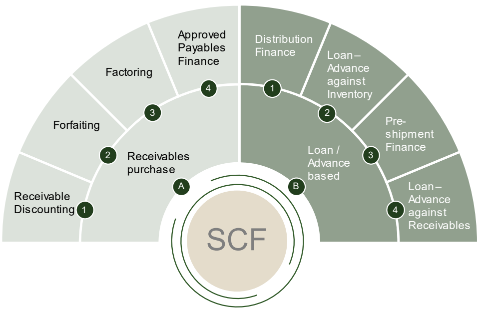
You say Supply Chain Finance, I say Approved Payables Finance – let's call the whole thing off

In our previous article (Lean Working Capital; improving your SETPOINT through structural change) we discussed how companies can achieve an improved setpoint level – allowing them to operate, sustain and even grow its operations with less working capital. This article will discuss structural change through the use of financial tools, focusing on Supply Chain Finance (SCF) – and specifically Approved Payables Finance (APF).

First and foremost – Supply Chain Finance is often inappropriately referred to as a single product, commonly used to describe what in reality is Approved Payables Finance (yes, we have been guilty of this as well). In actual fact, the term Supply Chain Finance covers a wider range of products within the trade finance ecosystem – all with the purpose of optimizing working capital and liquidity invested in supply chain processes and transactions – where APF is one of them (see figure 1 – A:4 for reference).

Figure 1. Supply Chain Finance products: ICC Standard definitions for techniques of Supply Chain Finance



So, what is Approved Payables Finance – APF is a buyer-led program enabling buyers and sellers to significantly improve both parties working capital and cash flow. This is achieved by extending the buyer's supplier payment terms, whilst providing the suppliers an opportunity to sell their buyer related receivables and receive payments much earlier than they would have in the first place – typically within 5-10 days – at a relatively low cost.

A third-party financial institution finances the time between early payment and extended payment term, often at a very favorable financing discount rate, as i.) it is based on the credit worthiness of one known buyer, and ii.) the fact that the supplier invoice has been approved for payment by buyer and therefore is considered very low risk (see figure 2 for reference).

APPROVED PAYABLES FINANCE - DISTINCTIVE FEATURES

APF is initiated by buyer, unlike other receivable discounting techniques. and assumes an unconditional and irrevocable buyer approval of supplier invoice before early payment (without recourse) from 3rd party financial institution can be made.

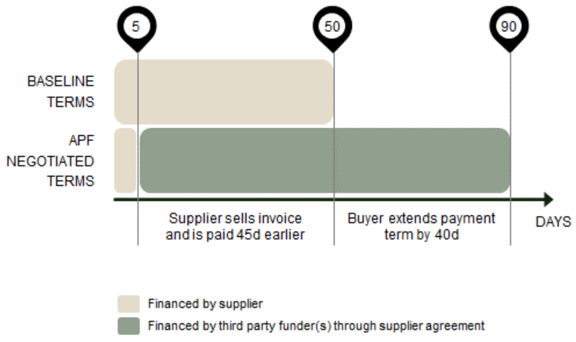
APPROVED PAYABLES FINANCE – BENEFITS

APF provides alternative and favorable off-balance sheet funding for both buyer and seller, as APF i.) is considered an extension of the buyer's accounts payable and thus not financial debt, and ii.) represents a non-recourse, true sale of receivable for the seller. Also, APF strengthens supply chain relationships, stability, and cash flow forecasting.

APPROVED PAYABLES FINANCE - SYNONYMS

Payables Finance, Reverse Factoring, Confirmed Payables, Supplier Payments, Vendor Pre-Pay, Trade Payables Management, Buyer-Led Supply Chain Finance.

Figure 2. Approved Payables Finance example



CASE EXAMPLE

1. Seller joins Buyers APF program and moves from baseline 50 days payment term to APF term of 90 days with option of selling and getting paid after 5 days,
2. Buyer uploads approved supplier invoice of $10.000 to APF platform;
3. Supplier requests early payment through APF discount facility and is paid by Funder after 5 days (45 days earlier than baseline terms), less financing cost^A;
4. Buyer pays Funder full invoice amount after 90 days (40 days later than baseline terms).

A. It is common practice the supplier carries the full financing cost, as they get access to favorable off-balance sheet funding.

With a case example discount rate of 1,8% (baserate + margin), the full financing cost is $42 - or 0,42% of full invoice value.

SETPOINT Group's view on Approved Payables Finance – we like it, very much! We strongly advocate win-win solutions that view and approach suppliers as part of an integrated value chain,

rather than external parties with competing agendas. Properly applied, APF strengthens supplier health and relationships, and is an elegant way of unlocking working capital for buyers and suppliers alike.

