element of a seller’s portfolio of open account trading receivables representing typically corporate risk, as evidenced by invoices with payment dates not exceeding 180 days and on average much less. In such an arrangement the factoring of debts is disclosed to the Buyer, because the latter is required to pay the proceeds of factored invoices to the factor. Factoring may be provided on a recourse basis or with the benefit of credit protection, which places the risk on a non-recourse basis. Factors apply a number of practices and rules to establish the ‘factorability’ of a given portfolio and in order to set the margins of advance (75-90%) They charge fees for both the management of the receivables portfolio and any value-added services and the cost of funding. The level of cost is related to the quality of the parties and the scale of transactions.

Factoring is largely a domestic or regional service for SMEs, traditionally those drawn from certain industries where factoring is common or those with a reduced access to conventional bank lending. Indeed historically the use of factoring has carried a certain ‘stigma’ but in recent times factoring has grown substantially and has extended to cross-border factoring through chains such as Factors Chain International. Factoring techniques have also been broadened to accomplish very large transactions, some way away from the traditional factoring core and perhaps reflecting a desire for alternatives to traditional trade finance and bank lending at a time of credit constraints. Many Factors are themselves part of banking groups.

Factoring deploys a large number of control and anti-fraud measures, because at the time of financing (unlike with Approved Payables Finance), the likelihood of full payment of a particular receivable is not known with certainty. The considerations below can in many cases also be applied to the other categories of Receivables Finance described above.

The key risks are:

- Goods not yet shipped but invoices are presented for factoring/financing
- Invoices issued together with credit notes (effectively a cancellation of the invoice), of which the Bank/Factor is unaware
- Invoices are paid into another bank account and the Bank/Factor is not informed
- There is a commercial dispute between parties of which the Bank or Factor are not aware.
- Inaccurate information is transmitted e.g. an invoice of € 10,000 is reported to be € 100,000.
- A client fraudulently transmits a mix of correct and false invoices.
These are mitigated by the control of invoices presented and assigned by sampling and review of large amounts; by direct contacts with the buyer on a random basis; the active follow up of the collection of the portfolio of invoices and monitoring of amounts paid and received; and various dilution, ageing and concentration controls.

‘Factorability’ is an important concept. This relates to the ‘sell it and forget it’ nature of eligible products. Any debt in respect of on-going service or support contracts is usually not acceptable. A factoring company would also exclude ‘sale or return’ contracts or any contract that allows the buyer to offset return from previous orders from the current invoices being financed.

3.4.2 Operational process

In view of the wide variety of instruments presented in this Receivables Finance section the following transaction presents the operational process from a simple single transaction. Figure 10 provides an example based on Receivables Purchase of the flows involved.

Figure 10: Receivables Purchase Process Flows

Source: Adapted from IIG Capital

The bank makes cash advance to the borrower at the time of shipment and invoicing against a percentage of the receivable value (80-100%).
The bank is repaid at the maturity of each individual transaction. All payments flow through the collection account controlled by the Supplier in accordance with the terms defined in the invoice. The maximum payment term for each transaction is contractually established from the agreed date. Funds repaid may be re-borrowed depending on submission of new receivables and the availability under a revolving credit facility.

Similar operations processes can be illustrated for the other types of Receivables Finance mentioned above but are not provided in this Market Guide as they are commonly available through the relevant industry associations.

3.4.3 Important issues for consideration

The scope of supplier-centric receivables finance is very broad and is an area where banks have been present for a long time. As a guide to the process of establishing soundly based receivables finance programs, the EBA SCWG suggests the adoption of a decision-tree framework based on a number of parameters/attributes. An example of such a decision tree is provided below.

| Receivables Finance Decision Tree - parameters to be taken into consideration |
|---------------------------------|----------------------------------|
| Initiator of the program        | Quality and standing of the Supplier |
| Risk                            | 1. With recourse to the Supplier or |
|                                 | 2. Wholly on the Buyer risk without recourse to the Supplier |
|                                 | 3. Not just a matter of credit risk, performance risk of both parties also must be evaluated. |
| Underlying instrument used for the financing | Open Account (OA) receivable, Bill of Exchange, Promissory Note |
|                                 | This Guide concentrates on OA receivables |
| Recurring nature of the requirement | Is there a continuing flow of activity or is it on a one-off basis on specific transactions only? |
| Credit enhancement              | Are there options to enhance the credit risk so as to provide additional guarantee/confirmation/credit insurance to give comfort to the bank? |
| Type of legal instrument for collateral | Purchase, Assignment, Pledge or other type of security interest? |
| Flexibility                     | Does the supplier wish to finance all receivables (whole turnover) or is it at the option of the parties transaction by transaction? |
### Geographic scope
- Domestic, Regional or Global/Cross-Border

### Notification to the buyer
- What is the level of interaction with the buyer? Silent or non-silent. In some jurisdiction there are specific rules covering disclosure and non-disclosure.

### Type of collection
- Who and how - Is the supplier acting as a collection agent for the bank. Or does the bank undertake the collection or a combination?

### Financing margin
- To establish initial advance against the receivable e.g., 60-90%?

### Technology
- Could be on a manual basis or automated/ semi-automated?

In some circumstances the receivables might be sold into the secondary market where investors seek to play in new funding opportunities. Receivables Finance has an attractive value proposition due to the nature of the collateral represented by acceptable receivables.

### 3.4.4 Comparison with the definition from BAFT-IFSA
The description in the BAFT-IFSA document reads that “Receivables Purchase allows suppliers to sell their receivables/drafts [...] to their bank to receive early payment”. EBA SCWG finds that this description is perhaps too specific and narrow, as there are many jurisdictionally specific methods for securing a bank's interests including purchase, assignment, pledge and executing another type of security interest. Therefore the BAFT-IFSA description is accepted with a proposed amendment that “sellers to sell their receivables” is replaced with “sellers to sell, assign or otherwise create a security interest in their receivables”. The generic term Receivables Finance may be more useful than Receivables Purchase as an overarching term.

### 3.5 Pre-shipment or Purchase Order-based finance

#### 3.5.1 Description
Also known as “pre-shipment finance” is made available to a Supplier based on a Purchase Order received from a Buyer. This financing covers the working-capital needs of the Supplier, including raw materials, wages, packing costs, and other pre-shipment expenses in order to allow it to fulfil delivery against the relevant Purchase Order. The Supplier's bank provides finance to the Supplier treating the Purchase Order as evidence of a good source of repayment.

#### 3.5.2 Benefits
This service allows the Supplier to raise finance against a specific order created by a Buyer. It requires a significant evaluation of the performance risk which is placed...
squarely on the Supplier. The source of repayment is the Supplier’s ability to perform against the Purchase Order, together with the Buyers undertaking to pay on delivery of the goods. The benefit to the Buyer is to have certainty that a Supplier will be financially supported during the production and delivery process.

Commentators on the SCF market expect this instrument to grow in importance as the necessary information flows and monitoring tools are put in place to form the ‘events’ and ‘triggers’ required in such an open account situation.

3.5.3 Operational process

The events that trigger the need for a PO-based financing solution (Figure 11) are:

- When the PO is issued by the Buyer
- When the PO is approved by the Supplier

**Figure 11: PO-Based Finance Process Flows**

1. The Buyer issues a Purchase Order to the Supplier
2. The Supplier accepts the PO and advises the Buyer
3. The Supplier submits the PO to its bank and requests financing
4. The bank evaluates the proposition and evaluates the amount of finance to be offered

**Source:** Bryant, Camerinelli

1. The Buyer issues a Purchase Order to the Supplier
2. The Supplier accepts the PO and advises the Buyer
3. The Supplier submits the PO to its bank and requests financing

4. The Supplier’s bank evaluates the proposition and evaluates the amount of finance to be offered, the relevant terms, and the monitoring process to be applied (i.e., ‘events’ and ‘triggers’). The Supplier’s bank may or may not seek security over the assets being transformed by the Supplier.

5. At the request of the Buyer, the Buyer’s bank may establish a Letter of Credit (or a Bank Payment Obligation- BPO) to cover the payment for deliveries under the Purchase Order when they are made. This is not a prerequisite for PO-based Finance as the Buyer’s ability and willingness to pay for deliveries may be sufficient.

3.5.4 Important issues for consideration

This form of SCF presents a relatively high risk due to the material nature of the performance risk represented by the Supplier’s inability to deliver. This requires a high level of monitoring by the Supplier’s bank during the production and delivery cycle.

The risk of non-payment after successful delivery can be mitigated by the use of a Letter of Credit or a BPO. In any case, if the Buyer is a strong credit-worthy entity, its ability to pay will not be questioned. From a risk evaluation point of view, a solid business partnership between Buyer and Supplier will improve the likelihood of the positive outcome based on the high level of trust and reciprocal business interdependency between parties. The banks involved need to have sound business relationships with the parties involved as well as a good knowledge and visibility of the underlying supply chain processes underpinning the particular Purchase Order.

For Purchase Order-based finance the intrinsic risk is higher than invoice-based techniques because the lender is engaged with the very early stages of the supply chain transaction. The bank will need structured contract documentation with the customer to mitigate risk together with the use of instruments such as letters of credit or guarantees (i.e., standby LC) and other title instruments. It is also an area where the recently developed Bank Payment Obligation (BPO) has particular application. There must be controls to mitigate the risk of receiving inaccurate data from the customer and ensuring that the location of goods and their shipping status is always known.

3.5.5 Comparison with the definition from BAFT-IFSA

BAFT-IFSA asserts that the SCF instrument “made available to a seller based on a purchase order received from a buyer” is called “Pre-Shipment Finance”. EBA SCWG would clarify that Purchase Order finance is currently the most common example of pre-shipment finance.

The BAFT-IFSA definition reads: “The buyer’s bank issues its commitment to pay the seller (at sight or at maturity) once the seller ships and makes available the required documents that match the purchase order and other stipulated conditions. This service allows the seller to take the risk of the bank issuing its commitment to pay instead of that of the buyer.” EBA SCWG finds that this definition places too much emphasis on the eventual source of payment (which could come from the Buyer’s bank or the Buyer directly) rather than positioning the most critical risk as being the risk of non-
performance of the Supplier. The eventual source of repayment is of course important, but the Supplier’s performance risk is the defining characteristic of pre-shipment and PO-based finance.

3.6 Inventory finance

3.6.1 Description
Inventory (or warehouse) finance is a form of SCF in which goods (either pre-sold, unsold, or hedged), are financed and over which the bank usually takes security interest.

Inventory financing may be used by suppliers and buyers depending on the manufacturing and transaction cycles involved, and in risk terms is based on two key variables:
1. The intrinsic value and saleability of the inventory
2. The use to which inventory is put in terms of a manufacturing or sales process

Inventory financing is usually confined to qualified commodities (e.g., raw materials such as minerals, metals and agricultural produce) for which a value can be readily ascertained, and for finished goods where a Buyer has already been identified and for which a PO has already been issued. Work in progress is unlikely to be a strong candidate for inventory finance due to its lack of marketability. Risk factors include the location and ability to possess the relevant inventory in the event of the borrower becoming illiquid or insolvent. A bank will typically structure its security within a warehouse or where goods can be easily identified if held on the premises of the borrower. The financing may be arranged as a straightforward advance against the inventory or by way of sale and repurchase agreement under which the bank obtains title of the goods for the duration of the transaction.

3.6.2 Benefits
The main benefit of this form of SCF is the ability of the borrower to obtain funding based on the security of easily realizable assets.

3.6.3 Operational process based on an example
A typical inventory finance transaction involves two main parties: the borrower and the lending bank. A third party warehouse may also be involved.

Let’s make the example of a processor and exporter of food commodities seeking to finance its exports to major food service companies and obtains financing from a bank by pledging the inventory of raw and processed goods.

The bank extends a facility which is repaid in a number of equal monthly instalments with a bullet payment at the end of the repayment period; Payments are received through assigned receivables from acceptable buyers.

The inventory pledged to the bank is stored in a certified warehouse, monitored by a reputable third party collateral management company, and released only when the bank is repaid. The bank is issued with monthly inventory inspection certificates by the collateral management company to ensure that the facility is fully collateralized.
3.6.4 Important issues for consideration

The financial partner must be very aware of the supply chain and logistics processes that underpin the dynamics of the inventory levels. The logistics complexities in managing levels and flows of physical goods might limit the supply of this SCF instrument to a few expert financial institutions that rely on logistics partners for the practical material handling and storage of the goods. Furthermore, only goods that can be easily exchanged in the market in case of repayment default can represent valid collateral to the financing party. Such criterion is met by consumables and commodities and restricts the potential of the SCF instrument to a limited set of product categories. In managing such transactions, the credit and performance risk elements need to be identified and managed on an integrated basis.

