Aberdeen Group
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Supply Chain Finance

Gaining Control in the Face of Uncertainty

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A Harte-Hanks Company

Executive Summary

Supply Chain Finance (SCF) is a topic that sits at the heart of the enterprise, with implications extending beyond finance out to every functional area. It is intimately tied to credit decisions, payments, and collection policies, and is impacted by decisions in finance, procurement, sales, supply chain, and more. This study, based on the responses of 145 finance professionals collected in November and December of 2010, examines how supply chain finance is viewed in the marketplace, what it has to offer to those seeking to improve their financial performance, and what responding companies are planning for the future to improve competencies and expand technology adoption.

Research Benchmark

Aberdeen's Research Benchmarks provide an in-depth and comprehensive look into process, procedure, methodologies, and technologies with best practice identification and actionable recommendations

Best-in-Class Performance

Aberdeen used the following three key performance criteria to distinguish Best-in-Class companies:

- 6.9 days to process an invoice for payment
- 57.4 days payable outstanding
- 6.5% decrease in average purchasing costs year-over-year

Competitive Maturity Assessment

Survey results show that the firms enjoying Best-in-Class performance shared several common characteristics. Specifically, they are:

- 112% more likely to have the ability to segment their trading partners to prioritize SCF enablement efforts
- 83% more likely to have online visibility into financial supply chain events (purchase order submission, invoice approval, etc.)
- 36% more likely to have executive management involved in their supply chain finance initiatives

Required Actions

In addition to the specific recommendations in Chapter Three of this report, to achieve Best-in-Class performance, companies must:

- Improve A/P processing efficiency to increase flexibility in choosing payment options
- Foster a collaborative approach to supply chain finance among traditionally-separated functional areas within the enterprise
- Explore technologies, where applicable, that can provide greater control and choice by expanding the number of trading partners and financial institutions with which to collaborate

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Chapter One: Benchmarking the Best-in-Class

Business Context

Supply Chain Finance (SCF) is a term that is commonly used in the marketplace. However, upon closer examination, it is clear that it has been defined in two completely different ways, leading to a lack of precision in usage. One approach, followed by Aberdeen since its initial coverage of the area (*Get Ahead with Supply Chain Finance*, July 2006), defines SCF in the context of technology solutions. It states that "a Supply Chain Finance solution is a combination of trade financing provided by a financial institution, a third-party vendor, or an enterprise itself, and a technology platform that unites the trading partners and the financial institution electronically and provides the financing triggers based on the occurrence of one or several supply chain events." The alternative approach treats SCF as broader topic inclusive of traditional trade document management and financing options, with a focus on the international transactions of larger enterprises. So, which approach is correct?

Fast Facts

√ **60%** of responding enterprises view procure-to-pay (buy-side processes) as a necessary element of supply chain finance

√ **30%** of respondents feel order-to-cash (sell-side) is a necessary part of SCF

Setting the Ground Rules

The answer is that neither approach is fully satisfactory. The solution-based definition is too focused on *how* things are done, and the topical approach is too focused on the specifics of *which* transactions are included. A better option, which underlies both, is to focus on the goals of Supply Chain Finance: to facilitate transactions between trading partners by providing financing and payment options that are negotiated to improve each partner's financial position. The technologies and financing arrangements utilized to achieve these goals are secondary, and can adapt over time without changing our understanding of SCF itself. This approach is consistent with the way respondents to Aberdeen's most recent survey define Supply Chain Finance.

The results in Table 1 reflect the percentage of respondents who feel each of the listed elements are required for their definition of supply chain finance. Looking toward related technologies, procure-to-pay automation, although occurring wholly within the buyer's operations, is prominently featured. This offers a slight variation on the solution-based definition, which viewed SCF through the lens of collaborative technologies. That domestic transactions were more often cited than international, and that trade document management fell farther down the list, hints that our community is not aligned with the topical approach (though this appears to be an area where end-users and solution providers diverge). It is the goal-oriented and solution-agnostic approach that will guide the discussion that follows, with a greater emphasis on the buy-side perspective to bring the approach in-line with the market's current view.

Table 1: Elements of Supply Chain Finance

Attribute	End-Users	Providers
Early payment discount programs	63%	51%
Financing of domestic transactions	60%	55%
Financing of international transactions	51%	61%
Trade financing (letters of credit, open accounts, etc.)	44%	61%
Financing triggers based on events in the physical supply chain	31%	49%
Use of intermediary financial institutions	29%	51%
Factoring	16%	45%
Reverse factoring / forfaiting	14%	53%
Associated Technologies	**End-Users**	**Providers**
Procure-to-pay automation	60%	45%
Use of a common platform for buyers, sellers, and financial institutions	32%	41%
Order-to-cash automation	31%	37%
Trade document management	30%	29%

