GSCFF

GLOBAL SUPPLY CHAIN FINANCE FORUM

## ENSURING PAYABLES FINANCE REMAINS A FORCE FOR GOOD

# The Global Supply Chain Finance Forum addresses the concerns head-on

ICC INTERNATIONAL CHAMBER OF COMMERCE The world business organization

BAFT

FCI Facilitating Open Account – Receivables Finance

ITFA International Trade & Forfaiting Association

ABE EBA EURO BANKING ASSOCIATION

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## INTRODUCTION

Over the past decade, payables finance programmes have become a popular means of financing supply chains—bringing in new pools of investment liquidity from financiers to generate win-win benefits throughout the supply chain. For the buyer, this means improved payment terms and working capital optimisation, for the seller this means alternative sources of funding and at lower rates than most small and medium-sized enterprises (SMEs) can normally access. For both, it means more secure and stable supply chains and more sustainable business.

Such an arrangement should create benefits on both sides of the transaction. However, it is concerning to observe certain practices in the market and to read reports that this may not be the case in some instances, with criticisms emerging regarding these programmes: both their objectives and their outcomes.

With the focus on transparency, the Global Supply Chain Finance Forum (GSCFF)—made up of the major global associations representing the trade finance market: BAFT (Bankers' Association for Finance and Trade), Factors Chain International (FCI), the International Chamber of Commerce (ICC), the International Trade and Forfaiting Association (ITFA) and the Euro Banking Association (EBA)—outlines the criticisms within this report and provides the industry's perspective.

The report focuses on three key areas of concern:

1. Potential adverse impact on suppliers—especially SMEs—and notably those based in developing and emerging markets;
2. Financial reporting and transparency;
3. Potential credit and liquidity risks associated with these programmes.

## 1. What exactly is payables finance?

Before addressing the concerns, it is crucial to understand what payables finance is, and how it should be used. Payables finance is one tool in a suite of solutions falling under the umbrella of supply chain finance (SCF). It can be defined as "a buyer-led programme within which sellers in the buyer's supply chain are able to access finance by means of receivables purchase".[1] As such, if the seller elects to be paid earlier than the buyer's standard terms of engagement, the programme provides the option of receiving the discounted value of the receivables (represented by outstanding invoices approved for payment) prior to the actual due date.

The cost to the supplier of financing under such a programme is aligned with the credit quality of the buyer (usually an investment grade-rated entity) and is therefore lower than the cost at which the small supplier could borrow on their own. The buyer, meanwhile, pays the total value of the receivable to the financier on the due date. In this context, the buyer's creditworthiness assists the seller with improved financing conditions and access to additional liquidity without use of their own credit lines. Such financing helps to underpin the stability and integrity of the entire supply chain, benefitting not just the buyer and participating supplier.

For more information, see our factsheet "*Payables finance—how it helps global supply chains*".[2]

## 2. Addressing the concerns: potential impact on suppliers and SMEs

**The media have been quoting instances of SMEs reportedly being "bullied" into joining SCF programmes. Is this common practice? And what is the GSCFF's view on this?**

The notion of SMEs being "bullied" could be characterised as somewhat sensationalist, in as much as the presentation of the issue completely ignores the balance that can be achieved through well-structured payables finance programmes. This balance involves terms that help the buyer and therefore assures the health of the overall supply chain, combined with prompt access to funds for the supplier on an affordable basis, which helps address the systemic SME cashflow challenge.

It is notable that at the peak of the Global Financial Crisis, the UK, the US and other jurisdictions considered encouraging the use of payables finance programmes as a way to pump urgently-needed liquidity into domestic supply chains—yet, currently, that same technique is presented by some as "bullying". In reality, it is the abuse of such programmes and the abuse of market power that can sometimes lead to a bullying dynamic.

While such instances regrettably exist, this is not a widespread practice and it is most certainly not "best practice". Payables finance programmes should be used appropriately and, when they are, can become an important financing tool for corporate treasurers and the SME supplier community.

Sellers are accustomed to supplying goods and services to their buyers on various terms, with 30 days from invoice date being common, albeit not a formal standard. Buyers may need to increase payment terms to, say, 45 days (or more) for a variety of reasons, including improving their own working capital position or aligning the production and sales cycles. SCF programmes such as payables finance allow suppliers to be paid before 30 days—in many cases as quickly as five to 10 days.

