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What is Supply Chain Financing? Explaining the Various Products

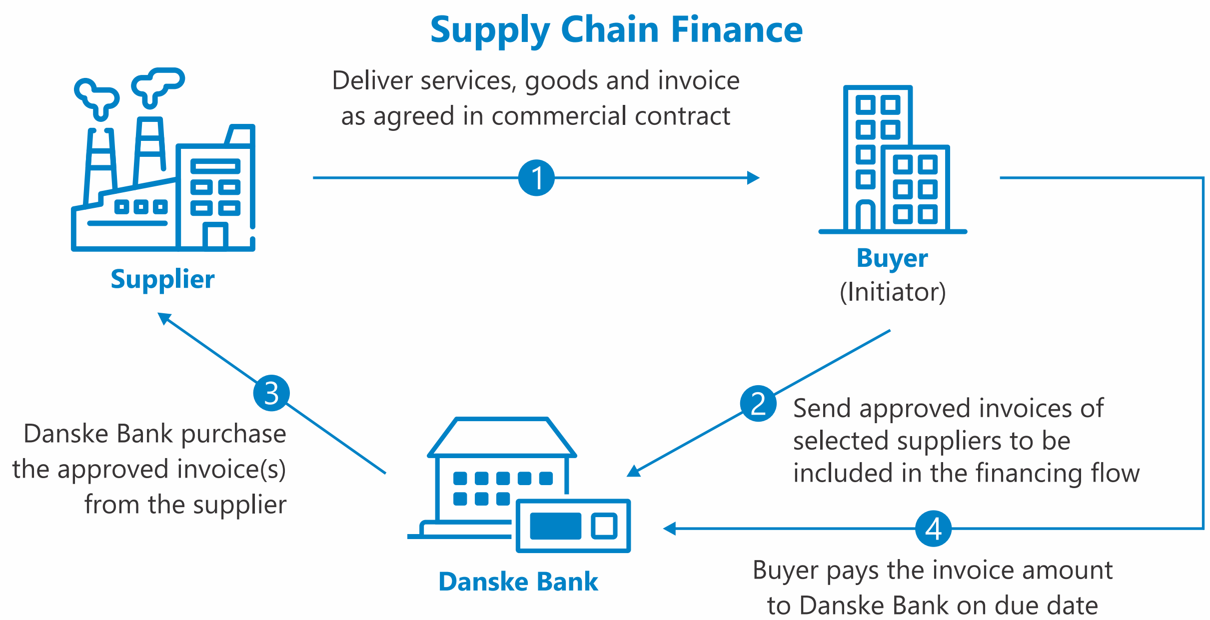
Prologue

- Supply Chain Finance is a cash flow solution which helps businesses free up working capital trapped in global supply chains.
- Supply chain financing is a type of financial service that provides businesses with the necessary funding to manage their supply chain operations effectively.
- Supply Chain Finance is also known as SCF, payables, reverse factoring and supplier finance.

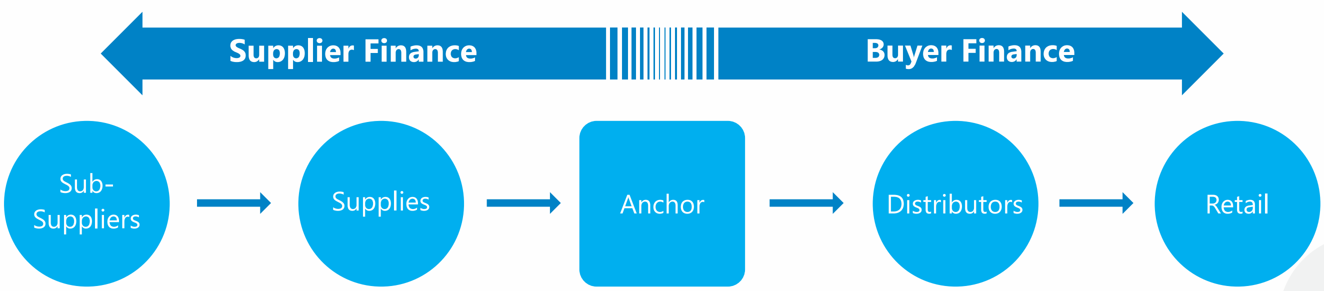
What is Supply Chain Finance?

"Supply Chain Finance is defined as the use of financing and risk mitigation practices and techniques to optimize the management of the working capital and liquidity invested in supply chain processes and transactions. SCF is typically applied to open account trade and is triggered by supply chain event. It is a financing solution in which suppliers can receive early payment on their invoices. It also the risk of supply chain disruption and enables both buyers and suppliers to optimize their working capital.

Supply chain finance works best when the buyer has a better credit rating than the seller and can thus access capital at a lower cost. It provides short-term credit that optimizes working capital for both the buyers and the sellers.



Supply Chain Finance is generally defined as **"An Arrangement whereby a buyer agrees to approve his suppliers' invoices for financing by a bank or other financier".** Supply chain finance (SCF) is essential to supply chain management.