3.6.5 Comparison with the definition from BAFT-IFSA

EBA SCWG finds the BAFT-IFSDA definition of “Warehouse Finance” to be capable of being interpreted to mean restricted to financing the goods stored only in a third party warehouse. “Inventory Finance”, instead, broadly covers the financing of any acceptable inventory regardless of its physical location, although the use of a third party controlled storage facility or warehouse is compelling.

3.7 The Bank Payment Obligation (BPO)

The Bank Payment Obligation (BPO) is an irrevocable undertaking given by a bank to another bank that payment will be made on a specified date after successful matching of data according to an industry-wide set of rules established by the ICC, known as the Uniform Rules for BPO (URBPO). Developed by the ICC Banking Commission in partnership with the financial messaging provider SWIFT and set to come into force on 1 July 2013.

The BPO is not a product, but is an inter-bank instrument or ‘enabler’ for a partner bank-based SCF solution. URBPO provide a framework within which the Buyer’s bank and the Supplier’s bank operate. The Buyer’s bank makes an irrevocable, but conditional undertaking in favour of the Supplier’s bank (known as the ‘recipient bank’ in URBPO). The undertaking is conditional upon the successful matching of supply chain data by a Transaction Matching Application (TMA), which is independent of any of the parties involved. Currently, the only TMA that exists is the TSU (Trade Services Utility) operated by SWIFT, although any TMA that supports ISO 20022 standards can be used provided that all parties agree.

The data to be matched is extracted initially from the Buyer’s Purchase Order and the Supplier’s sales ledger in order to establish a Baseline and create the BPO. Following shipment, there is a further data matching process involving data extracted from trade documents such as invoices, transport documents, and certificates. The BPO is designed to complement and not replace existing trade finance solutions.
3.7.1 **Comparison between BPO and Letter of Credit (LC) as Conditional Payment Obligations**

An LC is issued in favour of the supplier (the ‘beneficiary’) creating an irrevocable, conditional undertaking by the issuing bank. The advising bank, often the supplier’s own bank, may add its own conditional undertaking to that of the issuing bank. This is known as a ‘confirmation’.

A BPO, by contrast, is issued by the obligor bank in favour of the supplier’s bank (known as the ‘recipient bank’) not the supplier. In order for the supplier to benefit from the conditional undertaking, the recipient bank must issue a separate undertaking in favour of the supplier.

Both LC and BPO start out as contingent obligations. Once the conditions have been met, following presentation of compliant shipping and insurance documents (LC) or a successful data-set match (BPO), the obligation becomes unconditional. Both are irrevocable (i.e. they cannot be cancelled or amended without the agreement of the beneficiary/recipient bank).

The conditionality in respect of an LC relates to presentation by the beneficiary of compliant shipping documents. The documents may be examined by the two banks involved in the LC transaction independently. One bank is always the issuing bank. The other, known as the nominated bank, is any bank empowered under the LC to act as paying, accepting or negotiating bank. The nominated bank receives the documents from the beneficiary and is often the beneficiary’s own relationship banker. Differences in interpretation between banks arise from time to time, leading to delays in settlement and even disputes regarding the compliance of the shipping documents.

The conditionality is respect of a BPO relates to a successful data-set match, following submission of the supplier’s shipping data by the recipient bank. The potential for delays or disputes is eliminated with the BPO as the data is matched by an independent transaction matching application (e.g. SWIFT’s TSU), is entirely automated and virtually instantaneous. There is no judgement involved and so no scope for interpretation. In addition, the probability of a data mismatch is greatly reduced as the buyer’s purchase order and supplier’s sales ledger data will already have been matched to create the BPO baseline at the outset.

LCs and BPOs may be used to facilitate the financing of a trade transaction. An LC may be regarded as acceptable collateral to support pre-shipment finance and, where deferred payment terms are specified, it is also used to provide post-shipment finance. The latter is usually provided on a non-recourse basis, by discounting an acceptance or negotiating documents drawn under the LC. Similarly, the BPO can be used as collateral to support both pre- and post-shipment finance and as a vehicle for the provision of non-recourse finance once the obligor bank’s undertaking becomes unconditional.

3.7.2 **BPO for Approved Payables Finance**

With the Approved Payables Finance model, the buyer’s bank normally receives a file of approved payables from the buyer and then purchases the resulting receivable from the supplier. This is a ‘three-cornered’ model where the financing bank is dealing with one buyer and multiple suppliers. The latter will not typically have an account with the
Supply Chain Finance
European market guide

financing bank and may well be located in countries where the financing bank has limited, or no physical presence. This model creates significant challenges in respect of finalising, implementation of the required e-channel capability, assignment of receivables and compliance with KYC and AML regulations.

The BPO may be incorporated in the model, eliminating the above-mentioned difficulties. The issuance of the BPO can be deferred until after the payable has been approved, minimising unnecessary cost and maximising credit and capital efficiency. Once issued, a four-cornered model is created allowing the buyer’s bank to deal solely with their own customer (the buyer) and the suppliers to interact with their own bankers locally (the recipient banks). The buyer’s bank takes risk on the buyer and makes an undertaking in favour of the recipient bank. As the BPO is issued post-approval, the undertaking becomes unconditional as soon as it is issued. The recipient bank can provide non-recourse finance against the obligor bank’s unconditional BPO undertaking.

3.7.3 BPO for Receivables Finance

The BPO may be used to replace the risk of the buyer with that of the buyer’s bank. The BPO can be issued just before shipment so that a data-set submission can be made as soon as the invoices have been created. The financing bank, being the recipient bank under the BPO, may use the BPO as collateral to provide post-shipment finance to the supplier. The finance may be reclassified as non-recourse once the shipping data has been matched and the buyer’s bank obligation under the BPO becomes unconditional.

3.7.4 BPO for PO/ pre-shipment finance

Pre-shipment or purchase order finance may be provided on an open account basis, but this is still relatively uncommon. The financing bank would have sight of the purchase order and then provide finance to the supplier (with recourse). The financing bank would place reliance on both the ability of their customer to fulfil the contract and also on the ability of the end buyer to pay.

If a BPO is issued shortly after the purchase order is initiated, the supplier’s bank (the recipient bank under the BPO) has far greater certainty that payment will be received to settle the pre-shipment advance. A baseline will have been established when the BPO was created, evidencing matched purchase order/sales ledger data, so there is a high probability that the shipping data will also match the established baseline. The financing bank may, therefore, regard the BPO as acceptable collateral for the pre-shipment advance. In essence, the BPO-backed pre-shipment or PO finance model is similar to the Export LC based pre-shipment finance models that are used today.

3.7.5 Benefits

BPO combines the security of L/Cs with the simplicity of open account trading. The BPO combines an assurance of payment with scope for risk mitigation and the possible use of collateral for finance. One of the key features of the BPO is that it supports interoperability between participating banks, because it makes use of a standard set of ISO 20022 messages. This interoperability enables banks to
Supply Chain Finance
European market guide

collaborate with one another in a four-cornered model to extend reach across global markets (Figure 12), in order to provide a comprehensive range of supply chain services to corporate customers. The matching of data reflects events that have taken place in the physical supply chain, which create trigger points for the provision of financial supply chain.

The BPO and related ISO 20022 messaging standards can provide evidence of progress along the physical supply chain, reducing contractual performance risk and enabling the financing bank(s) to place greater reliance on the end-buyer as the source of repayment. Each event in the physical supply chain provides an opportunity for a bank intervention in the financial supply chain. Such financial supply chain interventions include the provision of risk mitigation, finance and settlement solutions. As the BPO deals with data extracted from the trading parties, or their third party vendors, data matching and reporting is virtually instantaneous and is not susceptible to differing interpretation, creating certainty, visibility and efficiency.

Figure 12: Illustration of the BPO Process Flows

<table>
<thead>
<tr>
<th>Business Role</th>
<th>Supplier/Exporter</th>
<th>Participant</th>
<th>Participant</th>
<th>Buyer/Importer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tchin Wa manufacturer</td>
<td>BBBBCNSH</td>
<td>Matching engine</td>
<td>PPPPLSS33</td>
<td>Big-Mart distributor</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Messaging Role</th>
<th>Beneficiary</th>
<th>Advising bank</th>
<th>Issuing bank</th>
<th>Applicant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creditor</td>
<td>Advising bank</td>
<td>Issuing bank</td>
<td>Applicant</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Trade and payment Processing service</th>
<th>Matched purchase order</th>
<th>Guaranteed payment</th>
<th>USD 15,370</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-/post shipment finance</td>
<td>Risk commitment fee and service charge</td>
<td>Risk commitment fee, payment fee and service charge</td>
<td></td>
</tr>
</tbody>
</table>

Source: SWIFT
4 Risk and regulation - a number of issues need addressing

A number of issues falling under the heading of risk and regulation are identified and described in this chapter. They range from questions relating to internal risk management within banks, to the external regulatory environment including the emerging Basel III framework, compliance obligations, and the accounting treatment of SCF transactions. The Chapter sets the context by describing various aspects of the issues raised and then is primarily evaluative.

4.1 Internal risk management for SCF

Based on interview findings and discussions with members of the EBA SCWG, a number of questions spring to mind about the business characteristics of SCF and which need answering before a financial institution would seek to enter or grow the business:

1. What are the fundamental risk characteristics of Supply Chain Finance and trade finance in general? Does its often cited short term self-liquidating nature focused on the core trade cycle offer a genuinely acceptable risk profile at a time of constrained credit appetite?

2. In practice, are the challenges and complexity of transaction structures, the implied control overhead and unclear definitions, a disincentive to adoption, and what lies below the surface in terms of having to meet the demands of customers for ever more tailored and complex solutions?

3. Do banks face a real challenge to develop the necessary credit and transactional skills historically vested in trained individuals and increasingly replaced by quantitative techniques implemented in the interests of cost reduction and rationalization? Where is the expertise combining supply chain knowledge and credit judgment skills going to come from?

4. Given the need for automated tools either created within the bank or integrated from outside, what can be done about the squeeze on IT spending and the overwhelming priority of mandatory developments as opposed to new business opportunities? Does the lack of standards and market norms in any case prevent the full benefits of automation?

5. What impact does the lack of visible market size estimates and the wide scattering of SCF opportunities have on market development?

6. Do documentation and client/transaction initiation processes create long sales cycles and exhausting contract negotiation between corporate clients and banks?

7. How can senior management attention be nurtured and sponsorship gained for the SCF business based on a compelling business case?

8. Is there a problem in finding the right individuals in the corporate customer with regard to pitching the SCF value proposition? Is it the CEO or the CFO or both? Is it the treasurer, or the chief procurement officer, or both?
9. Do the number of internal actors that require coordination, militate against response times and recognition of the business value among corporate relationship managers? Are fundamental silo effects just too big a hurdle to overcome?

10. How can the credit approval processes of institutions be sensitized to the SCF business?

11. How can banks meet the challenge of supplier on-boarding? The required suppliers are usually widely dispersed and not always easily accessed.

12. How can bank-to-bank collaboration be mobilised and do partnerships with B2B networks and e-invoicing eservice providers provide a risk-mitigated avenue for on-boarding?

Many of the answers to these questions lie in the chapters and sections of the Market Guide.

4.1.1 Perception of risk

A first issue for this section is the perception of risk. It is often asserted that internal credit and risk management procedures apply similar criteria to trade and SCF transactions as they do to traditional balance sheet lending and do this without making an appropriate adjustment for the risk characteristics of such financings. A common response by supporters is that rather than being predicated on purely financial considerations, trade and SCF financings should be viewed more on a transactional basis and more readily on their performance and self-liquidating aspects as well as pure credit risk. An example of a physical shipment (Figure 13) serves to illustrate this point:
Experience shows that the risk that accompanies the goods diminishes progressively with no quantum changes. The financial institution which wishes to finance this process should approximate the real risk profile of the supply chain trade transaction by breaking down the generic, and monolithic physical supply chain process down to its main elements (i.e., ‘Build the product to be loaded’, ‘Load Product and Ship’, ‘Deliver Product and Receive Payment’ - Figure 14).

Each sub-process carries a level of increased visibility – and consequent possibility of control – that lowers the level of inherent risk. At each of the connecting points
between the process elements the level of risk falls, thanks to the additional information exchanged (Figure 15) that becomes the communication protocol, between the process owners.