Source: Aberdeen Group, January 2011

Supply Chain Finance versus the Financial Supply Chain

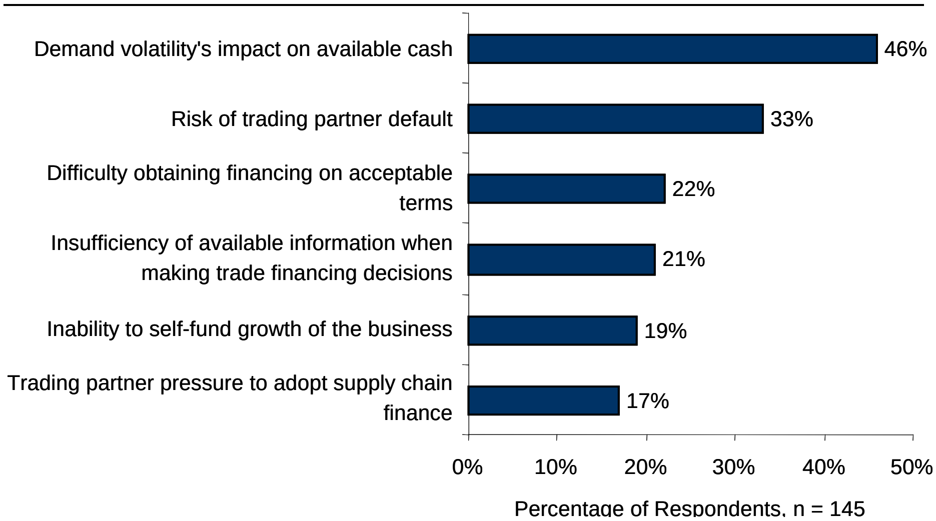
The terms Supply Chain Finance and Financial Supply Chain may appear quite similar, but this is potentially misleading. Traditionally, the Financial Supply Chain refers to the transactions that occur between trading partners that facilitate the purchase of, and payment for, goods and services (sending purchase orders and invoices, making payment, etc.). Supply Chain Finance, however, has been focused on providing liquidity to suppliers through pre-shipment, post-shipment, and post-acceptance financing, with or without a facilitating technology. The results in Table 1 hint at a convergence of the two ideas. With the increasing maturity of procure-to-pay automation, the ability for organizations to process invoices and pay much more quickly (substituting their own payment for what was previously third-party financing) appears to have influenced the overall view of Supply Chain Finance itself.

The inclusion of early payment discount programs also calls attention to the nature of the transactions that are being discussed. In the traditional view, Supply Chain Finance was focused on less frequent, large transactions. With discounting programs leading the list of elements in our community's definition of Supply Chain Finance, the focus has shifted to more common (higher frequency, lower value) transactions. This does not change the fundamental goal of SCF (providing supplier liquidity, as described above), but it is important to keep in mind, as the choices made, and technologies used, can vary based on the scale of transaction involved.

A Need for Control amid Uncertainty

Even though the National Bureau of Economic Research has marked June 2009 as the end of the recession and consumer demand is slowly rebounding, the harsh realities of recent times have left their mark. When there is volatility in demand, enterprises are pressured from two directions: internally, inventory investment may increase to provide a buffer against stock-outs; and externally, cash inflows may both decline in volume and become less predictable. The risk of trading partner default will impact the value of Accounts Receivable (A/R), with an increase in the allowance for doubtful accounts. Actual default, still a realistic possibility, can likewise impact A/R as well as new sales, if the trading partner in question was a potential customer. These pressures, along with others presented in Figure 1 are the driving forces behind organizations' interest in supply chain finance.

Figure 1: Top Two Pressures for a Focus on Supply Chain Finance



Source: Aberdeen Group, January 2011

The Maturity Class Framework

Aberdeen used three key performance criteria to distinguish the Best-in-Class from Industry Average and Laggard organizations. These metrics capture the complexity of managing liquidity in times of uncertainty: invoice processing time provides a measure of flexibility in decision-making; Days Payable Outstanding (DPO) shows the organization's effectiveness in maximizing cash on hand, and; the change in purchasing costs ensures that DPO gains are not negated elsewhere in the business cycle.

Table 2: Top Performers Earn Best-in-Class Status

Definition of Maturity Class	Mean Class Performance
Best-in-Class: Top 20% of aggregate performance scorers	▪ 6.9 days to process an invoice for payment ▪ 57.4 DPO ▪ 6.5% decrease in average purchasing costs
Industry Average: Middle 50% of aggregate performance scorers	▪ 17.3 days to process an invoice for payment ▪ 41.8 DPO ▪ 2.5% decrease in average purchasing costs
Laggard: Bottom 30% of aggregate performance scorers	▪ 25.7 days to process an invoice for payment ▪ 34.8 DPO ▪ 8.4% increase in average purchasing costs

Source: Aberdeen Group, January 2011

The Implications of Extending Days Payable Outstanding

The usage of DPO as a criterion for defining Best-in-Class organizations may strike some as objectionable, for good reason. There are a few elements at play, and it may be helpful to walk through the analysis. By definition, an extension of DPO entails an increase in accounts payable relative to the cost of goods sold (or cost of sales in the service context). As such, paying suppliers later would increase DPO through an increase in AP. In the traditional two-party (buyer and supplier) analysis, extending DPO through the extension of payment terms gives the greatest cause for concern. Here, later payments would mean later cash inflows for suppliers, adding pressure to an already-difficult environment, and jeopardizing supplier relationships (if not the ongoing viability of the supplier itself). Similarly, delaying payments outside of terms renegotiation could entail imposition of late-payment penalties, and that is not an ideal state for either party. But the topic of this study, and thus the definition of the Best-in-Class, is different.

This discussion of supply chain finance, in light of the focus on payment-related aspects expressed by survey respondents, adds a third party to the equation: the financial institution, or other external source of funding. When these three-party relationships are effectively managed, buyers can lengthen payment cycles, suppliers can receive funds quickly at a discounted rate, and the facilitating intermediary can profit by receiving full payment at the end of the maturity term. The end result is an extension of DPO for the buyer without the equivalent shortage of cash for the supplier. As long as such gains are not offset by price increases on the buy-side, the overall performance is rightfully called Best-in-Class.

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The Best-in-Class PACE Model

Translating an understanding of supply chain finance into an actual alleviation of business pressures requires a combination of strategic actions, organizational capabilities, and enabling technologies that can be summarized as shown in Table 3.