It is a solution designed to benefit both suppliers and buyers; suppliers get paid early and buyers can extend their payment terms. This solution allows businesses which import goods to unlock working capital as well as reduce the risk associated with buying goods in bulk and transporting them globally.

How Does Supply Chain Finance Work?

Supply chain finance works best when the buyer has a better credit ratingthan the seller, and can consequently source capital from a bank or other financial provider at a lower cost. This advantage lets buyers negotiate better terms from the seller, such as extended payment schedules. Meanwhile, the seller can unload its products more quickly, to receive immediate payment from the intermediary financing body. The shipment of goods marks an essential sequence for SCF; it dictates the facilities most suitable for financing.

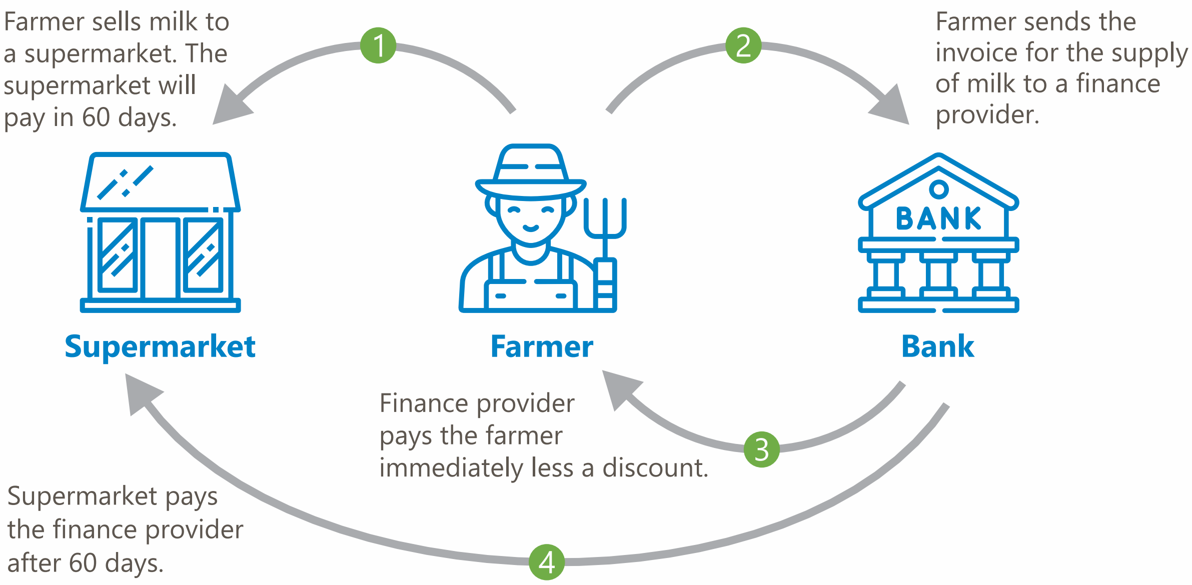
Process Flow

Supply Chain Finance Process Flow

The process is summed up in the following steps :

1. KYC and due diligence are performed on the buyer and its suppliers. These procedures validate that both sides are eligible for SCF services.
2. The Supplier invoices the buyer and then transfers the invoice to the financing company.
3. The Financing Company advances about 80% of the notional amount.
4. At maturity, the Buyer pays the whole amount of the invoice. Then the funds are transferred to the financing company accounts.
5. The Financing Company re-pays the supplier the remaining 20% minus the agreed fees.

Lets understand supply chain financing with help of an Example :



Benefits of Supply Chain Finance

1. Improved Cash Flow :

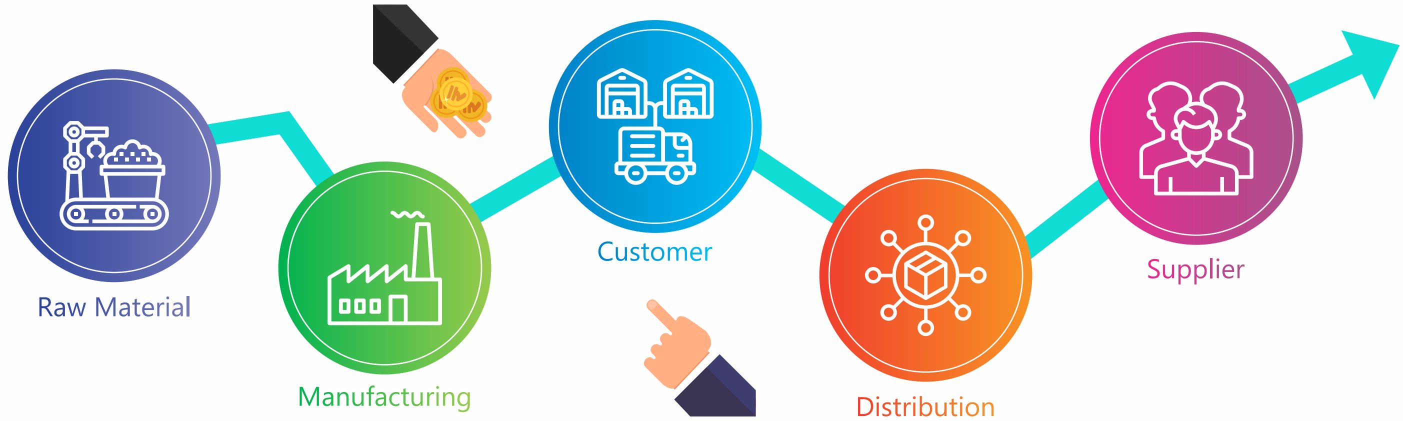
Supply chain financing products can provide suppliers with immediate access to cash, enabling them to improve their cash flow. This can help suppliers to pay their bills on time, invest in their businesses, and grow their operations.