**Figure 15: Further Breaking Down Supply Chain Processes**

![Figure 15](source: Camerinelli)

The profile is still staircase-shaped, but with smaller leaps and closer to the real risk curve. The more granular the breakdown of the supply chain processes, the closer the overlap with the real risk contour. The key to making the *perceived* level of risk coincide with its *real* risk resides in the bank’s ability to encompass an understanding of all the processes that belong to the physical supply chain. A bank must therefore break the chain into its components to establish a risk profile for each one. The more granular the segmentation of the trade chain, the closer the risk profile to the real risk profile.

### 4.1.2 Credit risk versus Performance risk

As has been described a common form of SCF is the Approved Payables Finance model. The 'event' in the physical supply chain that triggers the financial supply chain intervention in this case is the approval of the payable by the buyer. Similarly the event that triggers Receivable Finance is the raising of an invoice by supplier on shipment of goods or services. The 'ultimate' SCF offering would enable financial interventions triggered by multiple events in the physical supply chain, starting with the Purchase Order. Each subsequent event in the physical supply chain has the effect of reducing the risk of performance failure or default.

If we consider that the rationale for SCF is the ability of the end-buyer to pay for the goods supplied, then it follows that this is the financing bank’s ultimate source of repayment. The credit quality of this source of repayment is effectively the ‘anchor’ that underpins the supply chain finance business.

This leads to a number of questions:
Can the Buyer pay?

Will the Buyer pay?

The first is a question of credit quality. If the Buyer's credit standing is not of sufficient quality or the Buyer is simply unknown to the financing bank, credit quality may be enhanced or transferred to a more acceptable party using credit insurance, traditional trade instruments such as an LC or the new BPO.

The second is a question of performance risk on the Supplier. This is often referred to as the 'can pay, won't pay' scenario. As each event in the physical supply chain is successfully accomplished, the risk of performance failure by the Supplier can be seen to have reduced. At the extremes it can be seen that the risk is at its greatest at the stage before a Purchase Order has been agreed. At this point, relatively little reliance can be placed on the Buyer's ability to pay. At the other extreme, once the Buyer has accepted the goods and approved the payable, performance risk is effectively extinguished and total reliance can be placed on the Buyer's ability to pay. Even here, any contract terms that allow the buyer to adjust the value of the invoice post-approval to reflect 'returns' or deficient service would need to be treated appropriately.

The interim events in the physical supply chain that progressively reduce performance risk, allowing correspondingly greater reliance to be placed on the ability of the Buyer to pay, include:

- Evidence of advanced Work in Progress in the Supplier's production cycle or evidence of finished goods awaiting despatch
- Pre-shipment inspection of inventory to verify compliance with terms of purchase order
- Evidence of shipment, arrival at destination, inspection at destination, delivery to buyer and/or acceptance of goods by the Buyer
- Storage of goods in a third party warehouse to the order of the financing bank and related price hedging

In an ideal world, each of these physical supply chain events would create a data element that could be communicated and matched with an agreed purchase order profile to provide an automated basis for a financing bank to 'model' the reduction in the performance risk relative to the credit risk. This would enable a 'borrowing base' approach to the provision of supply chain finance. The BPO has the potential to play a part in the development of a true event driven supply chain finance solution along the lines set out above.
4.1.3 Controls and Security

A further aspect of controlling the risk proposition is when and how to deploy solutions based purely on controls, and when to take and maintain a fully secured position, or a combination of both.

Where supply chain finance is based purely on controls, there is no security in the form of a legally enforceable title over assets such as receivables or inventory; however under such a controlled situation the bank is fully aware of the time-cycle of the transactions being financed, the respective obligations of buyer and supplier, the location of goods at all times and will always take steps to obtain sight of relevant documentation, whilst remaining technically unsecured. In a secured situation, the lender takes legal title to assets, which in the event of failure becomes the exit route for any exposure provided that the security is properly perfected, the location of security is accessible and the value has remained sufficient.

Of course a combination of such approaches where feasible is highly desirable. The maintenance of controls as well as the enforceability of security is beneficial in secured situations, given the fluidity of the transaction cycle. Security alone is rarely sufficient. Where security is readily available such as is the case with receivables it would seem appropriate to seek such. All solutions should take account of the nature of the transaction (e.g., volumes, underlying commodity, and credit rating of the clients). The need for legally binding security can be partially removed if the bank has a rising and experience-based knowledge of the clients to whom the SCF solution is provided. To avoid situations where delinquency or late payment is involved and generates high cost and complexity, banks are working to create more structured selection criteria to be applied to their choice of counter-parties.

4.1.4 The Management of the SCF business

The foregoing sections have attempted to position the essentially short term and liquid nature of the trade cycle and the opportunities inherent in the process to control and manage risk. But the questions raised at the beginning of this section posed other questions to be addressed in the context of the SCF business. Banks need to be organized to manage the risk profiles and inhibitors as well as the efficient deployment of SCF as a marketing proposition. Some key actions and policy steps are as follows:

Organization: it is important to create a management structure in which the appropriate levels of expertise in supply chain management are represented, not in a monolithic structure but one that leverages the various pockets of required expertise across the institution and relies on collaboration. Some may be located in a specialist SCF team and the others located in adjacent areas within a ‘matrix’ organization. Building a network of educated corporate bankers, product managers and sales representatives is key. This is a long process since bringing together various business lines (e.g., corporate banking, payments, factoring and trade finance) is not an easy challenge.

Internal education: relationship managers and other bank team members need a practical and useful understanding of how to spot opportunities and introduce SCF product lines to clients. The role of the organized SCF team is more than transaction execution; it extends to educating colleagues on the most appropriate options to select and how to initiate an SCF program with clients. Effective education programs involve
building a knowledge base and common language, creating an advisory network, preparing and delivering education workshops, and building case studies to further generate attention and momentum internally. A significant portion of the communication effort is directed to engage senior bank executives.

**Developing core and required adjacent capabilities:** An SCF program is as good as the sum of its parts. The various disciplines of financial structuring, credit evaluation, payments, operations, documentation, trade products and foreign exchange must be coherently developed, so that they all perform as required. A ‘Middle Office’ focused on the efficacy of transaction control is a useful concept. An example of a capability that will be increasingly needed for a more ‘joined up’ approach across the physical and financial supply chain is electronic invoicing expertise. This can be outsourced but at the same time must be integrated into the portfolio. Other areas of specialist knowledge development could be inventory management and purchase orders.

**Go-to-Market Strategy:** An SCF business strategy will need to be supported by the normal climate-creating activities in the form of marketing collateral, client seminars, web-site/webinars, media communication, attendance at external events etc. Another aspect is the building of a step by step approach to market roll-out. Multinational corporations (MNCs) are more aware of the attractions of SCF and may buy-in to the proposition more readily. SME’s who may form the supplier side of the proposition will need careful education and the selling of the benefits. The on-boarding issue emerges clearly in this context because it is unlikely that an SCF strategy can be based solely on targeting the upper tier of the market. Some banks are still in the stages of internal discussion to decide how and to what extent they should embark on SCF programs. As a consequence they are not actively working with clients until a fully shaped decision is reached at the senior/board level. From a marketing and risk management point of view perhaps a more forward looking strategy would embraces an incremental approach based on a few initial SCF pilot to gain vital data and experience before launching an industrial strength proposition.

**Program management tasks:** The demands of program management are illustrated with reference to a hypothetical example in this case the pursuit of Approved Payables program. For a major customer this will include

1. Ensuring that the corporate customer agrees the purpose and objectives of the program and is provided with transparency of costs to buyer and supplier;
2. Undertaking a spend analysis: it is important to understand what spend categories are the most critical and what suppliers must be involved in the program;
3. Developing the legal structure and documentation;
4. Partner bank selection and setup (e.g., jurisdictions to cover, pricing, financial capacity);
5. Operational setup (e.g., work flow, technical setup in selected jurisdictions; transactional banking setup); accounting treatment validation, training..
6. Supplier selection & deployment calendar; supplier segmentation; Confirm goals and align Finance and Procurement incentives; define internal and external communication (e.g., supplier meetings / mailing campaign / webcast / individual communication;
7. Definition and agreement on performance indicators with internal teams, providers, and banks

8. Supplier marketing: announcing SCF program launch and supplier enablement (i.e., on-boarding): actual supplier registration; bank account verification; signing supplier contracts; executing KYC policies

4.2 Regulation and Basel III

**Basel III and SCF:** It is a common view of bankers that the perceived level of operational and credit risk arising from trade and SCF as seen by regulators does not always match economic reality. Trade finance generates a high volume of off-balance sheet obligations, and some have argued that it has to some extent become caught up in the ‘Derivatives’ debate.

The new Basel III framework proposes tighter risk and capital allocations than Basel II and concerns have been expressed as to the possible impact on the availability of trade finance to finance the global recovery and future growth in world trade. This is the background to the on-going negotiations in the industry. For example in the industry letter of December 2011 (“Joint Industry Communication on Trade Finance and the Basel Framework”) it is stated that Basel III rules on the leverage ratio and on additional liquidity requirements will imply more costs for SCF and trade finance and reduce the availability of such finance, so critical for the world economy.

The evolution of the regulatory environment for SCF is a sub-set of the on-going negotiation of this new Basel III framework and the European Capital Requirements Directive. These issues are subject to evolution in the months ahead. The current focus of the discussions is with national regulators in major countries. It is not yet clear what can be expected as a likely timetable for these developments.

The Basel III Regulatory Framework is a complex and comprehensive framework, which addresses Capital, Liquidity and Leverage requirements. For trade and SCF a number of proposals have been made that would support the growth of the business whilst recognising its risk characteristics; these are:

- Applying the One-Year Maturity Floor Waiver to all trade finance instruments to reflect their typically under 180 day maturity and self-liquidating nature. Trade finance is typically of 147 average days maturity for on-balance sheet assets and 80 days for off-balance sheet exposures. Retaining a One-Year Maturity Floor treatment could be punitive for trade related finance and expectations for relief in this area are quite high and some jurisdictions having already removed this restriction.

- Adjusting the Credit Conversion Factor for Contingent Trade Finance Instruments. The Credit Conversion Factor influences the amount of Capital to

---

be held against Risk Assets and is used to compute the level of Risk Weighted Assets (RWA) held by a Bank.

- Create Separate Asset Value Correlations for trade finance. The Asset Value Correlation is a formula to measure the way a portfolio of assets is behaviourally correlated with other assets or economic indicators under distress conditions and in the light of loss experience (Loss Given Defaults). It favours asset portfolios with a wide spread of underlying obligors and limited concentration risk.

- Account for the Low Risk Behaviour of trade finance under the Liquidity Coverage Ratio.

For the Credit Conversion Factor, there is a clear distinction made between off-balance sheet trade related business such as Letters of Credit and Guarantees and on-balance sheet assets such as receivables finance and trade loans. In 2010 a concession was agreed in relation to letter of credit commitments under the Basel III framework whereby undrawn L/Cs were given a Credit Conversion Factor of 20% instead of 100% in the original Basel III proposals. Where off-balance sheet SCF financings are concerned, commentators do not expect any movement from the 100% CCF weighting applied to the broad range of commercial loans, but there is scope in the off-balance sheet area for example with the BPO’s to structure solutions that minimise the use of Risk-Weighted Assets (RWA). The use of the BPO as used in ways akin to the L/C may offer scope for a Basel III relief.

The ICC has lent support to this process by creating a Trade Register in which market participants are providing information about trade finance transactions and any default experience arising. Already it is reported that the Register demonstrates a very low incidence of such defaults. It is also likely that ICC will issue a range of educational materials to set out the issues and provide explanations over the coming months.

**Basel III as an opportunity:** A noteworthy result from the interviews of bank representatives on this matter is that Basel III is also seen as an opportunity. While the allocation of additional capital in a constrained credit market indeed creates challenges, corporate clients are not very much concerned as long as credit costs are as low as possible and expect their banks need to find alternative solutions to keep credit costs sustainable in the light of the requirements for capital allocation. Trade and Supply Chain Finance with its inherent liquidity and under one year tenor is likely to remain attractive relative to other asset classes, despite Basel III.

An opportunity lies in the ability of banks to acquire new sources of data from clients and turn that into measures of risk evaluation of the financings against which capital must be allocated (a new form of KYC). The deployment of systems that analyze a repository of trade transactions can propose appropriate corrections to the risk grade of a particular transaction. The presence of a technical platform that provides analytics for trade transactions is an enabler for improved visibility and regulatory management: the platform not only stores the transactions but also allows the profiling of trade habits (e.g., payments, collections, and inventory) of trading parties.

