INTERNATIONAL BANKING

How Efficiently Does Your Cash Flow?

HOW TO LEVERAGE SUPPLY CHAIN FINANCE FOR CASH FLOW OPTIMIZATION

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J.P.Morgan
An effective cash flow management strategy can increase your business’s liquidity, minimize capital costs from borrowing, free up funds for capital investments and may even boost profits. Find out how you can utilize a supply chain finance program to optimize your cash flow—and that of your suppliers.

Reducing your business’s cash conversion cycle is crucial to improving liquidity and maximizing profitability. Cutting the amount of time that passes between your initial expenditure on sourcing or manufacturing and the final sale of your product or service effectively increases the return on your working capital while decreasing the amount of money tied up in unsold inventory.

Each step in the cash conversion cycle has the potential for improvement. Imagine the possibilities:

- Your production or procurement functions could adopt lean, just-in-time inventory management.
- Shipping and logistics could cut transit time and bring finished goods to market more quickly.
- Automated payment processing could rapidly turn sales receipts into cash on hand.

A comprehensive cash flow management strategy can help you identify ways to increase your days payable outstanding (DPO). Every day that a payment can be extended puts your company one day closer to the goods’ final sale—which helps you to more closely match your inventory cycle to the payment cycle. From the perspective of your balance sheet, extending your DPO is the equivalent of cutting time from your production process, expediting your shipping or speeding up your collections.

Looking for Solutions Outside Your Organization

Financing teams strive to do everything they can within their organizations to get cash cycles under control and optimized, but occasionally they run out of options. When that happens, reaching and influencing those outside of your organization—in your supply chain—can be one of the best strategies for getting over the plateau.

Supply chain finance (SCF) prevents the liquidity equation between buyer and supplier—whether domestic or international—from becoming a zero-sum game. When you’ve decided to focus on reducing working capital needs by maximizing your DPO, SCF can help you to do so without increasing suppliers’ days sales outstanding (DSO).

Furthermore, while enabling you to extend payment terms on invoices, an effective SCF program can also strengthen relationships with suppliers, differentiate your company as a preferred customer and improve the reliability of your critical partners in the supply chain. Most importantly, SCF typically comes free of cost to you—the costs are borne by your suppliers, at their discretion. And most suppliers are more than willing to take on the cost because SCF can provide them with a valuable new source of liquidity. Meanwhile, they’re able to cut their DSO, resulting in an improved balance sheet position and a reduction in their own cash conversion cycle.
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How Supply Chain Finance Works

Supply chain finance offers your suppliers the option of redeeming approved invoices before they come due. Your organization arranges the purchase as usual, negotiating the terms of the contract directly with the supplier. You approve invoices as they are received and validated, queuing them for future payment. Instead of waiting until the scheduled payment date, however, your supplier has the option of receiving cash immediately. Your business pays the invoice in full when it’s due—just as you would have done in the normal course of business.

If your supplier opts for the accelerated payment, that payment is discounted for a fee based on the length of the financing period and your business’s creditworthiness—since the invoice ultimately represents an obligation of your company, the discount rate offered to suppliers is based upon on your firm’s credit rating, not theirs.

Suppliers are in a position to take advantage of a new pool of financing—SCF provides a source of liquidity that operates independently of their own bank lines, a valuable asset for any business. If the supplier’s cost of credit is higher than yours, SCF will provide them with relatively inexpensive financing. Even if it isn’t, other attributes such as increased liquidity, optionality and counterparty risk management can still be attractive.

Invoice and Payment Flow

1. Supplier invoices buyer
2. Buyer sends invoice to SCF partner
3. SCF partner offers supplier the option to receive payment early, with a small discount
4. Buyer funds invoice at due date

Case Study: Supply Chain Finance At Work

Take the example of Company A, a fictitious manufacturer focused on deploying its working capital as efficiently as possible. They intended to negotiate longer payment terms with suppliers—but didn’t want their strategic working capital initiative to place an undue burden on these suppliers. Their solution: engaging J.P. Morgan to develop a supply chain finance program.

SCF proved particularly effective for Company A’s Japanese suppliers, which were smaller, cash-strapped and lacked access to capital markets. Since Company A was an established enterprise with a low credit risk, the bank offered to redeem the suppliers’ invoices at a 3 percent per annum discount from face value. For Company A’s overseas suppliers, this presented an excellent deal—they could use the immediate cash from redeemed invoices as a substitute for commercial loans that often charged interest above 10 percent per annum. Even as Company A moved payment terms from 30 to 90 days, the suppliers’ financial picture improved, as did Company A’s DPO.

Company A had similar success offering SCF to its domestic suppliers. Although many of the US suppliers already enjoyed ready access to inexpensive commercial loans, some saw value in the SCF program as an alternative source of immediate funds. Unlike Company A’s Japanese suppliers, they didn’t regularly rely on the program; however, having the option of early redemption allowed these businesses to adopt a leaner cash flow position by leveraging SCF as an emergency backstop, available at a moment’s notice, should they find themselves unexpectedly pressured for liquidity. SCF allowed these suppliers to operate with a smaller cash reserve while still allowing them to accommodate cyclical needs and free up capital for new investments.
A Win-Win Situation

SCF can improve cash flow for both you and your suppliers, increasing flexibility and reducing risks. When buyers extend payment terms, they can release working capital, reduce cash requirements and run their treasury operations more efficiently—and SCF can help them do this without placing a burden on their suppliers. In fact, in many cases suppliers end up in a stronger position than before the extension of payment terms, so buyers benefit from a more financially secure supply chain and enhanced relationships with these key partners.

From the supplier standpoint, SCF tends to provide a new source of financing, in addition to their existing bank credit facilities, that’s attractively priced and off the balance sheet. They gain certainty of payment, the ability to reduce counterparty risk and enhanced control over their own cash position. If the supplier is a smaller company, or if they are operating in a country with an underdeveloped financial sector, SCF can serve as a financial lifeline, effectively extending the buyer’s strength to the supplier. And even if your supplier is an established firm with adequate access to credit, they may be attracted to SCF as a valuable outside line of liquidity, capable of providing an injection of cash without disrupting their balance sheet.

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For many companies, supply chain finance can be a win-win situation: Both buyers and suppliers can improve their cash conversion cycles and boost working capital efficiency as they work toward achieving their own financial objectives—while contributing to the collective benefit of the entire enterprise.

To find out more about supply chain finance and how it can help your business, talk to your Commercial Banking representative or visit jpmorgan.com/cb/global-trade

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