SCF TRENDS

# The Critical SCF Trends Shaping Corporate Supply Chains

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**Following a deluge of shocks to global supply chains, treasurers are searching for ways to build greater resiliency into their supplier relationships. SCF, enabled by progressive regulation and digital tools, offers benefits to both corporate buyers and their supplier base.**

The proliferation of black swan events in recent years, including the Covid-19 pandemic, the climate crisis and the war in Ukraine, have had tangible impacts on corporate supply chains – from a shortage of raw materials to the drastic increase in energy prices. This has served to underline the importance of resilient supply and value chains.

SCF – referring to reverse factoring rather than wider supply chain finance tools – is a crucial building block for securing sustainable and diversified international value creation, so it is perhaps no surprise that utilisation of this tool is rising among corporates worldwide.

Jacqui Kirk, Head of Trade and Supply Chain Finance, EMEA, Global Transaction Services (GTS), Bank of America, comments: "Our own book has seen continued growth, driven by new programmes being set up and an increase in suppliers joining the established programmes in place. Suppliers see this as an important tool giving them access to liquidity, often at lower rates than they can otherwise achieve."

Additionally, corporates are not only using SCF to look at the financing aspect but also when it comes to modelling their supply chain. The pandemic obviously caused multinationals to reassess their supply chains, but that was just the latest in an ongoing series of events that forced firms to consider their supply chain structures.

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"Supply chains are always evolving, prompted by specific industry or regional shifts or more dramatic events like the pandemic," notes Kirk. "There's currently a general theme where companies are reassessing offshoring and wondering whether to onshore. We'll probably see corporates modify to a mix of the two rather than a wholesale swing to nearshoring. A myriad of factors are now affecting how corporates consider supply chains, from geopolitics and freight costs to climate risk."

## Regulatory challenges and opportunities

The growth in the SCF sector is occurring despite certain complexities that corporates using the tool may face on the regulatory side. For example, in November 2021, the International Accounting Standards Board (IASB) published proposals to amend the IAS 7 Statement of Cash Flows and IFRS 7 Financial Instruments: Disclosures rules to compel corporates to divulge additional information about their SCF programmes.

"We aren't hearing clients say that they consider these to be a deterrent," remarks Kirk. "In fact, many welcome the transparency. Often, corporates have already been disclosing much of the data these new rules look set to require."

At its January 2023 meeting, the IASB deferred a decision about the effective date and transition requirements of the amendments, to consider further analysis of feedback on the topic.

Kirk adds: "In general, SCF has become a central focus for treasurers when thinking about working capital and supply chain viability. It's no longer a novel or peripheral consideration – it's right at the core."

Making trade digital is another strong trend for regulators. In the past year, the International Trade and Forfaiting Association (ITFA) has attracted new participants to its Digital Negotiable Instruments (DNI) Initiative, including Citi, Traxpay, Surecomp and, most recently, Kyriba. These organisations join businesses including Emirates NBD, Lloyds Bank and Nokia in the initiative, which aims to bring together FIs, law firms, technology providers and policy stakeholders to pursue the digitisation of trade flows. A cornerstone of the initiative is based on the United Nations Commission on International Trade Law's Model Law on Electronic Transferable Records (MLETR).

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Markus Wohlgeschaffen, Managing Director and Head of Markets & Sales, Traxpay, reflects that the work being carried out to digitise trade documents is not being reflected in law as quickly as many would like. "The slow adaptation and implementation on the part of national legislators, as well as on the part of economic operators, especially banks, despite the enormous benefits and business potential, is quite surprising."

One country that is leading the way in enshrining digital trade into law is the UK, which introduced the Electronic Trade Documents Bill to Parliament in October last year. The bill will give digital versions of documents, such as the bill of lading and the bill of exchange, the same legal rights as their paper equivalents. This should reduce administration costs, slash processing times and cut carbon emissions.