Another opportunity lies in the potential for optimisation of the deployment of Risk Weighted Assets through the use of secondary market activity and structuring transactions around those instruments that minimise RWAs.
Industry collaboration: SCF executives have also been considering the benefit to their business of the possibilities for consensus-building among banks and other stakeholders as to how they could suggest improvements and manage the regulatory requirements without impinging on competitive freedom. Ideally such a consensus should encompass European, North American, Asian, South-South and other banking communities and beneficially involve service and solution providers.

4.3 Compliance and Anti-Money Laundering

SCF products and services must satisfy generic requirements for compliance with anti-money laundering (AML), Terrorist Financing and Sanctions procedures. It is noteworthy that an industry group has recently created and circulated a set of industry guidelines issued under the auspices of BAFT-IFSA and referred to as: ‘Industry Guidelines Related to Anti-Money Laundering (AML) for Supply Chain Products and Trade Loans’.

The following is an extract from the introductory section of this document:

‘Industry standards have existed since the 1920s for the processing of many types of traditional trade transactions. They consist of rules of practice as well as established standards created by industry groups. These processing standards provide the framework around which banks can effectively implement AML programs for trade finance products. This document is part of an ongoing industry effort to establish guidelines for the control of AML risks in trade transactions. It also aims to address several products that have typically not been addressed in written standards. For industry standards related to traditional trade products, see the Wolfsberg Trade Finance Principles.

This document addresses two specific products that are offered by banks in the normal course of financing international trade that are generally seen as extensions of open account settlement - supply chain financing and trade loans.

The last section of the document, “Guidelines for AML”, addresses what the industry regards as the minimum or baseline information that banks require to meet regulatory requirements for effectively monitoring and screening for sanctions compliance transactions based on the amount of information that is available from the customer or in a given transaction. These guidelines do not address the requirements for KYC information that would be required in addition to the transaction specific information required by these guidelines.’

---

8 The term AML as used in this document includes typical AML activities, Terrorist Financing and Sanctions.
9 The Wolfsberg Trade Finance Principles can be found at www.wolfsberg-principles.com. The Wolfsberg Group consists of the following leading international financial institutions: Banco Santander, Bank of Tokyo-Mitsubishi-UFJ, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan Chase, Société Générale and UBS.
4.4 Accounting issues

The various instruments of SCF require decisions about the accounting treatment of the transactions both in the books of the trading parties concerned and the financing bank. The latter has an impact on the regulatory aspects raised above.

The treatment of SCF transactions in the books of the trading parties has implications for balance sheet presentation of the relevant assets and liabilities. In particular commentators have discussed the potential for the reclassification of trade receivables and payables as bank indebtedness and/or adjustment of off-balance sheet treatments.

Clearly case by case advice is required and in view of the sensitivity of the issues raised, the varying accounting rules and practices on a country by country basis, and the reservation of this area to an extent for the development of competitive advantage by market participants the issues are raised here but not further developed out flagging them for attention.
5 Automation unleashes SCF and e-invoicing is a ‘game-changer’

Supply Chain Management is now focused on the intelligent use of automated information systems in a way that moves beyond their use as a tool for efficiency towards creating competitive advantage. Automation enables information to be distributed quickly to trading partners and internal functions, provides efficiency benefits for corporate operations and triggers a variety of financial supply chain events. Developments such as e-invoicing are potential ‘game-changers’.

5.1 Automation tools

1. The replacement of manual business processes by automated solutions is happening rapidly but has a long way to go to be fully embraced. Since SCF solutions rely on the fast and efficient processing of supply chain data, the adoption of automated processes are important for the development of the SCF market.

2. In the corporate environment there is a focus by leading corporations on business process re-engineering, ERP system development, and the installation of customer relationship management (CRM) systems which facilitate the tracking of customer business relationships and the on-boarding of suppliers. The most successful mechanism for such investments is through the creation of cost effective Shared Service Centres usually deployed on a regional or international scale. B2B integration is achieved through the use of EDI platforms and networks. Substantial effort is devoted to re-engineering AR and AP processes.

3. Improved information technology (IT)-driven monitoring and control is essential to realise business benefits. The use of online data management platforms has reduced corporate inventories and brought industries closer to just-in-time production. This has meant smaller, more frequent, shipments replacing single larger orders.

4. Internet trading can provide cost savings by eliminating ‘middle-men’, reducing administrative cost, and outsourcing the requirement to carry inventories. The Internet can not only be used for the sales side of a business but also to manage relationships with suppliers, making it easier to synchronise supply chain operations.

5. The growing popularity of business-to-business networks, which support e-invoicing and supply chain automation, is bringing to bear capabilities and benefits to end-users and other intermediaries such as financial institutions. With the increasing use of fully automated procure-to-pay solutions, the transmission of dematerialized business documents over B2B networks and connections now means that the SCF offering can also be automated. A key aspect is the ability to accelerate cycle times especially invoice, payment and other approvals.
6. The development of platforms that directly support the management of SCF as a discrete activity are also accelerating. Some of these are proprietary and seek success based on their ability to attract a critical mass of users and financial institutions. Others such as the SWIFT Trade Services Utility have the potential to create substantial value on an industry level basis.

7. The future perspective of a bank’s SCF offer is an “event-driven” financial chain: As soon as the financial institution is able to pinpoint when a transaction is triggered by the supply chain process, it is to offer value-added SCF services. Such a trigger may be the approval of a previously submitted e-invoice leading to the provision of finance against such a payable. RFID tags are seen to have a role in creating event-driven triggers.

5.2 Challenges and constraints

This said, there are a number of challenges that could prevent the widespread use of supply chain automation:

1. The constraints represented by the existence of legacy systems are complex; for example Enterprise Resource Planning (ERP) Systems in most sizeable businesses consist of many instances and versions. Supply Chain management tools need to be carefully architected on top of legacy systems to provide an overlay of information aggregation and decisional capability. The same applies to bank legacy systems.

2. Most companies have -at best- automated only fragments of the supply chain and only the largest corporations have established buyer-supplier connectivity via electronic data interchange (EDI) or B2B networks.

3. In the traditional paradigm, the interests of suppliers and buyers are at odds: suppliers want to shrink DSO, while buyers want to extend their DPO. There has to be a move towards a more collaborative win-win approach to this issue.

4. The migration to electronic payments for business-to-business transactions has been variable often influenced by country practices and behaviours. Maximum use is not made of such instruments in terms of STP, remittance data and automated reconciliation.

5. Legal and compliance issues have often impacted the full dematerialization of the documents used in support of SCF activities. In this context dematerialisation means the complete replacement of paper documentation, as opposed to the extraction and processing of data from paper documents that continue to exist and play a role. The latter raises fewer legal and compliance issues.

6. E-invoicing users and their service providers are progressively addressing the legal effectiveness of dematerialisation on a country by country basis to ensure fully compliance with local requirements and by taking steps to protect the authenticity and integrity of transactions at every stage.
7. Historically, there has been a lack of clarity and agreement on standards for data formats and interoperability for the key documents and datasets and processes used in supply chains. This is not usually a showstopper, because systems are able to carry out mapping, format conversion and interoperable processing, but more standardization would undoubtedly help. Standardization efforts are proceeding and this will be to the particular benefit of financial institutions which prefer to operate in a more standards-driven environment for a variety of reasons.

8. SMEs have the much to gain from more widely distributed SCF facilities. However, they have not yet been involved in SCF initiatives on any significant scale. Even though they are often suppliers to a Buyer undertaking SCF, their size and complexity of on-boarding has inhibited their inclusion. Among a variety of possible approaches, banks have the reach to provide services to SMEs in a cost effective manner (often out-sourced to service partners) and are further able to provide financing services integrated into their SME offerings. This requires a significant shift in the mind-set.

5.3 The role of e-invoicing
Through dematerialization and the acceleration effects, e-invoicing is demonstrating its potential as a ‘game-changer’ for the SCF business. Nevertheless, there are varying views on the applicability of e-invoicing to SCF. The supportive argument goes as follows:

1. By replacing the paper document and its distribution with wholly electronic processes, a number of very significant efficiency gains and cost reductions can be achieved. Further benefits can be achieved by integrating other supply chain processes including liquidity, cash management and financing techniques.

2. A large element of the SCF product offering relies on the invoice as a key financing ‘trigger’ and as a pivotal document, providing the essential linkage between the physical and financial supply chains. The invoice provides insights into the trading partners involved, the ability of the buyers to pay, and the quality of supplier receivables thus supporting the making of knowledgeable credit judgments.

3. SCF solutions could be enhanced if they are actually embedded in or linked to e-invoicing platforms, which can handle the key information exchanged between trading partners. By also extending this ‘Joined-up’ approach to financial institutions, e-invoicing enables SCF to be substantially automated without having to replicate the trade process in the SCF platform itself. Once an e-invoice is submitted through the platform, and approved, messages are triggered that permit access to the relevant offer of finance and the receipt of the early discounted proceeds of the invoice.

4. E-invoicing eases the on-boarding challenge since suppliers will already be present on the e-invoicing platform. As soon as SCF is bundled with e-invoicing, the campaign-driven approach to on-boarding provides mutual
reinforcement as SCF creates yet another incentive for suppliers to join and also strengthens the buyer’s business case. KYC processes do not disappear but are considerably eased. In the latter context there is talk of ‘lite-KYC’ for such in-boarded suppliers, who do not become full bank customers but simply the beneficiaries of finance.

5. Currently the on-boarding of suppliers onto pure SCF platforms is manual and complex and as a consequence, only a ‘top slice’ of the largest suppliers are invited and the potential value in the ‘long tail’ supply chain is lost.

6. E-invoicing facilitates the 3-way match cycle with all parties electronically connected. A 3-way match is a practice where the invoice from the supplier is matched against the purchase order and delivery documents.

7. Perhaps most decisively, e-invoicing makes earlier invoice approval by the buyer entirely possible, increasing the “window of opportunity” (see Figure 16) for the provision of SCF. In traditional invoice management the time taken to receive and approve in-bound invoices dramatically reduces the time-interval in which financing is feasible.

Figure 16: E-invoicing expands the “Window of opportunity”

7. Proprietary SCF solutions and portals have so far struggled to achieve critical mass. There is clearly a need to create much more broadly based B2B and interoperable networks, which are now developing strongly. This in turn encourages the alignment of e-invoicing and related services with transaction-based lending solutions and makes SCF potentially available on a volume rather than a purely ‘cherry-picking’ transactional basis.

Source: EBA
The other side of the argument about the relevance of e-invoicing takes the view that:

1. E-invoicing has yet to realise its potential accounting only for between 10-20% of total invoicing volume.

2. SCF can be better organised on the basis of a selective approach to client participation thus focusing scarce resources on the most profitable opportunities.

3. The implied application of SCF to a very broad range of suppliers creates KYC challenges and costly customer engagement processes.

4. E-invoices are not well understood and doubts remain about their validity and legal compliance in all circumstances- a key factor in a financing program requiring the highest standards of risk management.

5. The invoice is not needed for transaction initiation or collateral, as information files listing approved payables and/or a forward dated payment instruction coupled with a receivable assignment are quite sufficient to conclude transactions.

6. The banking and finance industry and the e-invoicing service provider community will need to work closely together in order to make SCF facilities easy to access and use in a ‘joined up’ sense.

The current status of e-invoicing and the role of banks

E-invoicing on a European scale is growing rapidly at between 30-40% p.a. for B2B, b2B (small business to large business), B2C (often referred to as e-billing) and B2G (Business to Government usually for public procurement) segments - 18% of total invoice volume in Europe is currently estimated to be automated. The question remains as to the pace at which these developments will continue and deliver real critical mass, so that e-invoicing and SCF can become mutually reinforcing.

Electronic and automated invoice processes can result in savings of 60-80% compared to traditional paper-based processing [source: Billentis e-invoicing/e-billing report 2012]. The European digital agenda is supportive and public procurement is also going electronic creating substantial network effects from adoption by. There is a strong Green and Corporate Social Responsibility (CSR) case, which is well recognised.

There is a healthy and competitive market for the provision of e-invoicing services and solutions and their activities are driving adoption by relieving users of many of the challenges involved and creating network effects and reach.

The European Commission regards e-invoicing as an important public policy priority and has taken steps to improve the legal and VAT environment by enshrining the principle of Equality of Treatment between paper and electronic invoices in legislation, by creating a European Multi-Stakeholder Forum and a network of National Forums through which efforts to promote good practice, harmonisation and standards

Banks have varying attitudes on their role and the business case. Many banks have experience of Business to Consumer (B2C) or B2b (Business to SME) electronic bill presentment and payment (EBPP) services and continue to introduce services in this
area. On the other hand the relatively slow engagement of the majority of banks in offering Business to Business (B2B) e-invoicing services signals that few banks are at present interested in entering this business as e-invoicing processors especially as other non-bank players offering B2B platforms are already active in the market.

