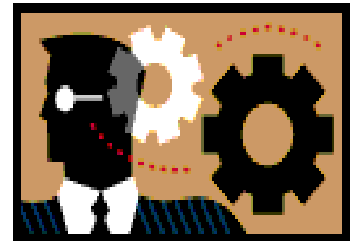




Tips & advice for purchasing professionals

Welcome to Transform, the source for comment, news and information for organizations and procurement professionals whose goal is increased added value and improved corporate performance through effective management of procurement and the supply chain.



Financial Crisis!!! -

Is your financial supply chain placing your company at risk?

A guide for CEO's, CFO's and purchasing leaders on managing Supply Chain Finance (SCF) to build competitive advantage for their company

What's in it for you? Discover how supply chain finance management can provide higher returns to shareholders by balancing the conflicting pressures of improved payment terms, reduced prices and better cash flow.

Reading time: 15 minutes

Introduction:

The headlines are startling; once invincible brands have collapsed, GM is on the brink of bankruptcy, billions of dollars in bailouts and daily news of large layoffs in almost every sector. Anyone who thought the financial crisis would not spill over into the 'real economy' can now have no doubt that it has arrived faster and fiercer than anyone could have anticipated and has now settled in to stay for some time.



According to a survey by the Association for Financial Professionals, the dramatic events impacting Wall Street during September 2008 have had a profound impact on organizations' access to short-term credit. Combined with the pressure on selling prices and over supply, the credit crisis has brought supply chain liquidity and access to capital to the top of most CEO's and CFO's agenda.



Leadership

The pressure on CEO's to grow quarterly earnings requires that organizations continually improve performance, and one of a CEO's most important jobs is to put in place an organization, resource it and ensure its resources have the capabilities to deliver that performance. Without this the organization will always deliver sub-optimal performance, in turn everyone works harder not smarter, value destroying turf wars ensue and so the CEO has set the culture for the organization and its values.

Procurement is one resource, that in many organizations is still sub-optimized, not regarded as a **“must get right”** core business process, and consequently has fallen beneath the CEO's radar. This needs to change.

Procurement in the spotlight



If ever there was a time for procurement leaders to engage their CEO's, now has to be it. With so many businesses failing, the risk of supply chain failure has never been greater, and procurement must be prepared to provide the answers. How many, buyers know the financial condition of even their direct suppliers, let alone their second and third tier suppliers? Procurement leaders around the globe need to ensure they have the answers, by ensuring they have intelligent sourcing, a comprehensive SRM program, and support these with robust processes and skilled staff. See previous blog entry - <http://purchasingpractice.com/is-your-procurement-team-ready-to-lead/>

How solvent is your supply chain?

Left unmanaged, the FSC can undermine a company's financial health, and its brand. To better manage this risk requires companies to develop superior transparency in their financial supply chains and adopt a more holistic approach to the FSC.

Reports are emerging where buyers are increasingly adopting strong arm tactics to obtain significant reductions to current prices. For example, it has been reported that Persimmon one of the UKs largest house builders, has already demanded and received a 15% price cut from its suppliers. Whilst leveraging raw buying power in this may be an effective short term survival strategy, it can also backfire in the form of a less solvent and therefore higher-risk supply base.

The use of similar tactics to extend payment terms is equally short sighted as to survive in business; suppliers are eventually forced to bury the cost of extended payment terms in the cost of goods sold. So in the long run, merely **shifting** cost and risk to suppliers will result in an overall higher cost of goods sold versus competitors that have mastered more advanced SCF practices.



Develop Strategies for a healthier supply base

Have you got an effective plan?

Techniques such as payables extension or supplier-managed inventory programs transfer credit risk and capital costs up the supply chain – in effect, pushing them to their weakest point. In order to develop a more cohesive plan Purchasing Practice believes the future will see organizations developing a more holistic view of their supply chains, by assessing the solvency not just of their direct suppliers but of suppliers further down the chain. Any supplier in this chain with an unacceptable insolvency risk could have the ability to disrupt an organizations ongoing operation. The success of both buying and selling organizations are therefore tied together and so understanding the challenges faced by suppliers can help improve the relationship.

What is required is a more intelligent approach to sourcing and sharing of risk whereby the party best equipped to manage the risk or who can supply access to cheaper sources of capital does so to reduce risk and cost over the entire supplier chain.