Table 3: The Best-in-Class PACE Framework

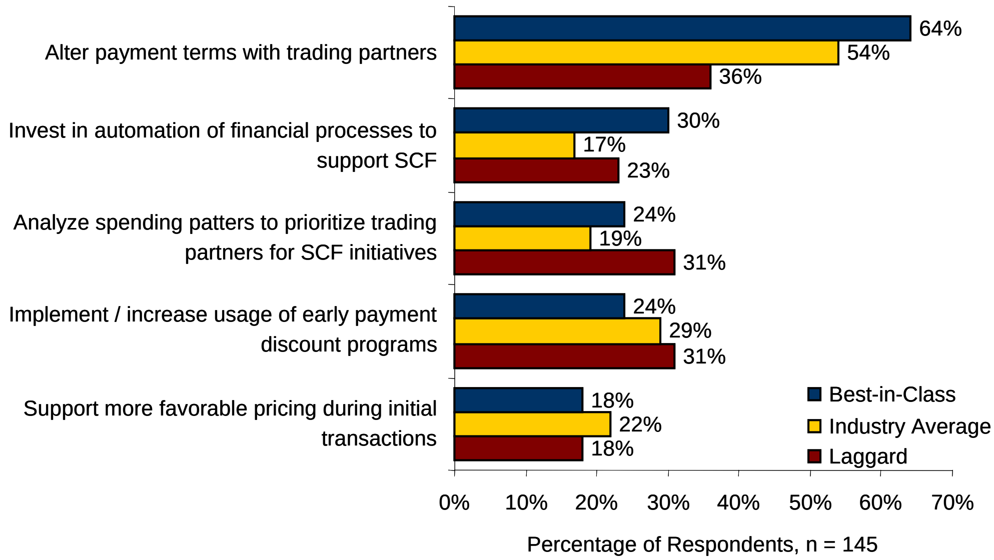
Pressures	Actions	Capabilities	Enablers
▪ Demand volatility's impact on available cash	▪ Alter payment terms with trading partners ▪ Invest in automation of financial processes	▪ Executive management actively collaborates in the organization's supply chain finance initiative ▪ Online visibility into financial supply chain events ▪ Ability to segment trading partners to prioritize SCF enablement ▪ Ability to access SCF at various stages in the supply chain	Buy-Side Technologies: ▪ Electronic purchase order (PO) creation and submission ▪ Electronic invoice receipt and approval workflow Sell-Side Technologies: ▪ Electronic invoice creation and submission ▪ Electronic payment receipt and reconciliation Collaborative Technologies: ▪ Electronic Invoice Presentment and Payment (EIPP) ▪ Supplier Networks ▪ Online payments platform with access to automated discounting, invoice reconciliation, and/or third-party financing

Source: Aberdeen Group, January 2011

Best-in-Class Strategies

Across all three maturity classes, demand volatility was the most-often cited pressure driving respondents' interest in supply chain finance. Looking closer at the secondary pressures, the three classes begin to separate. While risk of trading partner default ranked second for the entire pool, it was cited approximately 50% more often by mid- and low-performing organizations than by the Best-in-Class. Similarly, Laggards were nearly three-times as likely as the two higher-performing groups to cite insufficiency of trade finance information for decision-making as a top pressure, highlighting their fundamental struggle to gain visibility into both their performance and their available options. These difference help to understand the mix of strategies these groups employ, as illustrated in Figure 2.

Figure 2: Top Two Strategies for Alleviating Business Pressures



Source: Aberdeen Group, January 2011

"[Supply Chain Finance] will become a 'needed' tool in order to become global, which is intended. Education will be first, followed by finding knowledgeable 'partners' and finally implementation."

~ General Manager, North American Wholesale Distributor

As with the pressures they face, for all three groups the same strategy ranks at the top of their lists: the desire to alter payment terms. Likewise, there are also visible degrees of divergence. For the top- and mid-performers, payment term alteration is clearly the dominant strategy. Industry Average organizations, though less likely to look to automation for improvement, still display a similar set of priorities with the Best-in-Class. Where this differs is in an area not shown in Figure 2: seeking alternative (or additional) sources of financing. The frequency with which it was cited still falls below term adjustment and discounting programs (at 22%), but helps to complete the picture. The lowest-performing firms, in contrast, do not display a true dominant strategy. They are, on the whole, less mature in terms of the length of time they have been involved in SCF initiatives than the other groups. The discussion of capabilities and enabling technologies in Chapter Two, and the maturity class-specific recommendations in Chapter Three, are intended to help guide these organizations in focusing and prioritizing their improvement efforts.

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Corporate Alignment and Supply Chain Finance

At their core, supply chain finance solutions aim to improve an organizations' ability to put financial resources to their most productive use. When cash is tight, payments can be selectively disbursed at to lengthen the payment cycle. In healthier times, additional savings can be derived by paying under an early discount program. In both scenarios, the key is control: the ability to react quickly enough to adjust strategy to current conditions.

In discussing the technological approaches to supply chain finance, it is difficult to present a holistic picture because SCF pushes may financial levers - each of which may ultimately be controlled by a separate division within the company.

As a starting point in viewing financial health, you can look to the **working capital ratio**, which is equal to *current assets divided by current liabilities*. It is a measure (at the highest level) of an organization's ability to meet their short-term obligations. The problem, of course, is that not all current assets are created equal. Cash on hand can be immediately employed to settle debts, but may be more effectively used for short-term investment. Inventory, given the concern of demand volatility, is not as reliably converted to cash and can be costly to carry over time due to storage and obsolescence. Accounts Receivable can suffer a similar fate, with customers' efforts to extend payment terms and potential for non-payment looming.

Taking a closer look, supply chain finance touches on all elements of working capital in some way, with major influences on three in particular. These items are captured in the **cash conversion cycle**, which is calculated as: *days sales outstanding plus days inventory outstanding minus days payable outstanding*. The goal is to minimize this value while maintaining the ability to service customers. DSO is reduced through the organization's A/R collections activity, as well as adjustment of terms negotiated through sales activity. DPO is increased through A/P financing arrangements and the renegotiation of payment terms with suppliers. DIO is a function of the organization's ability to forecast and shape demand, through data analysis and efforts such as trade promotion management.