For banks the sheer heterogeneity of the corporate world, the lack of standards, regulatory overheads and business case issues have led to more questions than answers. Those that have entered have usually done so on the basis of alliances with established players. Those who haven’t are clearly looking for a more compelling business case through attractive adjacent income streams before engaging.

The re-shaping of the landscape of digital business processes so close to the ‘payment franchise’, the vast potential of the SME market, and the opportunities to re-intermediate banks in transactional finance, explains why a banking debate about how to engage continues to gather momentum. A bank may tie such an offering to a ‘bank-manufactured’ e-invoicing service or may enter into a partnership with established service providers for the e-invoice processing (either white-labelled or stand-alone).
6 Collaboration and competition- identifying the collaboration space in SCF

In a networked industry, there is always a continuing debate about the relevant roles of competition and collaboration between market participants. Up to now, outside the framework of traditional trade finance, SCF has largely been conducted as a purely competitive activity with limited industry cooperation, reflecting its relative immaturity.

For the purposes of this analysis the following breakdown of relevant spaces is identified:

1. Competitive space, where collaboration has no role. This will certainly cover the value propositions of individual competitors, pricing and customer specific information,

2. Collaboration between business entities undertaken on a bilateral basis through partnerships or commercial contracts.

3. Collaboration on a collective basis between market participants in areas defined in advance as being non-competitive, non-infringing of competition law and having the effect of creating the basis of overall market development to the benefit of individual competitors.

6.1 Bilateral collaboration

6.1.1 Bank to Bank

Geographic coverage: An important aspect related to transaction completion and risk-taking is the dimension of to the geographical proximity. In general it is usually the preference of financial institutions to provide financing facilities where the customer is close at hand or easily accessible. Clearly geographically concentrated banks need to cooperate to cover client transactions that cross geographies. Global banks also work with local banks that better know the profile for example of an SME supplier and are better positioned to mitigate the performance risk of the SME giving rise to a collaborative opportunity.

4-corner models: The need for interoperability among banks, for serving both ends of a transaction, and for risk sharing are all forms of a collaborative approach. Networked 4-corner models are used extensively in the payments market, where two customers use the services of two different banks or service providers. The effectiveness of the four-corner model for channelling transaction data and documents, for on-boarding, for financing, for risk participation and distribution and for creating a scalable solution illustrates the relevance of this model. Reference to the BPO as an enabler for the four-corner model has been made already.

The need to collaborate using a 4-corner model is particularly evident where a bank does not have an extensive branch network in the required markets. For example, a buyer’s bank that does not have an extensive branch network in the countries where their customer is sourcing will struggle to make the 3-corner model scalable and cost
Supply Chain Finance
European market guide

effective. For global banks local networks are typically somewhat less extensive and offer more limited services than do those of indigenous banks. In addition, the buyer’s bank using a 3-corner model will effectively be displacing the local banks with whom the suppliers often have long-standing and broadly based relationships. The 4-corner model (Figure 17) is, by contrast, scalable and leverages the capabilities of the local banks, opening up the potential for reciprocity rather than resistance and competition.

Figure 17: Three-Corner vs. Four-Corner Model

![Three-corner vs. Four-corner Model diagram](source: Aite Group, Camerinelli)

6.1.2 Bank to Technical Providers

**Outsourcing of technology and business processes under partnering agreements:** This is a typical business process and could cover many technical and business requirements and functions. Since these are well established and routine functions there is no further need to cover these categories of collaboration.

**Cooperation between banks and B2B networks and SCF-enabling platforms:** There are many opportunities for banks and other service providers to cooperate to deliver solutions that play to each other’s complementary strengths. These are usually one-to-one relationships, but there may be opportunities to explore collective modes of collaboration and working agreements on an industry to industry basis as covered below in the section on collective collaboration.

B2B networks and SCF-enabling platforms can and will in the future take various forms; they may provide not only tools and technology but are more and more involved in building the connections between all or key constituents of the SCF ecosystem through gateways and portals. Alongside these connections they might provide financial intermediation and other added value-added services such as
Supply Chain Finance
European market guide

process management and business transformation, multi-level transaction visibility and reporting, supplier on-boarding, the assessment of the credit quality of trade partners, and the development of new applications. In would be rare for one provider to support all these functions but banks have the opportunity to enter into a variety of bilateral collaborations for discrete aspects of their portfolio.

There is also an aspect of a major customer relationship that creates a partnering opportunity beyond the conventional banking relationship. Large corporate organizations are themselves stepping onto the supply chain finance stage. They are typically multinational, cash-rich organizations with extensive supplier networks, usually consisting of mid-size companies. Such companies may find difficulty in accessing sufficient credit in a constrained credit market.

In this scenario, the cash-rich corporations are strategically utilizing their available liquidity to sustain the financial health of their upstream counterparts, in order to maintain a healthy environment by ensuring that financial stress does not represent a threat to business continuity. In such a scenario, there may still be opportunities for banks to partner with the large buyer to provide additional services such as a dashboard for liquidity management, process support or additional finance to meet peak loads or seasonal requirements— in other words to ‘partner’ the customer in a productive way.

6.2 Collective collaboration

Collective collaboration is recognised as a growing need and the SCWG has identified or confirmed numerous areas of potential collaboration among financial institutions and other stakeholders.

6.2.1 Governance

**Creation of a governance structure:** a maturing industry, that creates a collaborative agenda, needs to create effective and united membership organisations to act as industry bodies in the non-competitive space, and take responsibility for collective collaboration. Such a collective body should have open and transparent admission criteria. Such organizations provide continuous and direct communication with governments and regulators, to promote industry standards and market rules at both a regional and global level, and to provide other services to their members. There is also scope for industry bodies representing one sector to reach out to bodies from other sectors.

**Regulatory cooperation:** Creating a common approach to the regulatory regime and the developing common definitions for regulatory compliance should continue to be a valuable role for collective collaboration. There is a need for an industry effort to engage in direct and continuous communication with governments and regulators on matters of collective importance to the supply side of the industry in the regulatory sphere.

**Industry schemes and joint projects:** Experience of market development can lead to the recognition that collective schemes, best practice guidelines and industry rulebooks have a place in the industry and may lead to tangible projects pursued.
through the above mentioned industry governance structure in the non-competitive space. As a starting point the development of a common market terminology and good practice guidelines would appear to worthwhile activities requiring attention.

**Risk sharing and secondary market development:** Although supply chain finance is primarily a competitive matter, collaboration is required for risk sharing for a) larger multi-bank deals and/or b) establishing standard risk measurements to allow competition for transactions with different risk profiles c) commonly accepted rules and procedures. A common risk model established as the result of a collaborative effort enables banks to individually decide (i.e., compete) on SCF opportunities, eventually sharing risk with or without the support of outside funding. Risk sharing is/might be organized through specific commercial intermediary organizations or by means of established inter-bank arrangements

**Communication and marketing:** For the generic promotion of the benefits of supply chain automation and SCF there are potential benefits of collaboration in information dissemination, in generic marketing activities and education. Education, communication and training are seen to be critical activities as the SCF market seeks to gain further traction.

### 6.2.2 Standards

**Cooperation on interoperability and technical standards:** Interoperability is the ability of two or more systems or components to exchange information and to use the information that has been exchanged. To guarantee interoperability an important aspect for collaboration relates to establishing standards and implementing them consistently.

A number of layers of collaboration have been identified including the business level, the semantic level such as data formats, and the technical or syntactical level. Interoperability represents the capability to run business processes seamlessly across organizational boundaries and is achieved by understanding how the business processes of different organizations can interconnect. Seen as a central prerequisite to establishing e-business, interoperability enables information to be presented in a consistent manner between business systems, regardless of technology, application or platform. It thus provides organizations with the ability to transfer and use information across multiple technologies and systems by creating commonality in the way that business systems share information and processes across organizational boundaries.

Whereas the supervision of standards development is often taken by the industry governance body, technical standards for data formats and message types are usually developed by standardization organizations, such as ISO, UN/CEFACT, SWIFT etc. There is a need to develop a standards strategy and development plan for those standards considered important for SCF market development. The potential for the re-use of existing standards should be explored. It is noteworthy that the active efforts in the development of standards for supply chain management in general have not so far been accompanied by equivalent efforts to develop standards for the integration of related financing services.
6.2.3 Infrastructure

Collective cooperation between banks and B2B networks, marketplaces and platforms: Although collaboration with such providers is usually based on bilateral ‘one-to-one’ relationships, there may be opportunities to explore collective modes of collaboration and working agreements on an industry basis. Such modes of collaboration may be on the basis of a ‘Club’ or ‘Consortium’ approach to creating a shared platform, or through to industry level initiatives with very wide participation.

Such opportunities could include the provision of complementary capabilities at an industry level such as e-invoicing, logistics, information services and even the collective origination and distribution of financial transactions. Corporate clients are increasingly pointing to the need for multi-bank portals and portal providers of various kinds are active in the market.

For banks, however, proposals for multi-bank platforms are often controversial and need to find their moment, a time when industry consensus emerges on the need to create such a piece of infrastructure. In the SCF marketplace, proprietary platforms are still in their early stages and the concept of abandoning such platforms is not widely accepted; it is also an understandable reaction that the challenges of managing common technology projects are not trivial. However, collaborating over the long term on a collective basis could be an avenue worth exploring. This could be undertaken on the basis that the dialogue is confined to non-competitive propositions, such as for utility services or for services with high entry costs (e.g., where network economies have already been developed) or where individual banks cannot see a business case for entry. The SWIFT TSU development illustrates this kind of thinking.

This whole area needs mature reflection.
# 7 Annex 1 - Glossary of Terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Automation</td>
<td>Refers to the range of IT-based and business tools that support the management of Supply Chains and SCF.</td>
</tr>
<tr>
<td>AP : Account Payable</td>
<td>AP is money owed by a business to its suppliers and shown on its Balance Sheet as a liability.</td>
</tr>
<tr>
<td>AR : Account Receivable</td>
<td>AR is money owned by suppliers to a business and shown on its balance sheet as an asset.</td>
</tr>
<tr>
<td>B2B : Business to Business</td>
<td>Business transactions between businesses, such as between a manufacturer and a wholesaler, or between a wholesaler and a retailer</td>
</tr>
<tr>
<td>B2C : Business to Consumer</td>
<td>Business transactions between a business and a consumer</td>
</tr>
<tr>
<td>BASEL III</td>
<td>Basel III is part of the continuous effort made by the Basel Committee on Banking Supervision to enhance the banking regulatory framework. It builds on the Basel I and Basel II frameworks, and seeks to improve the banking sector's ability to deal with financial and economic stress, improve risk management and strengthen the banks' transparency. A focus of Basel III is to foster greater resilience at the individual bank level in order to reduce the risk of system wide shocks.</td>
</tr>
<tr>
<td>BPO: Bank Payment Obligation</td>
<td>BPO is an irrevocable obligation of an obligor bank to pay a specified amount to a recipient bank as soon as a matching occurs between data extracted from different trade documents like invoices, purchase orders, transport documents, and certificates.</td>
</tr>
<tr>
<td>Cash on delivery</td>
<td>Payment is collected by the carrier/ delivery agent on behalf of the supplier.</td>
</tr>
<tr>
<td>Cash-to-cash cycle time</td>
<td>Represents the interval between payment for raw materials and the receipt of cash generated by selling final goods. In mathematical terms, Cash-to-cash cycle time = [(DSO + DII) – DPO]</td>
</tr>
</tbody>
</table>

---

*Annex 1*
<table>
<thead>
<tr>
<th>Supply Chain Finance</th>
<th>European market guide</th>
</tr>
</thead>
</table>

**Letter of credit (documentary credit)**

A letter of credit is a written undertaking given by the issuing bank at the request of the buyer (applicant) to honour a presentation of compliant documents, i.e. to pay the beneficiary at sight, to incur a deferred payment undertaking or accept a bill of exchange and pay the beneficiary at maturity.

**DII : Days In Inventory**

\[
\text{Average Inventory} \div \text{Cost of Goods Sold} \times 365
\]

**DPO : Days Payable Outstanding**

\[(\text{Accounts payable} \div \text{COGS}) \times 365\]

**DSO : Days Sales Outstanding**

\[(\text{Accounts Receivables} \div \text{Net sales}) \times 365\]

**Dynamic Discounting**

Dynamic payables discounting is a process which allows buyers and suppliers of commercial goods and services to dynamically change the payment terms—such as net 30—to accelerated payment based on a sliding discount scale. Dynamic payables discounting is “dynamic” in one or more ways.