2. Increased Efficiency :

Supply chain financing products can help to increase the efficiency of the supply chain by streamlining payment processes. By providing financing to suppliers, buyers can negotiate longer payment terms without impacting their working capital.

3. Reduced Risk :

Supply chain financing products can help to reduce the risk of non-payment for suppliers and financiers. By providing financing based on the creditworthiness of the buyer, rather than the supplier, financiers can mitigate the risk of default. This can also help suppliers to reduce their risk of non-payment.



4. Competitive Advantage :
Supply chain financing products can provide suppliers with a competitive advantage by enabling them to offer more flexible payment terms than their competitors. This can help suppliers to win new business and retain existing customers, while also benefiting buyers by providing them with access to a wider range of suppliers offering competitive pricing and payment terms.

5. Access to New Markets :
Supply chain financing products can provide suppliers with access to new markets by enabling them to offer competitive pricing and payment terms. This can help suppliers to win new business and expand their operations, while also benefiting buyers by providing them with access to a wider range of suppliers.

6. Increased transparency and visibility into the supply chain :
SCF platforms can provide buyers and suppliers with real-time visibility into their financial transactions. This can help to improve communication and collaboration, and to identify and resolve any potential problems early on.

7. Strengthened buyer-supplier relationships :
Supply chain Finance can help to strengthen buyer-supplier relationships by creating a more collaborative and mutually beneficial financial relationship.

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Products of Supply Chain Finance

Supply chain finance encompasses various financial products and solutions designed to optimize and facilitate the management of cash flow, working capital, and financial transactions within a supply chain. These are some of the products within supply chain finance :

1. Purchase Order Financing :
Suppliers obtain financing based on confirmed purchase orders from buyers, enabling them to fulfill orders and cover production costs. This type of financing allows suppliers to receive early payment for their invoices. The financing provider pays the supplier a percentage of the invoice value upfront, and then collects the full amount from the buyer when the invoice is due.

2. Invoice Financing :
Invoice financing, also known as accounts receivable financing or invoice factoring, is a financial arrangement in which a business sells its outstanding invoices or accounts receivable to a financial institution or a specialized lender at a discount in exchange for immediate cash. This type of financing allows suppliers to receive early payment for their invoices.

3. Inventory Financing :
Inventory financing, also known as inventory loans or inventory financing loans, is a type of business financing that allows companies to use their existing inventory as collateral to secure a loan or line of credit. This financing option is particularly useful for businesses that need working capital to manage their inventory levels, purchase additional inventory, or cover other operational expenses.

4. Dynamic Discounting :
This type of financing allows buyers to offer early payment discounts to their suppliers in exchange for a lower price. The financing provider facilitates the payment process and provides the necessary funding. This helps buyers optimize their cash flow and negotiate better prices with their suppliers.

5. Supplier Financing (Reverse Factoring) :

Supplier financing, also known as supplier finance or reverse factoring, is a financial arrangement that benefits both buyers and their suppliers within a supply chain. It involves a financial institution or a specialized financing provider assisting a buyer in providing favorable financing terms to its suppliers.

6. Payables Financing :

Payables financing, also known as accounts payable financing or trade payables financing, is a financial arrangement in which a business extends its payment terms to suppliers while freeing up its own working capital. This allows the business to better manage its cash flow and use the funds for other operational needs or growth opportunities.

7. Channel Financing :

Channel financing, also known as dealer financing or channel finance, is a financial arrangement in which a business or manufacturer provides financing support to its distributors, dealers, or intermediaries within its supply chain. This form of financing is designed to help these channel partners manage their working capital and improve their financial stability, ultimately benefiting the entire supply chain.

Conclusion

- Supply chain finance is a strategic financial approach that facilitates the efficient management of cash flow within a supply chain ecosystem. In this process, a buyer and its suppliers collaborate to optimize payment terms.
- Supply chain finance enhances financial visibility, fosters stronger supplier relationships, mitigates risks associated with payment delays, and ultimately contributes to the overall resilience and competitiveness of businesses in today's global marketplace.
- Supply chain finance holds immense importance in modern business operations. It serves as a financial lifeline, allowing companies to optimize their working capital.
- Stronger supplier relationships are fostered as it offers early payment options or affordable financing, making a company an attractive partner. Cost reduction is achieved through improved cash flow management and reduced reliance on costly short-term loans.
- Lastly, it enhances financial visibility by offering insights into transactions along the supply chain, empowering better control and informed decision-making.
- Hence Supply chain finance is a cornerstone in bolstering financial health, risk management, and fostering fruitful relationships in the world of commerce.

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