What does this mean? Putting all of the pieces together, it is clear that the full view of supply chain finance implicates a variety of different functional areas: the Controller for A/P and A/R, Treasurer for cash management, Sales for DSO and the promotional element of DIO, Procurement for DPO, and Supply Chain and Manufacturing for inventory planning. Not only are different elements the focus of different functional groups, but those groups may also have separate reporting lines to different executives. The emphasis of holistic supply chain finance, then, needs to be on executive-level engagement, to ensure that all the pieces are working towards a common goal, and not towards individual goals that combine to produce a less desirable result.

In the next chapter, we will see what the top performers are doing differently to set themselves apart from their peers.

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Chapter Two: Benchmarking Requirements for Success

With a broad selection of avenues to pursue, the successful execution of a supply chain finance initiative is built upon a foundation of thorough analysis of the available options and potential starting points. The case study to follow profiles one organization's approach, which can serve as a model for others looking to start their journey off on the right foot.

Getting Started with SCF in Global Manufacturing

For this global consumer goods manufacturer, supply chain finance held many opportunities. First, was the potential to positively impact working capital, highlighting the importance of cash in a time of transition towards new trade financing alternatives. Next, the company viewed SCF as a program that could mitigate supplier risk by providing access to capital at attractive rates in order to support the overall health and stability of the supply base. Last, the program was seen as a way to go beyond mitigating supplier risk to a point of promoting actual supplier growth by providing them with funding that could support purchasing of additional raw materials or investment in capital. With these goals in view, where should they start?

The starting point was the creation of a cross-functional team, with contributions from all interested stakeholders from procurement, treasury, AP, operations, IT and legal. This team put together a list of criteria against which each prospective provider bank would be judged. The main areas of focus were the strength of the banks' on-boarding process, the amount of resources that the company would need to use during on-boarding, the total cost (and whether it would be borne wholly by the suppliers or financed to some degree by the company), the availability of financing, and the usage of penalties (forfeiture of fees) for poor service. Each criterion was given a weight based on importance, and each prospective bank was given a scaled grade based on how well they met the requirements.

Ultimately, the manufacturer chose a program (and provider) that involved the bank as a third-party intermediary, providing the option of discounted early payments to suppliers, and collecting from the company at maturity. In this design, purchase orders, invoices, and receipts are handled the same. The bank steps in once PO-matching has occurred, at which point the supplier is notified that early payment is possible. For the company, the payments process continues on a timeline agree-to with the bank, while their supplier remains in control of their payment term based on their choice of early versus maturity payment.

continued

Fast Facts

- √ Best-in-Class enterprises increased the number of partners with which they have discounting programs by 12% over the last year
- √ Best-in-Class enterprises are 36% more likely than others to have executive management involved in their supply chain finance initiatives

Getting Started with SCF in Global Manufacturing

After working through the selection and implementation process, the company noted some important things to keep in mind:

- Review your supply base's footprint to ensure that a prospective bank can service the necessary locations and currencies
- Do not underestimate the need for education of suppliers for acceptance and training of the involved stakeholders for program success
- Make allowances for adequate team staffing to handle program management, and for time to work through a pilot program to optimize on-boarding efforts to support future success

Competitive Assessment

Aberdeen Group analyzed the aggregated metrics of surveyed companies to determine whether their performance ranked as Best-in-Class, Industry Average, or Laggard. In addition to having common performance levels, each class also shared characteristics in five key categories: (1) **process** (the approaches they take to execute daily operations); (2) **organization** (corporate focus and collaboration among stakeholders); (3) **knowledge management** (contextualizing data and exposing it to key stakeholders); (4) **technology** (the selection of the appropriate tools and the effective deployment of those tools); and (5) **performance management** (the ability of the organization to measure its results to improve its business). These characteristics (identified in Table 4) serve as a guideline for best practices, and correlate directly with Best-in-Class performance across the key metrics.

Table 4: The Competitive Framework

	Best-in-Class	Average	Laggards
Process	Ability to access SCF at various stages in the supply chain		
	44%	30%	21%
Organization	Executive management actively collaborates in the organization's supply chain finance initiative		
	68%	54%	41%
Knowledge	SCF decision-makers have access to external trading partner financial information		
	28%	27%	8%
Technology	Ability to segment trading partners to prioritize SCF enablement		
	53%	25%	25%
	Single platform to bring buyers, suppliers, and financial institutions together		
	15%	9%	0%

	Best-in-Class	Average	Laggards
Performance	Online visibility into financial supply chain events		
	64%	40%	26%
	Online visibility into shipment status and in-transit inventory		
	42%	32%	22%

Source: Aberdeen Group, January 2011

Capabilities and Enablers

Based on the findings of the Competitive Framework, Aberdeen's analysis of the Best-in-Class demonstrates that the keys to supply chain finance success are access to relevant information and the proper level of process efficiency to allow the organization to act on that information.

"I see [Supply Chain Finance] as becoming a differentiator between us and our competition. Those who are able to manage cash effectively will outperform their competitors and be able to garner additional market share."

~ Procurement Manager, North American Publisher

Process

A key theme of this discussion is control, which implies the ability to make choices. In the payables arena, the degree of control is really the story of 'Day 11.' In other words, if an enterprise is one day beyond the traditional 10-day discount window, is it there by choice or by reason of slow invoice processing speeds? According to Aberdeen's latest in-depth look at invoice processing (*Invoicing and Workflow: Turning Process Automation into Operational Cost Control*, April 2010), the biggest differentiating factors between top-performers and others were process-related: the existence of clear A/P policies to guide staff and process standardization across multiple locations or business units. These efforts were further supported by automation technologies, which help bring speed to the already well-defined procedures necessary to ensure efficient invoice processing. It is this efficiency that provides management with the ability to choose whether to make payments within a discount window, based on the current cash position of the enterprise.