**EBPP: Electronic Bill Presentment and Payment**

EBPP is usually consumer-oriented bill paying presented and paid through the internet.

**EDI: Electronic Data Interchange**

An electronic transfer of data from computer to computer using an agreed structured format that can be read by a computer and processed automatically.

**E-invoice : Electronic Invoice**

An electronic invoice is a document in electronic form representing an invoice. The electronic invoice can be in a human or in machine readable format, or in a combination thereof.

**ERP: Enterprise Resource Planning**

ERP systems integrate internal and external management information across an entire organization, embracing finance/accounting, manufacturing, sales and service, customer relationship management, etc. ERP systems automate this activity with an integrated software application.
<table>
<thead>
<tr>
<th><strong>The purpose of ERP is to facilitate the flow of information between all business functions inside the boundaries of the organization and manage the connections to outside stakeholders</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Forfaiting</strong></td>
</tr>
<tr>
<td><strong>FSC: Financial Supply Chain</strong></td>
</tr>
<tr>
<td><strong>Inventory Finance</strong></td>
</tr>
<tr>
<td><strong>Invoice Discounting</strong></td>
</tr>
<tr>
<td><strong>ISO</strong></td>
</tr>
<tr>
<td><strong>ISO 20022</strong></td>
</tr>
<tr>
<td><strong>KYC: Know Your Customer</strong></td>
</tr>
</tbody>
</table>
| **PSC: Physical Supply** | The series of business processes by which goods and
Supply Chain Finance
European market guide

<table>
<thead>
<tr>
<th>Chain</th>
<th>services are purchased, transformed, delivered and paid for.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase Order (PO) based finance</td>
<td>Also known as pre-shipment finance is made available to a supplier based on a purchase order received from a buyer.</td>
</tr>
<tr>
<td>Receivable Finance</td>
<td>Receivable Finance allows suppliers to finance their receivables relating to one or many buyers and to receive early payment, usually at a discount on the value and is accomplished in a number of jurisdictionally different ways under a number of business models including Receivables Purchase, Invoice Discounting, Factoring and Forfaiting.</td>
</tr>
<tr>
<td>SCF: Supply Chain Finance</td>
<td>The use of financial instruments, practices and technologies to optimize the management of the working capital and liquidity tied up in supply chain processes for collaborating business partners. SCF is largely ‘event-driven’. Each intervention (finance, risk mitigation or payment) in the financial supply chain is driven by an event in the physical supply chain. The development of advanced technologies to track and control events in the physical supply chain creates opportunities to automate the initiation of SCF interventions.</td>
</tr>
<tr>
<td>SCM: Supply Chain Management</td>
<td>Supply chain management is the systematic, strategic coordination of the traditional business functions and the tactics across these business functions within a particular company and across businesses within the supply chain, for the purposes of improving the long-term performance of the individual companies and the supply chain as a whole (Mentzer et al., 2001).</td>
</tr>
<tr>
<td>Working Capital</td>
<td>The amount of day-by-day operating liquidity available to a business. In mathematical terms, working capital is calculated as ( \text{WC} = (\text{AR}) + (\text{INV}) - (\text{AP}) + (\text{Cash}) )</td>
</tr>
</tbody>
</table>
8 ANNEX 2 - BAFT-IFSA Definitions of SCF Instruments

The following pages contain a replica of the BAFT-IFSA document\textsuperscript{10} that describes Open Account instruments, some of which correspond to the SCF instruments described in Chapter 3.

\textsuperscript{10} BAFT-IFSA Product Definitions for Open Account Trade Processing and Open Account Trade Finance, Publication Date: December 13, 2010 (Original) / REVISED May 2011
BAFT-IFSA

BAFT-IFSA Product Definitions for Open Account Trade Processing and Open Account Trade Finance

Publication Date: December 13, 2010 (Original) / REVISED May 2011

Annex 2
BAFT-IFSA
Product Definitions for Open Account Trade Processing and Open Account Trade Finance

Section 2: Processing/Servicing Definitions

Open Account Processing leverages the existing trade services processing capabilities of financial institutions. It can include purchase order upload to create transactions, document examination and/or data matching, tracing and follow up for payment and payment services. An important activity in Open Account transaction Processing is the exchange and sharing of documents and document data which can be sent to a bank via a number of methods, including paper documents and electronic records hereafter referred to collectively as documents.

These processing activities which are further defined below can trigger Supply Chain Finance opportunities. A bank may engage in some or all of these activities and/or financing opportunities.

1. Purchase Order Advice
A purchase order specifying the goods and terms is created by the buyer. The seller is then notified of the purchase order and other shipping instructions through a collaboration platform, fax, email, portal or other method. Once notified, the buyer may require the seller’s acknowledgement.

2. Document Presentment and Data Matching
Documents are created and presented by the seller. Matching criteria under Open Account are defined by the buyer. They may consist of simple checking for the presence of all the required documents or detailed checking of specific data values within or among documents in an automated, semi automated, or manual fashion as defined in the Purchase Order Advice.

3. Discrepancy Handling/Dispute Resolution
If the matching results include discrepancies between the buyer's matching criteria and the presented document data, the buyer is typically notified to determine if the documents will be rejected or approved. For efficiency purposes, the buyer can preauthorize the bank to pay documents where there are no discrepancies. Dispute resolution enables buyers and sellers to resolve disputes related to Open Account activity on-line or via other methods of communication.

4. Management of Approved Invoices/Drafts
The bank manages the approved documents process with respect to potential financing and the scheduling of transaction settlement and/or the collection of invoice proceeds.

5. Document Payment
The buyer pays at maturity (usually the document due date) and the seller is paid or seller's financing (if any) is repaid with any remaining proceeds going to the seller.

6. Documents/Payment Reconciliation
When payment is received, the bank may, on behalf of the buyer and the seller, reconcile payment to the documents' value (usually the invoice/draft value) and keep track of PO balances.
Section 3: Open Account Trade Finance Definitions

Supply Chain Finance
As applies to Open Account transactions, Supply Chain Finance (SCF) solutions encompass a combination of technology and services that link buyers, sellers, and finance providers to facilitate financing during the life cycle of the Open Account trade transaction and repayment. The below financing opportunities fall within the overall definition of Supply Chain Finance.

1. Purchase Order Commitment to Pay
The buyer’s bank issues its commitment to pay the seller (at sight or at maturity) once the seller ships and makes available the required documents that match the purchase order and other stipulated conditions. This service allows the seller to take the risk of the bank issuing its commitment to pay instead of that of the buyer.

2. Pre-Shipment Finance
Pre-Shipment Finance, also known as Purchase order financing, is made available to a seller based on a purchase order received from a buyer. This financing can cover all the related working capital needs of the seller including raw materials, wages, packing costs and other pre-shipment expenses. Once the goods are ready, refinancing or repayment can occur.

3. Warehouse Finance
Warehouse financing is a form of trade finance in which goods are held in a warehouse for the buyer, usually by the seller, until needed. At a minimum, warehouse receipts are commonly required as evidence for the financing. Some banks may only do this under structured trade transactions.

4. Post-Shipment Finance
Post-shipment financing is provided to a seller using the receivable as collateral. The seller presents shipping documents as evidence of a receivable and the bank may also require a bill drawn on the buyer for the goods exported. The bank may prefer to purchase and discount a bill drawn on the buyer for the goods exported.

5. Approved Payables Finance
Approved Payables Financing allows sellers to sell their receivables and/or drafts relating to a particular buyer to a bank at a discount as soon as they are approved by the buyer. This allows the buyer to pay at normal invoice/draft due date and the seller to receive early payment. The bank relies on the creditworthiness of the buyer.

6. Receivables Purchase
Receivables Purchase allows sellers to sell their receivables/drafts relating to one or many buyers to their bank to receive early payment. The bank may require insurance and/or limited or full recourse to the seller to mitigate the risk of the pool of receivables.

7. Flexible Due Date
As an alternative to payment on the scheduled repayment date, customers may request payment prior to or following the scheduled due date. Repayment prior to the scheduled date would result in expected prepayment discount, while extensions of due date would equate to additional financing.
Section 4: Opportunities Diagram

Open Account Processing and Financing Opportunities
# BAFT-IFSA

**Product Definitions for Open Account Trade Processing and Open Account Trade Finance**

## Section 5: Opportunities Matrix

<table>
<thead>
<tr>
<th>Supply Chain Finance Trigger Events</th>
<th>Bank Processing Opportunity</th>
<th>Bank Financing Opportunity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase Order Agreed</td>
<td>Purchase Order Advice</td>
<td>Pre-Shipment Finance</td>
</tr>
<tr>
<td>Goods Warehoused</td>
<td>Document Checking/Data Matching</td>
<td>Warehouse Finance</td>
</tr>
<tr>
<td>Documents Issued</td>
<td>Documents/Purchase Order Reconciliation</td>
<td>Receivables Purchase</td>
</tr>
<tr>
<td>Documents Presented</td>
<td>Document Checking/Data Matching</td>
<td>Post-Shipment Finance</td>
</tr>
<tr>
<td>Documents Approved</td>
<td>Management of Approved Documents</td>
<td>Approved Payables Finance</td>
</tr>
<tr>
<td>Due Date</td>
<td>Document Payment</td>
<td>Repay any outstanding financing</td>
</tr>
</tbody>
</table>
9 Annex 3 – EBA SCWG: Terms of Reference, membership and methodology

9.1 Terms of Reference

It is proposed to re-launch the E-Invoicing Working Group as the Supply Chain Working Group for the next phase of activity over a twelve month period.

Background

The EBA E-Invoicing Working Group has been working for three years in assessing the opportunity for banks in e-invoicing and in particular has worked on the development of a concept for a pan-European network model for the delivery and processing of e-invoices based on exchanges between banks and non-bank service providers.

Concrete deliverables have included the drafting and endorsement of a Service Description and Rulebook (SDRB), a White Paper containing the SDRB, a business rationale and the findings of a desk research-based Proof of Concept exercise with a number of service providers; and two editions of a well-regarded market guide.

Given that the role of the EBA (Association) is primarily as a forum for practitioners and as a means for the development of research and innovative concepts, it typically does not aim to launch operational services based on its intellectual property. Indeed it usually hands over such materials to organizations such as EBA Clearing and SWIFT; The SDRB has been made available to SWIFT for incorporation in its evolving solutions on a non-exclusive basis.

Moving forward, it is the proposal of, the Working Group to continue with its monitoring role towards e-invoicing developments. It also wishes to make recommendations on the scope of its mandate in other areas related to e-invoicing in particularly Supply Chain Finance. This document summarizes the reflections of the Working Group in relation to these fields where there is felt to be additional value in producing findings and materials for the EBA community.

Expanding the scope to encompass the financial supply chain

The invoice is seen by many as a pivotal document in a key set of business processes, providing an essential linkage between the physical and financial supply chains. By replacing the paper document and its distribution by electronic messages and delivery, a number of important efficiency gains and cost reductions can be achieved. However, e-invoicing alone may not bring sufficient benefits to its users or to their service providers. By expanding digitalization beyond the invoice and the payment towards further supply chain data and integrating other supply chain processes including finance, liquidity and cash management, opportunities are created to substantially increase the potential benefits.

The relatively slow engagement of the majority of banks in offering B2B e-invoicing services signals that only a few banks are at present interested to enter this business-in contrast to B2C Electronic Bill Presentment and Payment (EBPP) services, which
Supply Chain Finance
European market guide

are offered by a growing number of banks. This is confirmed by the questionnaire that EIWG conducted among selected member banks and by other market reviews. However, the same questionnaire did demonstrate that a much larger number of banks have a strong interest in Supply Chain Finance (SCF) service offerings. This demonstrates a desire on the part of banks to engage in inter-corporate supply chains and re-intermediate themselves in trade related flows.

In such scenarios e-invoicing plays a crucial role by accelerating invoice approvals and thereby creating an enlarged ‘window of opportunity’ for the provision of transaction-based SCF. A bank may tie such an offering to a bank-manufactured e-invoicing service or may enter into a partnership with established service providers for the e-invoice processing (either white-labelled or stand-alone). Pre-shipment finance may also be offered based on Purchase Orders.

The current EIWG members have concluded that to promote the deployment of a wider portfolio of bank services, to continue to support the take-off of e-invoicing and to provide further value to members through collaborative work, the following aspects should now be explored:

- Expanding (‘broadening’) the scope of the work to cover Supply Chain Finance;
- Deepening the scope to include related supply chain processes, whilst maintaining a focus on the challenges of the achievement of the wide adoption of e-invoicing across Europe.