Suppliers that are not in urgent need of cash can opt to receive payment in full on the original due date. We are very clear on this point: sellers should feel as though they can freely elect to participate or not, when invited, with absolutely no obligation. The GSCFF strongly encourages finance providers

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1 GSCFF, "2016 Standard Definitions for Techniques of Supply Chain Finance", https://iccwbo.org/content/uploads/sites/3/2017/01/ICC-Standard-Definitions-for-Techniques-of-Supply-Chain-Finance-Global-SCF-Forum-2016.pdf

2 GSCFF, "Payables finance—how it helps global supply chains", http://files-eu.clickdimensions.com/iccwboorg-avxnt/files/20200212gscffmessageonpayablesfinance-finalversion.pdf?m=2/12/2020%203:17:25%20PM&_cldee=bGR1YXJ0ZUBpY2N3Ym8udWs%3d&recipientid=contact-296a61d8f797e911a991000d3ab27d56-fad47b3e419b432986b0ecfbfab75e8d&esid=4d6044a3-6d4e-ea11-a812-000d3aba77ea

to follow accepted practice in considering extensions of terms; if a given sector is characterised by payment terms in the range of 30-60 days, for example, a programme based on 120-day terms might need to be supported by clear rationale, or may be deemed outside of the typical parameters for that industry sector. That fact in isolation would not make the proposed programme structure inappropriate, but financiers and buyers deploying such solutions may attract queries.

The question of market power has long been understood as a challenge in developing and deploying payables finance programmes. Most payables finance programmes are therefore structured in a manner that allows suppliers to avail themselves of early payment without this being made visible to the buyer. The intent has always been to provide balanced benefits to both trading partners.

As with other established forms of trade financing, such as Documentary Letters of Credit, the GSCFF and the global community of trade finance practitioners consider that good faith and a genuine desire to do business to mutual benefit should underpin payables finance programmes. The benefits of the programmes should speak for themselves.

### Would you agree that some buyers' intentions when implementing payables programmes are to generate a working capital benefit for themselves, not for their suppliers?

The primary aim of a payables programmes is to generate a win-win for buyer and seller in terms of working capital benefits. Buyers pay on standard industry terms and sellers can choose to receive payment early, or at the original maturity.

The payables finance programme itself may well be initiated by the buyer in order to improve its working capital cycle, but such programmes would not work if the seller/supplier did not also see a benefit in accessing early payment facilities—otherwise they would not (and should not) agree to participate.

A payables finance programme is put in place in the ordinary course of business under standard industry-specific payment terms. A seller has the choice not to discount their receivables/invoices or not to sell to a specific buyer on terms that they cannot and do not choose to support. The notion of suppliers being "bullied" is deeply concerning, although the GSCFF observes that most buyers are establishing such programmes to further support their suppliers and, at the same time, better secure their own supply chains and production lines.

In terms of generating working capital for the supplier, most programmes offer a less costly alternative than overdrafts or corporate loans.

### In Australia, the ombudsman for small businesses has accused large corporates of pressuring suppliers to join SCF programmes and claimed financial intermediaries are using artificial intelligence (AI) to extract excessive returns from smaller firms. Do you agree with the ombudsman in this respect?

AI can be utilised to set up new, or further optimise existing, financial programmes of any kind. AI is a powerful tool for evaluating risk, enabling banks and other providers to establish pricing and attract liquidity. Yes, it can be misused, which the GSCFF condemns. How the intelligence generated from AI is used and how it is ultimately translated into concrete measures is something a particular buyer needs to decide according to their own business policy and corporate ethics.

The GSCFF condemns exploitative pricing that is not warranted by the risk the financing provider is taking and is against using AI for such purposes. From this perspective, AI should promote and support the original objectives of the programmes: to generate win-win scenarios for both buyer and seller by attracting new sources of liquidity into supply chains.

Finally, it is worth noting that the ombudsman also highlighted the benefits of payables finance in the same report.[3]

**Payment terms have been a key area of criticism for SCF programmes—with days payable increasing 30 to 45, 60 or even 90 days (and since the COVID-19 crisis, there have even been instances reported of 180 days). To avoid such terms, it is said that suppliers are "encouraged" to accept a discounted payment on their original terms via a related financing organisation. Some authorities are considering curtailing this practice.**
**Do you agree that curtailing such practices would be a good idea?**

In order for a SCF programme to be labelled a "payables finance" programme, certain parameters must be respected. This generally means that tenors do not exceed 180 days (or 360 days on an exceptional basis). A number of the cases in which buyers have attempted to lengthen payment terms are short-term reactions to the unprecedented COVID-19 situation and are not reflective of the payables finance industry as a whole, nor should they continue in the longer-term.

Ultimately, industry-aligned payment terms ought to guide the structuring of programmes, acknowledging that those terms vary by sector, and that exceptional circumstances—or legitimate, commercially-agreed practice—can evolve, that is beyond the more common terms.

Generally, payment terms are subject to negotiation between the trading parties in which neither party is pressured into accepting them. Banks and other finance providers leave such discussions to the discretion of the contracting parties and their accountants.