Although the processes above (and much of the current improvement focus) is concerned with the terms and discounts negotiated between buyers and suppliers, the importance of sell-side flexibility in financing should not be ignored. Best-in-Class organizations are nearly 50% more likely than the Industry Average–and more than twice as likely as Laggards–to be able to access financing for transactions at various points in the supply chain. The cost of available financing is a function of the risk associated with non-performance. As such, the ability to tap into financing as a transaction proceeds closer to completion (whether it be as goods clear customs or the associated invoice is approved for payment), can also help to reduce the associated costs.

At present, the use of post-shipment financing is a differentiating factor for Best-in-Class suppliers. They are 50% more likely to employ this financing method, and on average, use it for twice as many transactions as other firms (27% vs. 14%). The trend may not have gone unnoticed, as 20% of all

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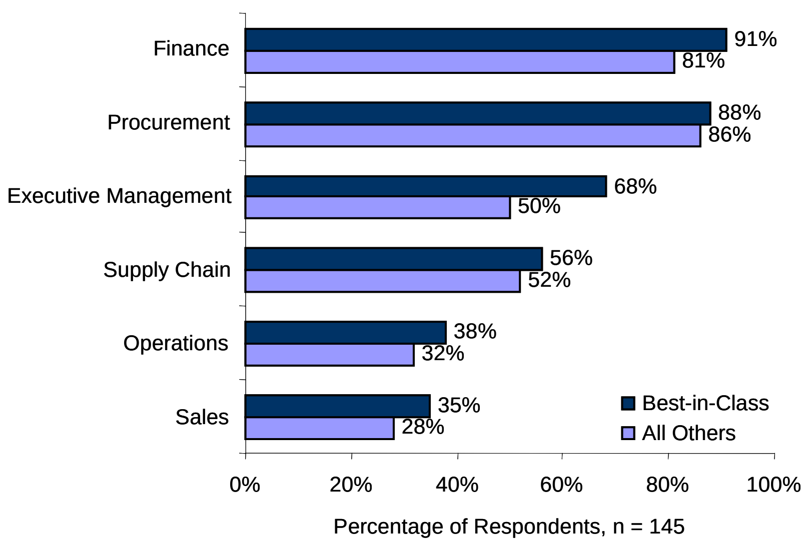
responding suppliers intend to increase their usage of post-shipment financing. Only the use of post-acceptance financing (where third-party intermediaries provide funding for a discounting arrangement) showed greater intended growth, at 27% of responding suppliers.

Organization

The execution of supply chain finance programs in responding organizations is largely controlled by finance and procurement. This is understandable, given the predominantly buy-side perspective on the subject reflected both by how they define SCF itself and the strategies they pursue. Figure 3 summarizes the percentage of respondents for which each function is involved in their SCF programs. Even though sales has a large impact on DSO (as discussed in Chapter One), and supply chain can heavily influence both DIO and DSO, they are not involved in this process for a large number of organizations. Knowing that the interests of so many different groups all converge under supply chain finance, it is important to note that the area where there is the greatest difference between the Best-in-Class and their peers comes with regard to executive involvement in SCF. Collaboration at this level holds the promise of balancing and aligning the disparate payment, collections, cash management, and inventory policies that can work at cross-purposes when operating independently.

Figure 3: Functions Involved in Supply Chain Finance



Source: Aberdeen Group, January 2011

Knowledge Management

On its own, strategy does not produce results. In order to derive benefit, the enterprise must translate those strategies into policies that inform decision-making and specific tasks to direct employee behavior. In the supply chain finance arena, this means providing employees (both staff-level and managerial) with the information they need to understand why different financing options can be beneficial and how they can be executed once selected. This is also an area where the Best-in-Class are twice as likely as others to provide such support. As mentioned previously, the key in supply chain finance is flexibility - the ability to identify options and effectively execute on them once the best choice is made.

Shifting focus from the management of internal resources, Best-in-Class firms also outpace their peers in their access to trading partners' financial information. This is both a measure of the ability to effectively collaborate, as well as the ability to tailor financing methods based on the needs of an individual trading partner. Knowing that an at-risk supplier faces difficulty securing financing to support production would highlight the benefit of either using either a self-financed early payment program or engaging a third-party intermediary to provide lower-cost financing based on the buyer's ability to repay (rather than the supplier's risk of non-payment). Without this knowledge, arms-length dealings with the at-risk supplier may follow traditional (and non-productive) avenues focused on driving purchase prices lower and extending payment terms beyond what the supplier can agree to. In such a situation, both parties may be worse off for failing to discuss alternative arrangements.