Objectives and deliverables of the next phase

It is proposed that the Working Group conducts a set of comprehensive research activities over the next 12 months with following deliverables:

a) **Supply Chain Finance**: Carry out a study (by integrating other work and analysis already completed) of the Supply Chain Finance (SCF) market and opportunities based on four layers of work:
   - Provide a common basis for the EBA community to understand the ecosystem of supply chains (physical and financial) and integration to e-invoicing and provide a picture of the market and opportunities for related SCF services.
   - Analyse and make recommendations for common definitions, terminology and conceptual language related to the financial supply chain and supply chain finance.
   - Explore the explicit link between e-invoicing and SCF and how dematerialisation supports the process of better working capital management, optimal financing structures, and control of payables/liquidity.
   - Describe possible model(s) for the integration of SCF related e-invoicing platforms and messaging in a 4-corner service context, and on the assumption that a cooperative space for market development is identified and supported.

This study would further promote EBA’s image as a proactive “think-tank” and thought leader in the area of transaction banking. It would not only provide a description of the key elements of SCF and its link to corporate and service provider reality but it would also serve as an educational and a promotional tool for the banking and financial services industry to activate increasingly innovative offering in the field of SCF, linked to e-invoicing.
b) **E-invoicing**: In parallel, the EIWG would continue to monitor European developments in e-invoicing and identify issues and influence the implementation of e-invoicing in the market, with a focus on the unique role of banks in providing reach, integrating with payments as well as supporting the SCF opportunity described in 1/ above.

Elements of the current market to be monitored and acted on are:

- European Commission developments including the European Multi-Stakeholder Forum, VAT directive implementation and public policy generally
- Standards developments including UN/CEFACT, ISO and CEN
- Evolution of the service provider market and interoperability in the e-business environment
- Taking advantage of specific opportunities in conjunction with SWIFT to promote the network model and related concepts as developed by both over the last three years

**Composition**

Membership will be at the invitation of the EBA Board, following a newly circulated invitation to the Membership. In considering applications for membership, the Board will select up to 25 representatives of banks or relevant bank-owned organizations from a mix of EBA communities and will wish to strike a balance between:

- Experts with a specific knowledge of e-invoicing
- Supply Chain Finance experts including trade finance and factoring
- Individuals with a strategic “out of the box” mentality
- Product experts with backgrounds in payments and transaction banking

EBA Associate Members should be regarded as a source of knowledge (and participants) to bring in the vendor and IT integration flavour.

Members should have available the necessary time and a clear commitment to actively contribute to the success of the Group. The Group will be chaired by an EBA Board Member and facilitated by the EBA senior adviser with the support of other resources as are required and approved by the Board. It is proposed that an external expert is hired to conduct the SCF study process.

A selection of corporate organizations and (where feasible) SMEs or their representative organizations should be consulted as appropriate.

The Working Group will not be an appropriate vehicle for education and deriving market intelligence. There will be other opportunities for such activities based on EBA road-shows, seminars and conferences.

**Frequency and duration**

The EIWG would meet on bi-monthly frequency to contribute to and validate the deliverables of the study, using telephonic contact as required.
The Working Group will come into existence for an initial one year period and, in an appropriate form for further periods, as further deliverables are approved by the Board.

### 9.2 Membership of the EBA SCWG

- ABBL
- ABI – CBI Consortium
- AITE
- Banca Commerciala Romana
- Banco Santander S.A.
- Bank of Ireland
- BBVA
- Bundesverband deutscher Banken
- CECA
- Ceska Sporitelna
- Commerzbank AG.
- Crédit Agricole
- Danske Bank A/S
- Deutsche Bank
- Diamis – Atos
- DZ Bank AG
- Equens
- Finansraadet
- Fundtech
- Helaba
- ICBPI
- ING
- Isabel NV/SA
- JPMorgan Chase Bank AG
- KBC Bank
- La Caixa - Caixa d'Estalvis i Pensions de Barcelona
- Nordea Bank Finland Plc
- Rabobank
- RB International
- Royal Bank of Scotland
- SEB
- SIA – RA Computer
- SIBS
- Société Générale
- Swedbank Foreningssparbanken AB
- SWIFT
- UniCredit
9.3 Methodology of the EBA SCWG

9.3.1 Questionnaire template and relevant quotes and responses to the questionnaire

The questionnaire was sent to volunteers who accepted to run a telephone interview of one hour using the below questions as anchor points for an in-depth conversation around supply chain finance. The results of the interviews were all handled as confidential and no information or data gathered during the interview about an individual organisation have been disclosed. They were all added in aggregate to the report to reflect the views, experience and recommendations from the EBA SCWG members.

EBA Guide to Supply Chain Finance- Interview Plan

*Topic: SCF portfolio and terminology*

**Question:** Is there a need for a common terminology? Why?

**Question:** Is your preference for Supply Chain Finance based on CONTROLS where the banks is fully aware of the time-cycle, the obligations of buyer and supplier and has sight of relevant documentation, but is technically unsecured; or is your preference of adding to control a requirement for SECURITY represented by legal title to assets being made available to the bank; or is it a MIXTURE. If the latter what criteria would you apply to one or other models?

*Topic: Competitive landscape*

**Question:** Where should banks collaborate?

**Question:** Where should they compete?

*Topic: Issues and inhibitors*

**Question:** How do you assess the impact of Basel III on trade finance and SCF?

**Question:** Are the any other major inhibitors to SCF programs?

**Question:** How are you facing them internally within your organization?

**Question:** And externally with clients?

*Topic: Impact of SCF for small and medium enterprise (SME) business*

**Question:** Are SMEs part of your SCF target?

**Question:** If so, how do you make SCF interesting to SMEs?

*Topic: Benefits of SCF*

**Question:** What are the benefits you have identified so far in SCF for your organization?

**Question:** What are the benefits for your clients?

**Question:** Are you helping your clients build the business case for SCF?
9.3.2 List of participant organisations in the survey

1. Banca Comerciala Romana
2. Bank of Ireland
3. BBVA
4. Ceska Sporitelna
5. Commerzbank
6. Danske Bank
7. Deutsche Bank
8. DZ Bank
9. Equens
10. ICBPI
11. J.P. Morgan
12. KBC Bank
13. Nordea
14. RA Computer
15. Rabobank
16. Raiffeisen Bank International
17. RBS
18. SEB
19. SWIFT
20. The Luxembourg Bankers’ Association (ABBL)
21. Unicredit
9.4 Relevant quotes and answers to the questionnaire

**Topic: SCF portfolio and terminology**

**Question:** Is there a need for a common terminology? Why?

“Yes, indeed – a common terminology is important to get a clear understanding of what is meant by SCF over all, for financial institutions, industry, government etc. Also concerning a general standard which will probably be set in future, to guarantee interoperability of SCF-products on an international basis a clear terminology would be helpful.”

“Yes. For the following reasons:

1- Intra-Bank:

SCF is a suite of products which requires collaboration of a number of relatively discrete units within a banking organisation (e.g., Corporate Banking, Business Banking, Trade Finance, Payments and Procurement).

2- Inter-Bank

Collaboration between banks either for the purposes of risk sharing for very large deals or simply technical collaboration on the underlying aspects of SCF (e.g. e-invoicing) requires the same common language as outlined above for internal conversations.

3- Customer conversations

“Customer-Bank communications are aided by consistent terminology.”

“Needed, but not as a glossary carved in stone.”

“Need to speak the same language - between banks but also with IT providers and governments. It generates confusion and it would benefit from common terminology.”

**Question:** Is your preference for Supply Chain Finance based on CONTROLS where the banks is fully aware of the time-cycle, the obligations of buyer and supplier and has sight of relevant documentation, but is technically unsecured; or is your preference of adding to control a requirement for SECURITY represented by legal title to assets being made available to the bank; or is it a MIXTURE. If the latter what criteria would you apply to one or other models?

“The legal support truly depends on the type of financial instrument being provided.”

“Banks are forced to KYC requirements. Banks need stricter requirements than in the past. From trade finance angle banks need legally binding documentation. They cannot have only a subjective view for the sole purpose of facilitating a collaborative environment. Tight rules can also allow banks to
replace one another in syndicated SCF programs. If it facilitates collaboration then clarity can only come from legally binding setups.”

“The selection of security vs. controls really depends on clients. In general, if our bank is not the cash bank for the corporate client asking for SCF solutions then we need more formal requirements. If it’s already our bank’s client, then we can afford more relaxed controls. Currently our criteria go client by client and market by market. We are also working to create more structured selection criteria.”

**Topic: Competitive landscape**

**Question:** Where should banks collaborate?

“To guarantee interoperability an important aspect for collaboration would be data formats, technical aspects etc. Also from the European perspective, agreed communication in the direction of governments and regulations would be helpful to set a European- or worldwide standard.”

“SCF is primarily a competitive space generally. Possible area of collaboration is on risk sharing for either a) larger multi-bank deals or b) establishing standard risk measurements to allow competition for contracts at different risk profiles.”

“Banks can collaborate in sharing risk of financing with other banks. Collaboration is on the back end while competition sits at the front end.”

“The dematerialization of the physical supply chain by companies has not been followed by integrating financing services into this. Clarity on standards of data components requires a collaborative effort.”

“SCF can be covered where the bank is present. Problem is where the client is present and not the bank. Cooperation is important to share platforms and service clients on a shared-service level. Syndication deals also a collaborative space.”

“Collaboration materializes in building interoperability between banks. If supplier and buyer do not have same bank then interoperability between banks is important. SCF is to help SMEs mainly: they are not customers of large banks but of local banks. Large buyer has usually a large bank. Collaborative space helps global banks to work with local banks.”

**Question:** Where should they compete?

“Some examples of competitive areas are: service definitions, pricing, specific product details.”

“Pricing and services. For our bank technology is still an important differentiator to automate products and ensure cheaper delivery. It remains a strategic competitive tool.”
“Competition is in the corporate-to-bank interaction. Ownership of the customer is key to maintain competitive edge. Also with communication standards—typically falling in the collaborative space—the provision of added value services helps differentiate. Competition is established on pricing, easy to use services (i.e., convenience), user friendliness, presence in market and relationships with customers (i.e., physical presence).”

**Topic: Issues and inhibitors**

**Question:** How do you assess the impact of Basel III on trade finance and SCF?

“As described in EBA letter from Dec. 2011 (“Joint Industry Communication on Trade Finance and the Basel Framework”) we agree that Basel III implies high requirements especially for our SME and mid-size clients. Especially for German market which is known as an export-oriented Basel III means new challenges in optimizing trade finance and SCF.”

“Impact is yet to be determined. Pricing models are being developed and tested. Better revisit this question at later stage.”

“We foresee concerns in trade finance relative to the negative impact on liquidity resulting from BASEL III regulations. For invoice discounting – on the contrary—while the implications as yet are unknown, the expectation is that invoice discounting is likely to become more ‘capital light’ relative to other financial instruments.”

“We don’t have as of yet a consistent information on Basel III. SCF should be considered differently from other financing instruments. SCF is a liquid asset vs. other asset classes.”

“Basel III imposing more capital requirements should be seen as a motivation to use more SCF instruments to optimize working capital. Similarly, banks see more incentive to better elaborate and analyse their corporate clients’ data to assess their risk profile.”

“Basel III will increase capital cost for banks which will drive price increase. This however goes against the political agenda of G20 who want to boost trade and help SME market. Need to see how national regulators are implementing Basel III to protect SMEs.”

“We don’t think of Basel III as an inhibitor to SCF – Basel III means new requirements on SCF programs and in this regard SCF will get more attention from client’s perspective and also from the view of financial institutions.”

**Question:** Are the any other major inhibitors to SCF programs?

“Other major inhibitors to SCF are excessive documentation and paperwork. Long contracts from banks are also a roadblock. Electronic exchange will help. Delinquency and commercial disputes can fade away with electronic exchange because harder to counterfeit.”
“An inhibitor is the complexity due to the number of departments - at banks (e.g., credit, strategy, sales, risk) as well as at clients (e.g., procurement, treasury, finance). The problem is to convince each single internal department at banks. Is there a common agreement within banks? Is there an agreement on legal requirements? Is budget available?”

“Legal aspect to enforce assignment of invoices under local laws is a potential inhibitor. How does each national jurisdiction assign valid title on the invoice? KYC is also different from one institution to another.”

Question: How are you facing them internally within your organization?

“We are overcoming these issues using different communication levels. We are also adopting different marketing materials.”