Managing Supplier Liquidity Risk

If suppliers don't have access to capital, otherwise healthy suppliers with sound business models, become insolvent and die. Suppliers, who are increasingly struggling to balance cash and access to affordable capital, may resort to taking measures to cut cost, by cutting corners and frequently operate in a state of denial, often failing to tell their customers of their difficulties, until it is too late.

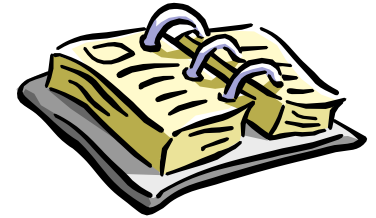
This puts the responsibility clearly on the buyer to ensure they have a strong supplier relationship management program (SRM) in place to closely monitor the health of suppliers. To effectively manage supplier liquidity, buyers must consider the entire procurement cycle. See previous blog entry - <http://purchasingpractice.com/%E2%80%9Cclosing-the-loop-between-strategic-sourcing-srm-and-negotiation-planning%E2%80%9D/>

Take action at the start of the procurement process

Competitive pressures have pushed companies to increasingly source from low cost countries over the past 10 - 15 years resulting in extended, more complex and vulnerable supply chains. The same pressures have also seen an increasing trend for many companies to adopt single sourcing to maximize their pricing leverage. Whilst both are viable and legitimate strategies, such practices have placed significantly more risk in company supply chains, which is now further exacerbated by the credit crunch.



All this makes for a very volatile mix, for which Purchasing Practice recommends that companies develop a “rules based” framework as part of their initial sourcing process to ensure these risks are addressed satisfactorily.



Visit the Buying Magician bog: “**FSC rules based risk management in the sourcing process**” www.purchasingpractice.com.blog

An Enterprise Level Initiative requiring Closer Collaboration between Supply Management and its Internal Partners:

Joined up thinking

SCF management requires board-level vision and leadership to drive a focus on releasing working capital from the supply chain. It involves difficult changes to processes, and organization that can make implementation difficult. Cultural barriers can exist between Supply Management and Finance managers that make change difficult, so collaboration is necessary to ensure a truly integrated approach to supply chain financing strategy.

What’s in your Toolbox?

At the strategic level, this collaboration must consider how business strategies, processes and technologies will evolve during the next three to five years to enable them to improve the use of working capital tied up in the supply chain? More immediately they must adopt tools from the following toolkit to manage working capital in the supply chain more effectively:

1. Supply Chain Finance Discount Management Strategy (SCF/DM):

SCF/DM is a business strategy that optimizes working capital and supply chain collaboration for both the buyer and supplier by seeking tailored payment terms for services and materials.

SCF/DM programs enable:

- Greater payables and receivables visibility
- Increased access to payment scheduling
- More effective supply chain interactions
- Integration throughout all supply channels and back-office billing and invoice functions

By developing a SCF/DM strategy buyers can harness a range of tools which can be used to fund early payment to preserve supplier’s cash flows, generate an excellent short term ROI and



achieve attractive financing options to optimize working capital requirements throughout the supply chain:

a. Static Discounts

Buyers can proactively negotiate discounts with suppliers in exchange for accelerated payment, the supplier receives the full amount of the invoice less the discount, which reduces the suppliers DSO and removes a debt from the buyers' balance sheet. It is a win-win for both sides of the transaction. Many discounts of this type are lost simply due to extended invoice processing times. Reducing invoice processing time enables the buyer to improve the capture of previously missed discount opportunities.

b. Flexible Discounts

With traditional static discounts such as 2.5% 10/net 30, an early payment is worth a 2.5% discount if paid by day 10, but nothing if paid on day 11 or after. Similarly, an invoice approved prior to day 10 is limited to a 2.5% discount, even if it is paid on day five. This problem can be overcome by negotiating discounts on a sliding scale.

c. Dynamic Discounts

The introduction of automated procure to pay systems has enabled buyers to become much more sophisticated in managing cash flows. Many suppliers may not need accelerated cash flow on an ongoing basis and are therefore unwilling to agree to ongoing early-payment discounts. However, some suppliers may have more appetite for cash at particular points in their business cycles. With these suppliers, Dynamic Discounting can add value by enabling buyers and suppliers to make opportunistic decisions on payment timing depending on their cash position:

Supplier invoices which have cleared for payment earlier than the agreed terms can be offered to the supplier for early payment with at a discount. This discount reduces over time, reaching zero when the due payment date approaches. Individual discount schemes can be created for different suppliers who can view their terms online. They can then self serve to accept one of the levels of early payment offered for each invoice automatically.