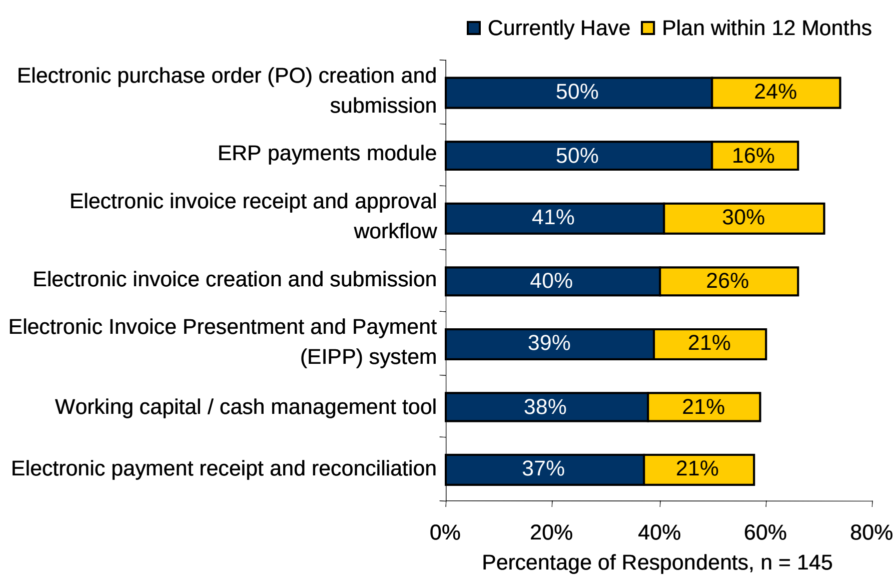
Technology

Picking up on the discussion of information access earlier, having relevant data in hand will allow organizations to focus their supply chain finance enablement efforts on the best outstanding candidates. Some partners may not see the value of coming on-board, while others may be reluctant to pursue the technological change necessary, if any, for participation. An area where Best-in-Class firms show a greater degree of ability (reported at a rate of twice their peers) is in segmenting their trading partners to allow for prioritization for SCF programs. Initiating and expanding these initiatives requires resources, and by harnessing data to take a targeted approach to on-boarding, Best-in-Class companies can focus their staff time (and associated labor and IT costs) on those trading partners for which supply chain finance offers the greatest benefit.

When looking to simplify enablement efforts – especially for the low-value, high-volume transactions discussed in Chapter One – the ability to minimize the number of one-to-one interfaces with trading partners may be a driving force towards the usage of a many-to-many collaborative platform. In this context, the platform could allow the exchange of necessary documents (purchase orders, invoices, and payments) between buyers, suppliers, and (if needed) intermediary financial institutions. As the market matures, the overall adoption levels of such services should rise from their current state at just 8% of current respondents. Looking at specific examples of these offerings, 37% of respondents who are not currently connected to a supplier network plan to begin use within the next 12 months. In a similar vein, 30% of enterprises not currently using an online payments platform supporting discounting and invoice reconciliation related plans to begin over the next year. This interest in collaborative technologies is likely founded on the greater popularity of internal process automation (Figure 4).

What is evident from the stated levels of current and future usage is an ongoing trend toward electronification of traditionally-paper-based documents and processes. While technology is not mandated, firms are looking to automation for their financial supply chain processes. All stages of the business-to-business purchasing and payments process are poised for growth of automation – from the initial creation and submission of a buyer's electronic purchase order through invoicing, receipt and approval, payment, and final reconciliation. What is encouraging for the growth of supply chain finance is the implications of greater technology adoption: larger amounts of financial information available for analysis, and greater potential for collaborative efforts through the link of common platforms for communication.

Figure 4: Current Implementations and Future Plans



Source: Aberdeen Group, January 2011

Performance Management

Performance management in the supply chain finance arena boils down to having the right information to make financially appropriate decisions. This need for visibility is present in all stages of both the physical and financial supply chains - and both are areas where Best-in-Class respondents differentiate themselves from the rest of the pack. Knowing when an invoice is approved provides suppliers with better information to forecast incoming cash flows. Knowing the location and timing of an en-route shipment helps the buyer plan for storage, helps the supplier anticipate the receipt date after which invoice matching can occur, and can provide financial institutions with the information they need to facilitate post-shipment financing.

Shifting from what capabilities help enterprises manage their financial performance, it is interesting to take a look at what expectations they have for future improvement. The picture that emerges for the group as a whole, as illustrated in Table 5, is focused on liquidity. There is a desire to improve working capital levels, which would require growth of current assets and/or reduction of current liabilities.

Table 5: Financial Performance Comparison

	WCR	DSO +	DIO -	DPO =	CCC
Current	1.32	46.19	40.51	44.72	41.98
Target	1.44	33.63	26.73	42.01	18.35
Difference	+9%	-37%	-52%	-6%	-56%

Source: Aberdeen Group, January 2011

Two categories of current assets that fall within the scope of supply chain finance (receivables and inventory) are targeted for reduction, as enterprises look to collect more quickly and slim down inventories. Similarly, SCF's contribution to current liabilities (payables) is also slated for a slight reduction - which runs counter to the traditional view of collecting more quickly while extending the enterprise's own payment terms. The necessary implication, then, is that improvements in working capital come from increases in those assets with this greatest liquidity - cash and marketable securities.

This result meshes well with a view of supply chain finance where the main goal is providing the enterprise with the flexibility to put its resources to the most productive uses possible by arming financial professionals with a portfolio of financing options and a window of opportunity afforded by process efficiency through automation.