“We engage with our senior executives to assess the institution’s appetite for electronic invoicing practices and SCF.”

“Our goal is to bring experts from different areas of the bank and describe the compelling proposition to breakeven at every step of the SCF program we want to offer to our clients. Only very large banks can afford running full SCF programs because they have clients with volumes.”

“We organise internal workshops, generate information for other departments, inform management, and get big enterprise names asking for SCF to generate attention internally.”

“We invest in internal education and promotion. The bank’s client managers do not understand yet. We had to help them build their own internal dictionary for SCF.”

Question: And externally with clients?

“We think about new solutions for clients SCF and inform them via press releases etc. about possibilities to benefit from SCF-Management.”

“Clients need to understand the value. Education is the key success factor. Multinational companies know more about SCF and are ready to buy in. Local suppliers—typically SMEs—are still not confident with proposals coming from banks. Banks need to build critical mass and educate market. Power of decision sits in different places. Need to find the right person to address.”

**Topic: Impact of SCF for small and medium enterprise (SME) business**

Question: Are SMEs part of your SCF target?

“As an operator in the cooperative banking sector SMEs are one of our main target clients. Therefore, we provide special solutions for SMEs.”
“We don’t address SMEs directly. We work with SMEs only if brought in through a large buyer, in which case we offer on-boarding services.

“In our experience it varies from country to country. It is the large buyer that asks the bank to cooperate with its supplier base (normally SMEs). A direct approach to SMEs is not in the strategy of our bank. We don’t see a mature market yet. It’s the buyer who arranges the program with suppliers. Then the bank comes in.”

“SMEs have higher risk and Basel III will be tougher. Banks need more security and like to work with “good” (i.e., safe) companies. Those SMEs who really need SCF are the “bad” companies that are—unfortunately—too risky to be served by banks.”

Question: If so, how do you make SCF interesting to SMEs?

“Educating and informing SMEs on how much they can benefit from SCF solutions. Another action related to offering web-based systems which can be used without expensive software licenses only via web-interfaces.”

“Allowing them to get financing without too many questions and at cost of financing they otherwise could not get.”

“By leveraging on the ‘ripple-down’ effect, we show that companies that have been involved in SCF programs as suppliers of Western Europe clients can replicate the same experience with their own supplier base.”

**Topic: Benefits of SCF**

**Question:** What are the benefits you have identified so far in SCF for your organization?

“SCF is an additional vehicle for revenue potential. Also it will tie the customer to the bank.”

“Follow the client is the key value. Finance real life cash flow. Not financing buildings or other assets but current flows of operations. From this the bank knows the behaviour of corporate clients and be ready to help them and anticipate eventual problems. Enhance relationship with companies is another value that drives more business.”

“SCF requires looking at supply chain processes first to find gaps and provide SCF solutions. Don’t look at point processes (e.g., shipping) but the entire process steps. Platform for SCF help gain new customers and increase relationship with customers. Platform allows to get more info and more difficult to change platform allowing longer relationship.”

“Suppliers can get financed and get payment on time and fast. They can grow fast with the buyer. Buyer does not ruin relation with the supplier, or vice-versa depending on the balance of powers in the relationship. Banks benefit from
cross selling and offering new services to clients. Banks get access to new clients.”

“Buyer and sellers need accelerated financing transactions in line with speed of movement of goods. Electronic exchange of data is a necessary system to do SCF. Supply chain partners already working with e-docs so banks risk to be set apart if they keep using paper documents. With SCF programs banks can follow the speed of their customers' supply chains.”

**Question:** What are the benefits for your clients?

“They optimise working capital, access to better liquidity- and finance structures, and access to smoother processes and interfaces with standardized formats.”

“They access an array of financing solutions, enjoy the ability to strengthen their supply chain, extend payment terms, and get cheaper cost of funding.”

“Buyers: improve working capital by extending DPO. Have suppliers that deliver constantly ensuring business continuity. Suppliers: happy with financing costs and certainty of getting paid early ad can focus on their business.”

“Strategic issue for buyers is to link suppliers to their company. Loyalty of supplier base can be achieved through facilitating payment term conditions.”

“SMEs exporters accept smaller orders once the platform allows matching POs and invoices, accelerates payments and control of discrepancies.”

**Question:** Are you helping your clients build the business case for SCF?

“We analyse the SCF together with our clients for two reasons:
- get an insight of SCF processes to identify potential for optimization
- build an individual solution package which is customized on clients' needs.”

“We offer a ‘working capital’ optimizer through a consulting approach.”

“Procurement needs to be convinced of the benefits. Our bank has learned from other SCF operators on the importance of getting procurement involved and manages this on a personal basis.”
10 Annex 4 – Traditional Trade Finance and Payments

This section briefly describes the portfolio of traditional trade finance instruments and payment instruments.

Traditional trade finance has always sought to align the provision of financial instruments with the production and movement of goods. The expectation is that this area of finance will continue to grow albeit it is declining in relative terms to SCF.

These forms of trade finance may be classified in two main categories:

- Forms of bank-intermediated trade finance (i.e., documentary trade finance)
- Forms of trade finance involving bank support without credit or risk engagement

10.1.1 Forms of bank-intermediated trade finance

A Documentary Letter of Credit (LC) is a written undertaking given by the issuing bank at the request of the buyer (applicant) to honour a presentation of compliant documents, i.e. to pay the beneficiary at sight, to incur a deferred payment undertaking or accept a bill of exchange and pay the beneficiary at maturity. Such letters of credit come in many forms of which irrevocable, and confirmed or unconfirmed are the most common. LCs may involve receipt of cash on shipment once the presentation of documents occurs or may include a variety of financial options including discounting of accepted bills or pre-shipment finance. The most appropriate reference to a comprehensive guide to documentary finance is the ‘Uniform Customs and Practice for Documentary Credits’ revision 600 (UCP 600\(^{11}\)), a set of rules on the issuance and use of letters of credit utilized by bankers and commercial parties in more than 175 countries involved in trade finance.

The importer and exporter must always remember that, unlike transactions in a domestic market, the complete and timely collection of outstanding international transactions may be affected by issues related to country risk, notwithstanding the standing of the foreign trading party. Credit and country risk are relevant.

The provision of bank-intermediated Documentary Letter of Credit (LC) requires the bank to undertake an assessment of the creditworthiness and performance capability of the party on whose behalf an LC is issued or confirmed - the Buyer or Importer-, as well as understanding the credit and performance characteristics of the beneficiary or exporter, as well as meticulously executing the transaction as a process. Accordingly these forms of finance are relatively expensive.

The exporter that decides to request the use of an LC must always be aware of the costs and operational requirements of such a transaction. It should be borne in mind that a large number of LC transactions involve discrepancies and thus the payment obligation depends ultimately on the other commercial party to accept and pay for the

\(^{11}\) http://www.iccbooks.com/Product/ProductInfo.aspx?id=487
goods, albeit there is a structured payment process involved. The exporter must also be aware that the counterparty risk shifts from the buyer to a bank, and therefore it is important to assess the standing of the banks concerned, and determine the need for appropriate confirmations.

Although 80%-85% of trade transactions are estimated to be settled on an open account basis, the L/C remains an important transactional instrument. A solid foundation of documentary credit-based trade will remain, especially between companies that have just started a trading partnership. They are still in the process of better knowing one another and the level of reciprocal trust is not yet at the point where open account transactions can take the place of more risk-averse documentary credit exchanges. The passage to open account will eventually happen once the level of confidence has reached the level for which a purchase order is sufficient to ensure the fulfillment of the order and the subsequent execution of the payment against an issued invoice.

LCs are likely to retain their popularity in connection with well-defined trade flows: for example in Asian trade where the instrument is commonly used to raise pre-shipment finance as well as assurance of payment. Another example is its use by exporters into emerging markets where factors such as exchange control rules, business habits, country risk and the credit standing of buyers and local banks motivates the use of confirmed LCs.

**Standby and Performance LCs** are simpler in form but present a more complex series of risks than Documentary LCs. As a conditional payment instrument, they may be issued in advance of shipment or contract fulfilment by a supplier to secure a tender or contractual performance. A simple demand or a pre-agreed statement evidencing non-performance is usually the basis of triggering payment. For the issuing bank the open nature of the commitment requires careful assessment. In some cases these instruments are used outside the trade related area to effectively provide a guarantee the granting of credit by another financial institution. It is important to distinguish the trade related type of standby/performance LC from the use they are put to for the credit enhancement of financial transactions.

**10.1.2 Forms of traditional support for trade without bank intermediated finance or risk assumption**

In international trade there are various means of payment not guaranteed by the bank that provide value and provide some degree of protection and security for the trading parties. The choice of the degree of protection depends on the perceived credit risk as seen by the exporter and the respective negotiating powers of the trading parties.

**Documentary collections** are a means of payment where the bank acts as an intermediary between the exporter and importer based on the collection of a bill of exchange and related shipping documents. It is an intermediate instrument between a transaction secured by a letter of credit and an open account transaction which is

---

12 Source: ICC Global Survey on Trade Finance, 2012
settled with a simple bank credit transfer. The costs of this service are generally lower than for a letter of credit, and higher than for a credit transfer. In a documentary collection the exporter’s bank, once it has received a mandate from its customer transmits to the importer’s bank the commercial documents that prove the dispatch of the goods or the provisioning of a service. The receiving bank delivers these documents to the importer only on payment of the amount due. The responsibility of the banks is therefore limited to forwarding and delivery of the documents against payment or acceptance of a draft without any responsibility and commitment to pay. The banks have no responsibility for the validity and effectiveness of the documents submitted, and no responsibility for delays, losses, or translation mistakes. A bank may consider the discount of such collections and if undertaken without recourse can be considered as close to a forfaiting transaction.

**Credit transfer** (also known as a funds or bank transfer) is the most commonly used form of payment in both domestic and international B2B transactions. The credit transfer is a transfer of funds from the account of the ordering customer into the account of the beneficiary usually by electronic means. With regard to choosing the credit transfer as a form of payment, it is a simple payment instrument that should be used in the case of high trust and confidence between trade partners. The bank normally advises its clients that the use of this form of payment must be tightly linked to the timing of acceptance of goods. The commercial contract should specify the date of execution of the payment transfer, or establish a starting point after a fixed number of days from the date of invoice. Trading parties also often arrange for Cash (Payment) on delivery (COD) or even Cash (Payment) in advance.

The majority of credit transfer payments are usually domestic in nature and that is where the larger volumes lie. For cross-border payments the SWIFT based credit transfer payment is most common, although there are a variety of other remittance services. In Europe the payments market is integrating integrating based on the Single Euro Payments Area (SEPA) and further underpinned by the Payment Services Directive.

**Debit Debits** are collections arranged by the creditor that require prior authorization by the debtor. They are usually adopted for recurring payment transactions. In the presence of numerous, on-going payments, the Supplier or Exporter may open an account at a bank in the country of the Buyer/Debtor. The Direct Debit may have some useful features for the exporter under such an arrangement as proceeds of sales can be received with certainty. Direct Debit is more common in domestic markets for recurring consumer bills, although it also has benefits for B2B transactions including international business flows. Specific B2B Direct Debit services are becoming more common, e.g. in the SEPA DD B2B scheme.

**Checks/Cheques and Lock Box services** for the handling of traditional paper-based payment instruments are still convenient in certain circumstances although considered increasingly slow and expensive. Trading parties may also consider the use of Bank Drafts, which are checks that are guaranteed by a bank.
11 Annex 5 – Reference & Sources Documentary and other bank services for trade

- EBA e-invoicing initiative – Service Description and Rulebook, an approach to interoperability between banks and service providers, EBA (https://www.abe-eba.eu/Documents-N=E-InvoicingDocuments-L=EN.aspx)
- Supply Chain Finance, Myth or Reality? Presentation from McKinsey, October 2010 (http://www.mckinsey.com/clientservice/Financial_Services/Knowledge_Highlights/Recent_Reports~/~/media/Reports/Financial_Services/MoP9_Supply%20chain%20f
ingace.ashx)
- BAFT-IFSA Product Definitions for Open Account Trade Processing and Open Account Trade Finance – BAFT-IFSA, May 2011 (www.BAFT-IFSA.com)
Supply Chain Finance
European market guide

– Gtnews, Supply Chain Finance column – (http://www.gtnews.com/financialsupplychain/default.cfm?s2=438)
– Global Trade Management- Solutions for the Financial Supply Chain - Tradebeam
– Invoice factoring - Useful information on Invoice factoring and Asset based financing (http://www.invoicefactoringguide.org/)