

Supply Chain Finance, a game changer in Corporate Funding

Speaker: John Sculley, Managing Partner SCF, former CEO Apple Computers and President Pepsi-Cola

Date: Thursday 15th March 2007

Chris Skinner welcomed John to the Club after explaining its purpose and meeting place origins. Without further ado John got straight to the heart of the matter

Why supply chain finance?

Today this area is estimated to be an \$18 trillion market. The development of the financing side of the business lags the physical side by about a decade.

What has been the evolution of this business?

The container, the standard unit in the physical supply chain was introduced about 50 years ago. Ten years after its introduction it was adopted by the US military for its Vietnam operations after which its use really took off. Today's value chain approach is changing the balance away from physical assets to mostly working capital. This had led to the emergence of the "platform company model" based on design, R&D, marketing and channels.

What is a platform company?

The platform company does product design, marketing and branding and outsources everything else. For example HP has 500,000 vendor relationships.

How do supply chain companies traditionally operate?

Over the last few years companies have focussed on reducing costs but the shift is now to increasing value. Traditionally supply chain operating managers hedge by holding more inventory, their finance managers hedge by holding more cash. This results in higher working capital. In this operating model distributors and contract managers have to fund inventory. One should think of the supply chain as a systematic process whereby slow payables push up the prices across the whole chain.

What therefore is the role of the new supply chain finance operations, as characterised by SCFCapital?

SCF Capital is a boutique merchant bank specializing in delivering earnings growth and working capital savings to multi-tiered industry vertical supply chain. SCF Capital provide

1. GAAP Compliant, Off-Balance Sheet Financial Supply Chain Structuring Services
2. Financial Trade Flow Platform for Corporate ERP to Procurement Conduits
3. Services to Private Equity Portfolios

for more information see <http://www.sfcapital.co.uk>

SCF capital works with other banks to provide an additive not normally found in even the most progressive banks. The SCFcapital platform comes up with novel solutions for synthetic receivables and payables, captures trade flows from ERP systems and provides integration into global banks conduits.

What problems does SCFcap solve?

A prime problem is that invoicing co-mingles performance and credit risk. SCFcap separates performance and credit risk. Hedge funds need tradable products hence the need to productise credit risk. Off balance sheet supply chain finance is cheaper than junior debt. The specialist programs can increase net earnings, lower costs of working capital and reduce taxes. For example avoiding the transfer of goods and only paying a service fee thus reducing excess customs and excise fees.

Logistics providers such as UPS and DHL do not take finished goods into their balance sheets whereas others do; usually a result of legacy problems. Synthetic receivables is an off balance sheet concept.

3rd party agents must be GAAP compliant.

What are the benefits of this approach?

The ability to replace junior debt with less expensive debt.
The buyer gets early payment discounts while stretching the payments process
Reduced taxes and excise.

How do the involved corporates react?

There is a game change taking place. However today's operations are very much silo based with established silo metrics. For example the main silos could be logistics, transactions, units and money; each with their own set of performance metrics. SCFcapital's approach is to deliver to these established metrics while improving the overall performance. SCFcapital needed to package its deliverables to match the metrics that Execs are rewarded by.

How will things evolve?

There should be a total systems view of the value chain and the advantaged economic system. A key to this is an industry procurement utility. Global banks will probably get into this business.

What changes will occur?

The common thread is transformation. i.e. how to change the ground rules and when and how. In the past a typical reaction has been to reduce the number of suppliers and get volume discounts from the reduced number. In future there is a need to see them as value partners.

How will major change come about?

Banks need to recognise this is not a business as usual scenario. There will come a tipping point. John gave the example of the global warming tipping point. This has now become main stream in the last 12 months after years of being a special interest groups activity. There will come such a tipping point in supply chain finance. Today 80% of the world's factoring is done in the EU.

Barriers to change are the huge operational changes needed on established trusted operations, so picking non critical areas is going for low hanging fruit.

What about resistance to change and who might be an early mover?

John described these as anti-bodies. It could be that a small country, and he stressed his regards for island countries will take the lead and make the SCF approach a part of their economy. This could be Singapore or Dubai for example. It is unlikely to be large country.

What is vital to such a change?

Interoperability is the key and global standards are needed. Europe has often been in a better position and more inclined to advance standards than the US. A lot of standards in financial services are emerging from and likely to be driven by Europe.