EXPLORING SUPPLY CHAIN FINANCE

UNLEASHING WORKING CAPITAL IN THE CONSTRUCTION INDUSTRY

For years, the construction industry has been afflicted by the lack of access to sufficient working capital. According to the 2015 Global Working Capital Survey from PwC, the engineering and construction industry took the longest to process payments of all industries analyzed. On average, engineering and construction companies worldwide took 73 days to process payment, while the top performing industry, hospitality and leisure, took just 15 days.

The long payment terms in construction are especially challenging as they put stress on contractors who often complete work before getting paid and distributors who deliver materials for that work before getting paid. That also means they must buy materials and cover payroll long before payment is received. In essence, the supplier and distributor are giving the contractor a free loan. This can create cash flow difficulties for subcontractors that can impact and even delay work, and for distributors who are not able to replenish inventory as quickly.

So how do they transform a long payment window into a program that will not only pay subcontractors and other suppliers earlier, but also free up working capital to help grow their construction business? The answer is supply chain finance, which is becoming a more common practice across various industries to optimize working capital for both buyers and suppliers.

Supply chain finance — also known as supplier finance, reverse factoring, or accounts payable finance — is a solution that helps meet corporate objectives by increasing access to working capital, as well as reducing the risks of supply chain disruption. With buyer-driven supply chain finance, cash flow is optimized by enabling businesses to increase payment terms to suppliers while in turn providing suppliers the option to get paid early at very competitive finance rates.

The funding rate is based on the buyer's credit rating, which is typically rated as "investment grade." While larger suppliers may carry a similar rating, the vast majority of suppliers typically carry sub-investment grade ratings or are not large enough to warrant a rating. As a result, their borrowing costs will be substantially higher than the cost of funding available via a supply chain finance program.

As a result, supply chain finance allows a distributor organization to optimize its payment terms to its suppliers and improve its working capital position by generating free operating cash flow. Depending on the size of the organization and how effective it is at driving term extensions across the supply chain, cash flow improvements can be very substantial — in the hundreds of millions to even billions of dollars for large corporations.

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Supply chain finance programs have another unique financial benefit for both distributors and suppliers, in that there will not be a negative effect on their outstanding debt levels. While a distributor unlocks cash flow that has been historically trapped in their supply chain, the accounting for trade payables remains as is. Similarly, suppliers electing to participate and trade their receivables for early payment do not account for those early payments as debt. Few other solutions offer material cash flow benefits while not incurring additional debt on a company's balance sheet.

Several key factors need to be taken into account for distributors to implement an effective supply chain finance program, including an analysis-driven approach, overall plan and appropriate training and messaging. A successful supply chain finance implementation can be broken down into five steps.

1 **Benchmark supplier terms and identify optimization opportunities.** Companies must be able to easily analyze and determine which suppliers will yield the most impact to their unique working capital objectives. This requires access to powerful benchmarking data based on supplier geography and commercial considerations such as contract length, sole- or multi-source supplier categories and other critical factors. Given the volume of supplier data involved in this exercise, strong data analytic capabilities are required to uncover optimization opportunities.

2 **Prioritize suppliers for program on-boarding.** The key to freeing up substantial working capital in a short period of time is prioritization. Which suppliers should be on-boarded first? Which will be included in subsequent phases of program rollout? What are the easy "wins" that will yield fast improvements to working capital? Such an approach customized to individual supplier characteristics maximizes working capital, cash flow and time to value.

3 **Customize your message based on your supplier targets.** "Know thy customer" is Sales 101 — and a lesson to be learned by any company looking to efficiently enlist suppliers into a supply chain finance program. Strategic sourcing teams need to create different messaging for different groups of suppliers. This messaging takes into account the supplier's business characteristics, drivers, value of capital, and the economic impact the program will have on their operations. By creating a customized and compelling message, distributor purchasing managers will gain higher levels of supplier acceptance and participation.

4 **Arm your sourcing team with the right training, tools and negotiation support.** Training must be provided to purchasing teams to ensure they understand the proposed payment terms and how the supply chain finance program impacts supplier financials. Additionally, purchasing teams need access to supplier financial data and scenario modeling tools to strengthen negotiations and keep suppliers engaged.

5 **Measure for continuous performance improvement.** Measurement of the supply chain finance program is critical to keeping performance on track. How much working capital are you freeing up? Which suppliers are making material contributions to your objectives, and which are not? The ability to track performance down to the regional, commodity and purchasing manager level provides visibility and accountability.