**Does the GSCFF believe there should be a legal requirement in place restricting enforced payment terms?**

Late payment legislation already exists in many countries and at a European Union level. Permissible terms vary with the competent authorities policing the rules. Our recommendation is to appeal to the stakeholders and motivate parties to negotiate fair industry standard terms that are acceptable and beneficial for both sides.

In principal, the GSCFF supports the notion of freedom of contract in which trading partners (sellers and buyers) enter into contracts based on mutual agreement and free choice.

## 3. Addressing the concerns: accounting implications

**With respect to SCF programmes, ratings agencies have been pushing for reforms to companies' financial disclosures. Originally pushing for cash received via the programmes to be recognised as bank debt, Moody's has since softened its approach, advocating now for corporates to disclose SCF programmes as a potential risk to liquidity. Would you agree with the rating agencies' position that these programmes do represent a risk to liquidity?**

In our view, the liabilities arising from SCF programmes do not create additional financial risk above and beyond those that already exist in trade between a buyer and a seller. Loan facilities usually contain wording that allow them to be suspended when negative events occur. A SCF programme, if undertaken by a corporate in poor financial condition, is no different.

Negative outcomes can be avoided by implementing strong credit analysis of a corporate's balance sheet before engaging in a SCF programme.

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3 Australian Small Business and Family Enterprise Ombudsman, "Supply Chain Finance Review", https://www.asbfeo.gov.au/sites/default/files/documents/ASBFEO-SCF-position-paper.pdf

**Given that there was no disclosure in the accounts of Carillion plc before its collapse, disclosure remains a prominent issue. What is the GSCFF doing to promote the use of SCF in a manner that ensures transparency and understanding of the risks involved?**

The GSCFF has undertaken extensive work to promote strong industry standards as well as agreed definitions, including the release of the Standard Definitions for Techniques of Supply Chain Finance.[4] In addition, the GSCFF has been working on a series of additional guidance documents for the techniques included in the Standard Definitions. The first report, on receivables discounting, was published in June 2019.[5] The next guidance paper in the series will cover payables finance and is expected to be released in the second half of 2020. The BAFT Global Trade Industry Council (GTIC) Payables Finance Principles document, also to be released this August, will prove another strong reference document in this respect.[6]

**In the US and elsewhere, calls are growing for buyers to disclose their use of SCF in company filings after concerns it can be used to obscure a company's true financial position. Do you believe there should be more transparency with respect to financial reporting?**

The GSCFF is highly supportive of transparency as it relates to the usage of these programmes. We recognise the need to develop proper parameters for disclosure in corporates' financial statements in coordination with accounting standards bodies—but also recognize the challenges that may arise in deciding how to implement these.

## 4. Addressing the concerns: risk of programmes

**At what point, in the view of the GSCFF, does a payables finance programme become more risky than rewarding for those involved? And do you agree that the risk is different for the buyer and supplier, with more risk to the (usually smaller) supplier?**

It should be remembered that the main risks are taken by the finance providers, particularly with regards to the buyer's creditworthiness. This can be managed by appropriate credit analysis, as previously mentioned, with the trade-off generally remaining in equilibrium for the duration of the programme.

Suppliers are greatly helped by the source of liquidity which, as we have pointed out, is available at better rates than they would normally be able to obtain. The smaller the supplier, the greater the benefit as their sources of finance are generally more expensive and more constrained.

**The greater risk concentration and alignment with reverse factoring (a variant of payables finance) compared to conventional factoring increases the likelihood that the facility may be curtailed if the sponsoring customer suffers material credit stress. Is conventional factoring therefore a less risky option for parties involved?**

The primary difference between a traditional and reverse factoring/payables finance programme is the concentration risk of a debtor when a financier funds suppliers. In a traditional factoring scenario, the finance provider takes the risk of a portfolio of debtors (customers of the seller)—thereby diversifying the risk. If one debtor experiences financial difficulty, the finance provider will still have other debtors under the factoring programme to rely on for the continued viability

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4 GSCFF, "2016 Standard Definitions for Techniques of Supply Chain Finance", http://supplychainfinanceforum.org/ICC-Standard-Definitions-for-Techniques-of-Supply-Chain-Finance-Global-SCF-Forum-2016.pdf

5 GSCFF, "Receivables Discounting Technique - Market Practices in Supply Chain Finance", http://supplychainfinanceforum.org/GSCFF-Receivables-Discounting-Common-Practices.pdf

6 BAFT, https://www.baft.org/

of its business. In a reverse factoring programme, however, the risk is concentrated on one debtor (referred to as the "anchor buyer"). In these programmes, the debtor is normally an investment-grade credit, and the likelihood of curtailment of the programme is diminished.