Having said that, we often come across some initial confusion or even skepticism towards the subject, partly caused by the historic lack of common nomenclature (as described earlier in text), and partly due to legacy. These legacy concerns are rooted in a set of common misconceptions we would like to address:

MISCONCEPTION # 1 – APF IS RESOURCE AND TIME CONSUMING, AND ONLY AVAILABLE FOR LARGER CORPORATIONS

Historically, APF solutions were only available through larger banks – geared towards their larger, investment grade client base and their largest suppliers. These early versions were manual and offered little flexibility or integration with ERP systems. However, the entry of FinTech APF providers has disrupted the industry, through user-friendly automated platforms with access to funding from multiple sources – increasing competition amongst banks to participate, making pricing more attractive – whilst offering a string of ancillary services simplifying implementation and supplier onboarding. The FinTech platform providers have simplified the roll-out of APF programs and helped open up the market for mid-market companies as well as for the long tail of suppliers.

MISCONCEPTION # 2 – PRICE IS THE ONLY DECIDING FACTOR

Price does matter, however, there are other important deciding factors that matter when it comes to attracting but also activating and retaining suppliers on the APF platform. These include user-friendly onboarding tools, technical support and plug'n'play integration, stakeholder motivation and training (buyer and seller), alignment to financial strategies, process readiness reviews and "getting-ready" support, legal support (including KYC/AML), ongoing admin and reporting support, etc. Availability and quality of such ancillary services should be given proportional weight to price in any APF decision making process and there will be industries where higher prices can be achieved due to the relative credit standing of buyer to supplier.

MISCONCEPTION # 3 – APF ONLY APPLIES WHEN THE SUPPLIERS CREDIT RATING IS WORSE THAN THE BUYERS

Yes, APF looks at the buyer as the credit "anchor" on which the programs discount rate is based: the supplier benefit is therefore more direct in cases where the buyer has an obvious rate arbitrage over its suppliers. However, even in reverse cases, rates can be competitive as the underlying

securities (supplier invoices with an unconditional and irrevocable buyer approval) are considered very low risk by nature. We cannot underestimate the value off-balance sheet funding, where the supplier gets access to capital without having to utilize any of its existing credit lines. These factors are just some good reasons why we should not discount suppliers with better credit rating too soon.

Where does Approved Payable Finance stand today – a successful APF program is not defined by discount rates or technical prowess alone, but by what level of supplier participation it manages to achieve – over time. Funding and platform represent the core of an APF offering, but there are ancillary services playing an integral role in activating and retaining suppliers on the platform.

These services have evolved to optimize each phase of an APF program installation: from i.) assessment and business case, to ii.) platform and funder selection, to iii.) implementation and supplier onboarding. Properly applied, they help secure best potential outcome throughout the APF lifecycle, using shortest time and minimum resources.

The evolution of ancillary services has led to an expanding APF landscape, moving from one traditional provider to an integrated ecosystem of providers – each playing his/her role in delivering value for all APF stakeholders: sharing the cake, but together making the cake much larger (see figure 3 for reference).

Figure 3. Indicative relationship between service providers in an expanding APF landscape – "who does what"

	KEY SERVICES AND PROVIDERS BEHIND APF ROLL-OUT	Funder(s)	Platform	Advisor
APF BUSINESS CASE	Review working capital processes, performance and monitoring, including APF readiness			●
	Provide internal APF stakeholder anchoring and training (e.g., finance and purchasing)			●
	Provide detailed APF assessment and business case, including prioritized 1st wave of suppliers		◍	●
	Provide detailed list of requirements for APF partner selection phase			●
APF CORE OFFERING	Provide funding	●		
	Provide functional and easy to use technical platform	◍	●	
APF IMPLEMENTATION	Support organization's readiness to APF roll -out (e.g., commitment and processes)		○	●
	Provide customization of APF platform installation		●	
	Provide supplier onboarding support	○	●	◍
	Provide business intelligence analytics and simulations	○	●	
	Provide automated accounting and reporting support	○	●	

● Core business ◍ Provide service ○ Can provide service, but prefers not to

In conclusion, Approved Payables Finance (APF) is a buyer-led structured finance tool within the Supply Chain Finance (SCF) family, unlocking working capital for both buyers and suppliers alike.

A buyer of APF solutions should not stare blind at cost alone, but rather look for the solution he/she thinks will lead to the greatest supplier onboarding and participation.

The evolution of ancillary services within the APF landscape has opened up new roles. In response, SETPOINT Group advocates an ecosystem collaboration model, where finance, purchasing team, platform provider and advisor work closely together to plan and review progress on a regular basis during an extended implementation period, to realize best value for both buyer and supplier.

More on SETPOINT Group's LEAN WORKING CAPITAL™ in coming articles.