In today's dynamic global environment, maintaining a strong, efficient, and secure financial supply chain is critical. The need to access liquidity, optimize working capital and minimize credit risks is becoming increasingly important. The construction industry has some unique challenges that contribute to cash flow issues, but implementing a strong supply chain finance program that works based on a company's specific business needs ensures the ability to free up working capital to further invest and grow the business. **CS**

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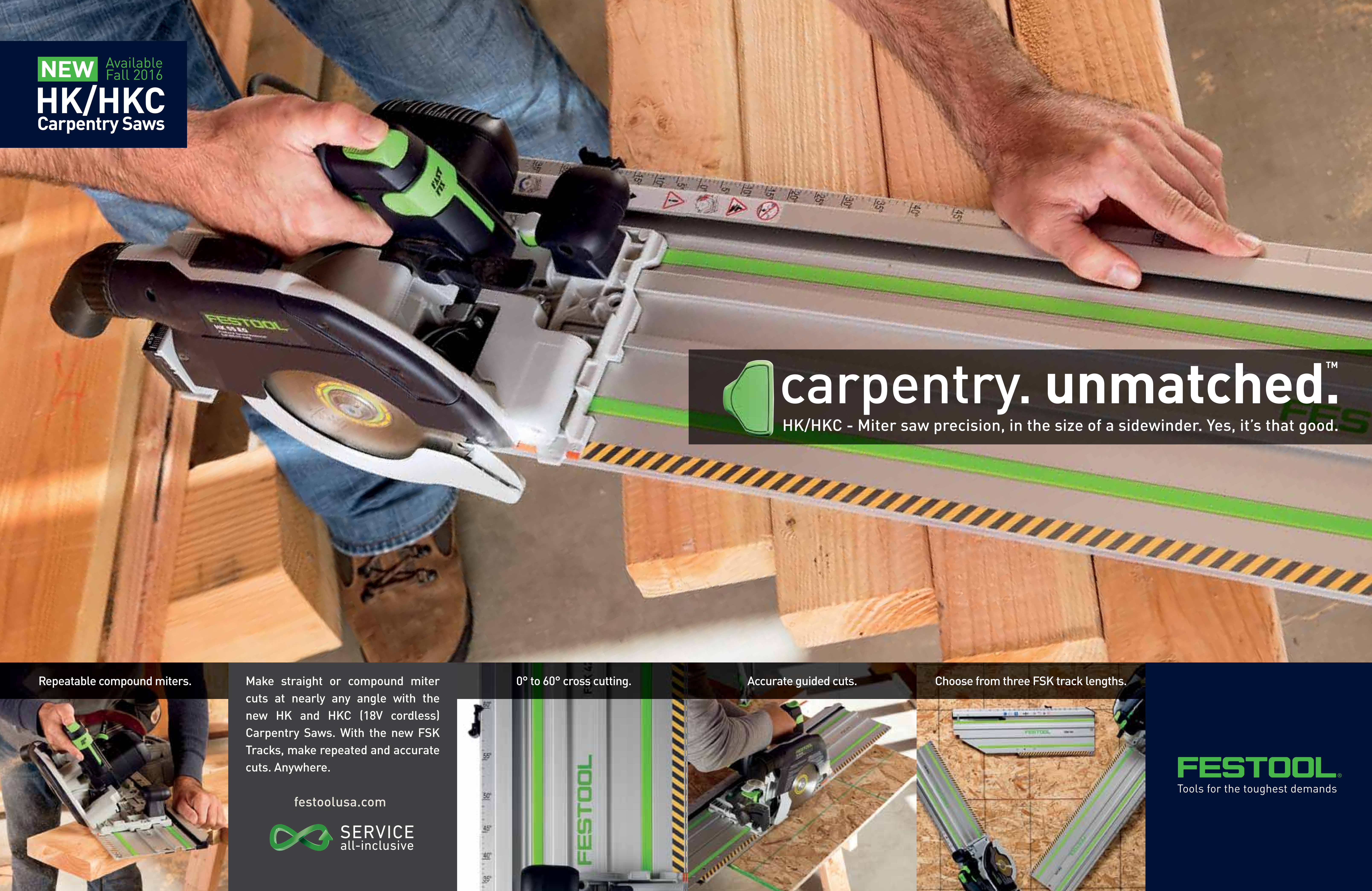
WORKINGCAPITAL

by Tom Roberts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