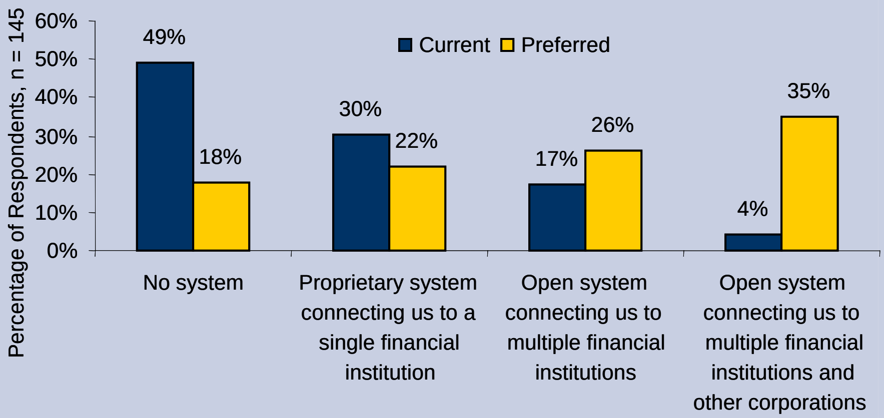
Towards a Connected Finance Community

That enterprises are moving toward automation of internal processes and seeking to capitalize on connections with trading partners is clear. Technology, while not a necessary component of Supply Chain Finance, can be an enabler of performance improvement. What the solution landscape will look like will be decided as the practice of supply chain finance matures, but the stated preferences of current respondents offer a glimpse of what is to come. In the current state, as shown in Figure 5, the majority of respondents have either no system at all or are hooked into a dedicated system connecting them to a single financial institution. If preferences translate into future implementations, however, the future looks to favor those providers who offer connections to a wider pool of trading partners and financing sources.

continued

Towards a Connected Finance Community

Figure 5: Current and Preferred SCF Systems



Source: Aberdeen Group, January 2011

This evolution is well-aligned with both the buy- and sell-side perspectives on supply chain finance, but its success will ultimately rest on the quality of information the platform can provide (either through stored transaction histories or by facilitating information exchange between parties). Gaining access to additional financial institutions will not be beneficial unless those institutions have the proper information to make risk assessments and determine whether and at what rate to extend financing. In the short term, this may signal an opportunity for single-institution systems to facilitate trading partner collaboration outside of a multiple-FI open system. But in the context of smaller-scale transactions, when adequate information payment risk can be quantified, receivables can be assessed and securitized. At that point, the full value of supply chain finance will be gained when commerce is conducted in an open marketplace that expands the options for all parties involved.

Chapter Three: Required Actions

Whether a company is trying to move its supply chain finance performance from Laggard to Industry Average, or Industry Average to Best-in-Class, the following actions will help spur the necessary improvements:

Laggard Steps to Success

- **Focus on faster invoice processing.** Once accounts payable can move from receipt to payment within the discount window, the enterprise gains greater control over the timing (and financing) of supplier payments. Responding companies that utilize electronic invoice receipt and workflow technologies reported processing times 18% quicker than others. Refer to Aberdeen's recent payables research for additional guidance on improving A/P performance.
- **Get management involved in supply chain finance.** Although buy-side processes dominate the current discussion of SCF, the intersecting interests of purchasing, sales, A/P, and A/R all impact overall enterprise performance. Enterprises that actively collaborate with executive management in their SCF initiatives see both quantitative and qualitative benefits. They are 77% more likely to have established cross-functional metrics to tie purchasing, finance and supply chain operations together. They have achieved an average cash conversion cycle nearly four days shorter than others, and report a 4% advantage in working capital ratio despite extending DPO and maintaining lower inventories.
- **Understand your trading partners and prioritize enablement efforts.** For Laggard organizations, lack of executive and organizational buy-in is a large challenge - and success is always a strategy for growing support. Companies that are able to segment their trading partners for prioritization not only report increasing the number of trading partners with discounting arrangements at nearly three-times the rate of others over the past year, but they have achieved DPO levels 25% greater than those without segmentation capabilities. In this context, segmentation should focus on partners that can be easily on-boarded as well as those most likely to find value in alternative financing arrangements.

Industry Average Steps to Success

- **Support staff improvement through availability of training materials.** Although complete automation and straight-through transaction processing may be the ultimate goal, at current levels of technological maturity the human element should not be overlooked. Those organization's that provide access to training materials for their staff report both improved process efficiency (with invoice processing times 38% faster than others) as well as a far lesser likelihood that staff time will be a constraint on SCF improvement (cited as very or extremely challenging at a rate nearly 50% lower than among other respondents).

Fast Facts

√ **64%** of the Best-in-Class have online visibility into Financial Supply Chain events

√ **53%** of the Best-in-Class can segment their trading partners to prioritize Supply Chain Finance enablement

Aberdeen Group
A Harte-Hanks Company

- **Improve reporting and visibility of financial supply chain events.** Information on the status and timing of payments and receipts are not only central to SCF, but they are immensely important to the enterprise's cash management function as well. Responding organizations with online visibility into these transactions not only report higher DPO than others, but are also 50% less likely to report uncertainty over cash flows as an impediment to active A/P and A/R management.

Best-in-Class Steps to Success

- **Explore supplier networks as means to expand supply chain finance-related partnerships.** As Best-in-Class organizations are more mature in terms of experience with SCF programs and related technologies, the best avenue for future improvement is expansion. In this study, enterprises using supplier networks as part of their SCF initiatives reported greater year-over-year increases in the number of partners with which they have discounting and financing arrangements than those not utilizing these offerings (4.5-times and 1.5-times the level of others, respectively).
- **Refine the approach to financial management by employing additional financing and payment methods.** While the focus for less-mature organizations should be on shoring up their payables practice to open possibilities for discounting, foster connections with financial institutions, and focus on the initial "quick wins," more mature organizations have the opportunity to pursue sell-side opportunities to complete the SCF picture. In this context, companies with the ability to access financing at different stages of the supply chain report cash conversion cycles 14% lower than others, accelerating inbound cash flows and supporting higher levels of working capital.

Supply Chain Finance - Summary

Supply chain finance is an evolving area, with increasingly strong ties to the accounts payable practice of purchasing organizations. As electronic invoices and automated approvals allow buyers to complete processing farther and farther ahead of final maturity dates, they also gain greater control. They can choose whether to explore alternative payment arrangements to capture discount-based savings, or to lengthen payment cycles by renegotiating terms with their suppliers. While supply chain finance does not require technology, there are areas where automation is making headway. With the addition of collaborative technologies to facilitate the exchange of documents between partners and to expose these transactions to increasing numbers of potential financial institutions, the potential for the available technology to support a holistic (rather than functional) approach to supply chain finance will benefit all interested parties - both internal stakeholders and external partners. The goal, whether pursued as one-to-one relationships or many-to-many, and whether facilitated by technology or traditional methods of communication, is to improve partners' access to liquidity, and address suppliers' difficulty gaining access to credit by capitalizing on the strength of the buying entity.