"The ratification of the UK Electronic Trade Documents Bill will be a quantum leap for trade digitisation," enthuses Wohlgeschaffen. "We are seeing several repetitive practical use cases of new supply chain finance tools and a real merging of the physical and the financial supply chain. With this, treasurers will gain more flexibility. It will enlarge the reach of working capital tools to ensure the availability of sufficient liquidity at all times and the reduction of payment risks."

Another area of regulation that is becoming particularly relevant to the supply chain is through increased scrutiny of ESG-related issues. The EU published a proposal for a Corporate Sustainability Due Diligence Directive in February 2022 and Germany applied the Lieferkettengesetz, or Supply Chain Act, in 2023, aimed at promoting human rights in the supply chain. Meanwhile, in the US, the Securities and Exchange Commission published proposals in March 2022 aimed at convincing corporates to adopt more standardised reporting methods relating to ESG in supply chains.

On top of these developments, other actions by regulators are impacting supply chain management. Goods are being

impounded on suspicion of forced labour being used in supply chains. An example of this can be seen in the US, where in January, Customs and Border Protection identified 282 suspicious shipments with a value of over $69m.

Tightening regulations around ESG marketing claims are also drawing greater scrutiny. In the UK, for example, the Competition and Markets Authority (CMA) announced investigations into the fast-moving consumer goods (FMCG) sector and specific British retailers in this regard.

Tim Nicolle, Founder, PrimaTrade, comments: "All the extra scrutiny around ESG means there's an increasing requirement for corporates to collect, organise, and digitise an increasing number of supply chain documents, not just from the tier 1 suppliers, but the deep tiers as well."

These documents are split into ESG proof of source, showing where an item was made, and ESG proof of claim – what it is made from. As this information must come from the supply chain, the importer has to be able to rely upon its suppliers to show an absence of forced labour in the manufacturing process.

"Most corporates need to tie in these enhanced information requirements with payments – so that suppliers can be held to account," continues Nicolle. "The result is an increasing requirement for organised and managed data flows between suppliers and their purchasing customers – and this needs to be tied into SCF."

## Getting beyond the 'E' in ESG

The regulatory scrutiny underlines just how essential the topic of ESG is for treasurers when it comes to corporate supply chain management. "Sustainable business practices can be tangible in the context of the supply chain because the financing is directly tied to particular activities," says Kirk. "If a corporate has particular suppliers that meet certain sustainability requirements, for example, they may choose to give greater liquidity to those suppliers."

As corporates bring an increasing number of suppliers into SCF programmes, there can be challenges in overcoming manual processing, mainly when dealing with small entities. But getting beyond the tier 1 supplier base to smaller suppliers, and suppliers of suppliers, can be critical to the corporate from the perspective of managing counterparty risk and to the supplier benefitting from the financing. But that's not all.

"There's a sustainable element to it that the banks, corporates, and the whole industry has an interest in, and that's in driving financial inclusion," affirms Kirk. "It's moving beyond environmental matters to societal matters. If corporates can think about smaller entities, they can also consider minority-owned entities, for example. We see in RFPs how important this is to corporates. They want to really broaden the footprint of supply chain with smaller suppliers."

## Platforms: the next generation

Technology is the critical enabler for the growth of SCF volumes, as both banks and corporates invest heavily in platforms that automate and digitise the connections between all parties in the SCF ecosystem.

"We are investing in upgrading our platforms to take advantage of automation, but that needs to be done in a compliant way," reflects Kirk. "There's been increasing interest in corporates having multi-bank platforms. I understand their interest in that, and we're building connectivity to ensure we have solutions to meet our clients' objectives."

One criticism levelled at SCF platforms is that they are not adequately integrated into the supply chain process but rather sit apart as an extra step to be taken. "Suppliers have to engage with platforms separately from their day-to-day process," explains Nicolle. "This leads to low uptake by suppliers since they do not see the early payment option as part of their regular interaction with the buyer. It is separate."

Other limitations that SCF platforms are accused of are that they are limited by funder KYC willingness and that approvals are untimely. "Funders, typically, have limited appetite to KYC smaller suppliers, those with low volumes, and suppliers in difficult geographies," suggests Nicolle. "This leads to most of the suppliers that really need access to early payment being excluded. In addition, the issue with late approvals means that early payment programmes are not that attractive for suppliers."