2. 3rd Party Financing (TPF):

TPF is now probably the most important tool for freeing up working capital currently trapped in the payment process, and when done properly provides as much benefit for the supplier as it does the buyer:

- a) Below Market Financing Rates
- b) Reduced Cash Flow Uncertainty
- c) On-Demand Access to Funding and Financing
- d) More Days-Sales-Outstanding Flexibility

The buyer can introduce a third party to fund accelerated payment to suppliers at very low rates. The supplier is paid early, while the buyer pays the invoice at its full net term, serving to remove the supply chain risk from maximizing DPO and lowering net working capital needs. As a result, buyers can extract savings from supplier's access to cheaper financing and longer payment terms.

3. Inventory

Optimizing inventory across the supply chain involves reducing total supply chain costs and lead times, not just moving inventory to a supplier. Tools to achieve this include:

- a) Improved forecasting: by segmenting customers and products for faster response times, a higher return on assets and reduced stock-outs from demand changes.
- b) Third party ownership: where a third party agrees to buy the supplier's product as soon as it is finished and then sell it to the buyer on a Just-In-Time (JIT) basis. Provided any service mark-ups, are considerably less than the combined inventory and financing cost to the supplier, they would be able to lower their price to the buyer.

It's time to bring supply management to the heart of your business strategy:

External spend on goods and services typically varies between 40 percent and 80 percent of operating costs, depending upon the industry sector. Given such status in the company finances, it is remarkable that in many businesses today that procurement is still regarded as a non-core function, and is typically buried in the corporate hierarchy without influence and even worse without any expectation from senior management of making a strategic impact. An effective procurement function can have a dramatic and powerful impact.



purchasingpractice
Corporate procurement made simple

Conclusion

The credit crisis has triggered a volatile market where nothing is certain. When financial failure can have such a serious impact and even the mightiest businesses are not invulnerable, buyers must systematically adopt SCF techniques to evaluate the health of their supply chains regardless of how respected the names of their suppliers.

CFOs and CEOs need to recognize that the supply management function merits a boardroom seat. This is justified by the function's top-line and bottom-line impact alone, not to mention the increasingly strategic importance in areas such as globalization and sustainability.

Those businesses who have failed to prepare adequately for the lean years 'beyond the boom' are often forced out of business or must radically downsize their scale of operation to survive. This provides better managed organizations with an opportunity to capitalize by building market share at the expense of their less prepared competitors. Strategic procurement can play a key role.

For More Information

Purchasing Practice Inc can work with your organization to develop a strategic procurement capability that will add value and positively affect your top and bottom line. To learn more, call 1-778-988-1052 to arrange a free consultation, or visit us at www.purchasingpractice.com





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Corporate procurement made simple

Purchasing Practice –*Corporate Procurement made simple*

Purchasing Practice works with clients on the complexity and barriers associated with implementing world class procurement practices; enabling our clients to gain more control over their third party spend management, processes and supply chains, resulting in enhanced capability to deliver innovative cost effective solutions to their own customers.



We drive superior and sustainable financial performance through top line growth, free cash flow and margin improvement (in private sector companies), and best value and service excellence (in public sector organizations).

We can help your organization “*make change happen*” in procurement. Our services include:

Transformation Management: We will act as a change agent by working with you to articulate and communicate the need for change, develop an enterprise wide procurement blue print and support you through the implementation process.

Opportunity Assessment: By working directly with those staff responsible for committing expenditure, or managing suppliers, we will carry out a rigorous review and present our recommendations

Sourcing Management: Using our strategic sourcing service enables clients to realize full value from their supply base through leveraging our proven processes

Category Management: We work with clients to analyze spend data, define suitable categories then working on a category by category basis to deliver significant benefits

Supplier Relationship Management: We will carry out a rigorous review using proven tools and methodologies to present our recommendations.

Call us on 778 988 1052 or email us at info@purchasingpractice.com to schedule a consultation.