"[We are looking to] progress to seamless transactions with less hassle and manual intervention. This would however be difficult to achieve unless there is a knowledgeable person at the helm driving the change."

~ Operations Manager, Asia-Pacific Construction Firm

Appendix A: Research Methodology

Between November and December of 2010, Aberdeen examined the use, the experiences, and the intentions of more than 140 organizations involved in the execution of supply chain finance initiatives.

Aberdeen supplemented this online survey effort with telephone interviews with select survey respondents, gathering additional information on SCF strategies, experiences, and results.

Responding enterprises included the following:

- *Job title:* The research sample included respondents with the following job titles: C-Level Executive / President (13%); EVP / SVP / VP / Treasurer / Controller (24%); Director (18%); Manager (31%); and other (14%).
- *Department / function:* The research sample included respondents from the following departments or functions: procurement / purchasing (32%); supply chain (23%); finance / AP / AR (16%); operations (6%); and other (23%).
- *Industry:* The research sample included respondents from various industries, including: consumer goods (10%), chemicals (8%), telecommunications (8%), wholesale / distribution (7%), computers and electronics (7%), healthcare - devices and services (6%), food and beverage (5%), oil and gas (4%), pharmaceuticals (3%), and utilities (3%).
- *Geography:* The majority of respondents (60%) were from North America. Remaining respondents were from Europe (22%), Middle East and Africa (9%), the Asia-Pacific region (8%), and South/Central America (1%).
- *Company size:* Forty-one percent (40%) of respondents were from large enterprises (annual revenues above US $1 billion); 30% were from midsize enterprises (annual revenues between $50 million and $1 billion); and 30% of respondents were from small businesses (annual revenues of $50 million or less).
- *Headcount:* Fifty-four percent (54%) of respondents were from large enterprises (headcount greater than 1,000 employees); 20% were from midsize enterprises (headcount between 101 and 1,000 employees); and 26% of respondents were from small businesses (headcount between 1 and 100 employees).

Study Focus

Responding finance professionals completed an online survey that included questions designed to determine the following:

√ The degree to which SCF is employed in their operations and the financial implications of the related technology

√ The structure and effectiveness of existing SCF initiatives

√ Current and planned use of AP, AR, and financing solutions to support liquidity management

√ The benefits, if any, that have been derived from SCF initiatives

The study aimed to identify emerging best practices for Supply Chain Finance usage across industries, and to provide a framework by which readers could assess their own management capabilities.

Table 6: The PACE Framework Key

Overview
Aberdeen applies a methodology to benchmark research that evaluates the business pressures, actions, capabilities, and enablers (PACE) that indicate corporate behavior in specific business processes. These terms are defined as follows: **Pressures —** external forces that impact an organization's market position, competitiveness, or business operations (e.g., economic, political and regulatory, technology, changing customer preferences, competitive) **Actions —** the strategic approaches that an organization takes in response to industry pressures (e.g., align the corporate business model to leverage industry opportunities, such as product / service strategy, target markets, financial strategy, go-to-market, and sales strategy) **Capabilities —** the business process competencies required to execute corporate strategy (e.g., skilled people, brand, market positioning, viable products / services, ecosystem partners, financing) **Enablers —** the key functionality of technology solutions required to support the organization's enabling business practices (e.g., development platform, applications, network connectivity, user interface, training and support, partner interfaces, data cleansing, and management)

Source: Aberdeen Group, January 2011

Table 7: The Competitive Framework Key

Overview	
The Aberdeen Competitive Framework defines enterprises as falling into one of the following three levels of practices and performance: **Best-in-Class (20%) —** Practices that are the best currently being employed and are significantly superior to the Industry Average, and result in the top industry performance. **Industry Average (50%) —** Practices that represent the average or norm, and result in average industry performance. **Laggards (30%) —** Practices that are significantly behind the average of the industry, and result in below average performance.	In the following categories: **Process —** What is the scope of process standardization? What is the efficiency and effectiveness of this process? **Organization —** How is your company currently organized to manage and optimize this particular process? **Knowledge —** What visibility do you have into key data and intelligence required to manage this process? **Technology —** What level of automation have you used to support this process? How is this automation integrated and aligned? **Performance —** What do you measure? How frequently? What's your actual performance?

Source: Aberdeen Group, January 2011

Table 8: The Relationship Between PACE and the Competitive Framework

PACE and the Competitive Framework – How They Interact
Aberdeen research indicates that companies that identify the most influential pressures and take the most transformational and effective actions are most likely to achieve superior performance. The level of competitive performance that a company achieves is strongly determined by the PACE choices that they make and how well they execute those decisions.

Source: Aberdeen Group, January 2011

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Appendix B: Related Aberdeen Research

Related Aberdeen research that forms a companion or reference to this report includes:

- *Operational Cash Management: Streamlining Processes to Unlock Liquidity*; November 2010
- *The E-Payables Solution Selection Report: A Buyer's Guide to Accounts Payable Optimization*; October 2010
- *E-Payables 2010: The Strategic Value of Accounts Payable Automation*; August 2010
- *Working Capital Optimization: Increase Cash Flow in the New Economy*; May 2010
- *Invoicing and Workflow: Transforming Process Automation into Operational Cost Control*; April 2010

Information on these and any other Aberdeen publications can be found at www.aberdeen.com.

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