Ultimately, treasurers must employ due diligence on any potential SCF platform partner. "For corporates, it's good practice to think carefully about any prospective fintech platform and look 'under the hood'," advises Kirk.

Whichever SCF platform a corporate decides to go with, the visibility that a technology solution can help provide into the supply chain can play a vital role in how the treasurer manages risk.

**Tim Nicolle**
Founder, PrimaTrade

"There's a lot of data reporting that, as a side benefit, helps corporates to model their supply chain, see where they've got concentration risks, and identify potential fraud, for example," outlines Kirk. "As all these platforms are becoming more sophisticated, data is becoming more helpful in managing not just the financing but also risk and stability in the supply chain."

New developments in the SCF platform space are also attempting to address the issues and limitations in the market. PrimaTrade is one example of this, which recently went live with a significant UK garment business on its next generation platform.

"We handle all shipments, whether or not early payment is requested," explains Nicolle. "KYC responsibilities are on us, not the funder. And by integrating logistics documents and digitising them, we achieve automated approvals at shipment, so suppliers get the funds very early. This leads to savings of up to 1% on landed costs for our clients."

## Corporate frustrations remain

For all the advances in innovation and technology in the SCF space, corporates can take a leap ahead in efficiency only once all the manual paperwork that has typically existed in the process has been eliminated.

"One element of the process that maybe gets less attention is the work to automate and improve the speed with which invoices are approved and matched in an accounts payable system," reveals Kirk. "If you nail that, it speeds up the processing of the invoice and makes it available to be discounted and financed quicker. It's just one small component of the overall picture, but it's a good example of our work to create efficiencies."

Wohlgeschaffen agrees that technology and digital solutions are critical to support more efficient corporate supply chains. "Banks and insurance companies, in particular, should embrace new technologies and collaborate with fintech companies to deliver concrete proof of concept cases for their corporate clients," he states. "This will demonstrate the value added that new technology offers. All major stakeholders – corporates, banks, insurance companies, freight forwarders, carriers – should urge the legislature to quickly create the legal preconditions for the widespread use of Digital Negotiable Instruments and to ratify the MLETR in as many countries as possible."

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Another area that could be improved is supplier onboarding. Traditionally, banks have tended to follow the due diligence model they would perform on their corporate clients. But in reality, a supplier is a different relationship, so due diligence standards and processes must adapt.

"It's important that, as an industry, we challenge how we've been doing things to be compliant," acknowledges Kirk. "At BofA, we have completed a huge amount of work that will soon simplify how we onboard suppliers while ensuring optimum protections against fraud and financial crime."

## The future's digital

The ratification of the MLETR in the UK will boost the digitisation of the physical and financial supply chain. Other jurisdictions, such as France, look set to follow suit.

"Commonwealth members will particularly benefit first from the UK development, as today some 80% of shipping documents and 60% of trade finance contracts are based on UK law," reveals Wohlgeschaffen. "As a result, value creation processes will become faster, more secure and flexible, and corporate treasurers will gain access to a wide range of new supply chain finance instruments."

As digital trade tools are increasingly given legal authority, a shift from traditional financing schemes such as commercial paper programmes to more transaction-based finance appears inevitable.

"Treasurers should familiarise themselves with digital negotiable instruments," advises Wohlgeschaffen. "Develop strategies, together with colleagues from procurement, on how to benefit from the digitisation developments, to enhance the resilience of their supply chains and safeguard liquidity along with value creation."

With the benefits and ease of use that digital trade documents offer, their greater adoption in jurisdictions worldwide looks set to support growth in the use of SCF programmes in the future.

"Supply chain finance is now a mainstay in a treasurer's arsenal for driving supply chain efficiency and viability," concludes Kirk. "We continue to see strong demand, and indeed an expansion in its use to drive financial inclusion. However, when there is a desire to onboard much smaller suppliers, companies should not overlook the importance of robust supplier due diligence."