Also, due to the low quantitative risk associated with reverse factoring/SCF programmes—and the ability to pass on the low cost of finance to the sellers based on the strength of the balance sheet of the anchor buyer—the cost of finance is lower than that of an overdraft or loan. By contrast, the cost of traditional factoring is higher as there is normally some recourse back to the seller, hence the risk is greater. Clearly, the seller is leveraging the credit analysis expertise of the finance provider on the buyer. If a finance provider opts to reduce the buyer facility and no longer purchases the receivables from the seller, the seller would be forced to discontinue the program as they would no longer receive requests to discount.

**Some newspapers have reported that increased use of supply chain finance due to COVID-19 brings additional risk to the system—as these are simply credit lines that banks can withdraw at a moment's notice. Does the GSCFF believe this to be a legitimate risk?**

SCF in general, and payables finance in particular, is a long-term business solution that corresponds to stable and long-standing relationships between business partners. Credit lines provided by banks will usually reflect the financial need of these business partners. If a situation like COVID-19 calls for more credit, banks will do their best to satisfy incremental demand.

Certainly, it would be counter-productive and inappropriate to swiftly withdraw credit lines—creating more distress for both the buyer and the seller. Our expectation is that banks will attempt to help their clients and their sellers to survive in these critical times. Indeed, we understand there have been a number of cases where credit lines have been extended and buyers were given extra time to pay. This is a very important, if short-term, way to provide financial relief and is, no doubt, welcomed by corporate treasurers looking for ways to overcome the current crisis.

## CONCLUSION

Misuse of payables finance and reports of suppliers being forced into accepting unfavourable terms are extremely worrying for the GSCFF—yet our understanding is that these incidents remain isolated and uncommon. We believe that, while they have attracted significant media coverage, they are not representative of how payables finance programmes are used by the majority of buyers and sellers in mutually supportive supply chains.

If correctly implemented, it is clear that payables finance is a means for buyers and sellers to optimise their working capital and strengthen their relationships with each other. It is our goal to ensure that this is correctly implemented across all industries and geographies.

We believe that fostering increased understanding of SCF, its benefits and how it can be best used it in line with standard market practice is crucial to achieving this goal. While we have made significant strides in this respect since the launch of the Standard Definitions for Techniques of Supply Chain Finance in 2016, we accept that more must be done.

To this end, we plan to continue to release further guides on SCF techniques, to help educate and guide best practice by banks, fintechs, buyers and suppliers.

Supporting SMEs is at the very top of the agenda for the GSCFF, and all of its participating institutions. The launch of ICC's "Save our SMEs" campaign in March 2020 is just one example of the industry's unwavering commitment to ensuring SMEs receive the funding they need, and that business works for everyone, everywhere, every day.

## Key contributors to this report

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### International Chamber of Commerce

The International Chamber of Commerce (ICC) is the institutional representative of more than 45 million companies in over 100 countries. ICC's core mission is to make business work for everyone, every day, everywhere. www.iccwbo.org

### BAFT

BAFT is the leading international transaction banking association, providing advocacy, thought leadership, education and training, and a global forum for its members in the areas of trade finance, payments, compliance, and regulations. www.baft.org/

### ITFA

The International Trade and Forfaiting Association, ITFA, is the worldwide trade association for companies, financial institutions and intermediaries engaged in global trade, forfaiting, supply chain and receivables financing. https://itfa.org/

### FCI

FCI is the global representative body for factoring and financing of open account domestic and international trade receivables, with close to 400 member companies in 90 countries. www.fci.nl

### OPUS Advisory Services Inc.

OPUS Advisory Services International Inc. is a Canadian consultancy established in 2001, focused on international business, trade and investment, including trade finance and supply chain finance. www.opus-advisory.com/

### EBA

The Euro Banking Association (EBA) is a practitioners' body for banks and other service providers supporting a pan-European vision for payments. www.abe-eba.eu/

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GLOBAL SUPPLY CHAIN FINANCE FORUM

## ABOUT THE GLOBAL SUPPLY CHAIN FINANCE FORUM

The Global Supply Chain Finance Forum was established in 2014 to develop, publish and champion a set of commonly agreed standard market definitions for Supply Chain Finance (SCF). Comprised of trade bodies BAFT (Bankers' Association for Finance and Trade), Factors Chain International (FCI), the International Chamber of Commerce (ICC), the International Trade and Forfaiting Association (ITFA) and the Euro Banking Association (EBA) the industry consortium leverages its collective footprint to aid the target audience of SCF in gaining clarity and consistency on the various terms and techniques used. The main objective of GSCFF is to support the sustainable growth of supply chain finance by establishing consistency and a standardized understanding of SCF across the industry. Subsequently, the GSCFF strives towards acknowledgement of its definitions and their benefits by its target audience, in specific on the regulatory side. The Forum monitors and reacts to major market developments in all relevant matters for Supply Chain Finance. It is open to financial institutions, non-FI Finance providers, accounting firms, investors, rating agencies, regulators and corporates who have a stake in supply chain finance.