CORPORATE VALUE PARTNERS

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CORPORATE FINANCE INSIGHTS

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Supply Chain Finance

Supply chain finance programs have been written up several times in the Wall Street Journal over the past 18-24 months. Apparently, they are becoming common enough that the US accounting standard-setter, the Financial Accounting Standards Board ("FASB"), has issued a standard about how to report supply chain finance programs in financial statement footnotes. I have been following the developments because of an article I wrote in 1996 that lays-out a framework to negotiate discount terms, which seems to be a part of the negotiations in supply chain finance programs (https://www.corporatevaluepartners.com/news-data/art_081808.pdf).

Prior to supply chain finance programs, there could be some room for agreement on discounting receivables directly between the customer and suppliers, as long as there was a significant difference in the cost of capital between the large customer (generally lower cost of capital), and the supplier (generally higher cost of capital). The greater the difference in their cost of capital, the greater the likelihood that a discount could be agreed to.

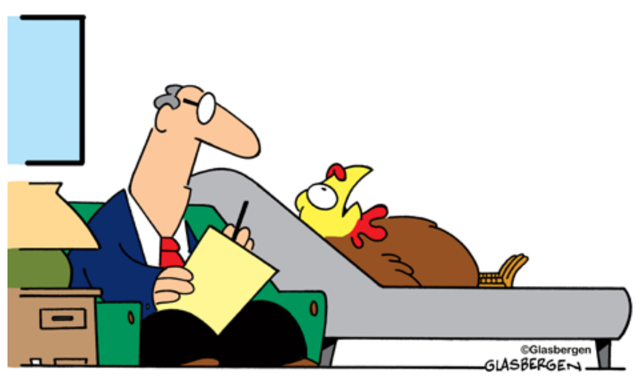
But suppliers have been reluctant to agree to discount terms directly with their large customers because they are concerned that the customer will take the discount, treat it as a price concession and then return to extended payment terms. This concern, along with the cost of discounts, traditionally caused small suppliers to avoid discount discussions with their customers.

How They Work

The emergence of supply chain finance programs seems, on its face, to offer a solution. There are three pieces to a supply chain finance program:

1) A large customer with many suppliers, which are primarily smaller businesses. The customer manages its accounts payable so that its suppliers may have to wait 90-120 days (or more) to be paid.
2) Suppliers to the large customer. Many feel constrained by carrying accounts receivable for an extended period, which creates cash flow and banking issues.
3) A financial institution (often a bank) that is willing to pay the suppliers earlier, at a discount, and wait for payment from the large customer on its regular payment date.

One benefit is that many financial institutions should have a lower cost of capital than the large customer, which should expand the range for an agreement on discounts with suppliers. Second, suppliers may feel more comfortable about dealing with a financial institution on discounts rather than their large customer, giving them some comfort that taking a discount for early payment will not turn into a price concession followed by re-extended payment terms.



"The medication isn't helping. I still get depressed around the holidays."

Some Useful Details

It is not clearly spelled out in publicly available data how the relationship between the bank and the large customer works in a supply chain finance program. But at a high level, it seems that the amount that the large customer would owe the bank under a supply chain finance

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program remains an unsecured debt, which is an important matter to the customer and the bank.

Banks are unlikely to accept an unsecured debt from any company with less than a "blue chip" credit rating. Large customers are unlikely to trade an unsecured debt to a supplier for a secured debt to a bank, regardless of the economic benefits involved. As a result, it is likely that only large customers with the highest credit ratings will be able to offer supply chain finance programs through reputable banks.

There are some non-bank "platforms" that are offering supply chain finance programs over the Internet. Based on what I have seen, some of the platforms simply act as an "app" that the customer and bank use to build a supply chain finance program. For other platforms, it isn't quite clear to me what is happening.

The lack of information and uniformity in the market would seem to create some risk for suppliers, but it is not clear at this point what those risks may be. Additionally, I have not found information about how supply chain finance programs work from the supplier's perspective. If you have any information from the supplier's perspective that you can share with me, I would greatly appreciate it. In the meantime, I will continue to dig around. Hopefully I will be able to provide an update in a future newsletter.

This is a time to express thanks, and I am deeply thankful for my family, friends and clients. I wish you a very Happy Thanksgiving!

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Please contact Ronald DiMattia at Corporate Value Partners at (216) 741-1330 or ron@corporatevaluepartners.com with any questions or if you need help with a valuation or corporate finance matter.

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