Adding Supply Chain Financing to Your Offerings

lending International Banking

Summary: Supply chain financing had already gained speed prior to the pandemic, but activity has picked up substantially over the past two years. What CFIs should know about the rise in supply chain financing and why they may want to consider adding it into the fold.

In the more than 30Ys that the "Popeye the Sailor" cartoon series ran on TV, J. Wellington Wimpy stood out as one of the most memorable characters. Wimpy was one of Popeye's sidekicks, and he had as much of an obsession with hamburgers as he had a penchant for never having money on hand to pay for them. His catchphrase became, *"I'll gladly pay you Tuesday for a hamburger today."* Of course, despite consuming countless burgers over the course of the series, not once did Wimpy pay for one.

Getting something you want now and wanting to pay later isn't unique to Wimpy. Over the past couple of years supply chain financing — which was already popular prior to the pandemic — has been picking up speed as more businesses struggle to maintain solid cash flows while avoiding having to take out traditional loans. As community financial institutions (CFIs) strive to strengthen their offerings for small- and mid-size businesses, and to remain competitive against fintechs, supply chain financing is something to consider adding to their offerings.

Untraditional Financing

Supply chain finance enables businesses to use short-term credit to pay suppliers for goods, while delaying the actual payments the purchasing company doles out, all at a much lower cost than traditional loans. For businesses, the appeal of supply chain finance is the ability to keep more cash on hand and to negotiate more attractive terms from suppliers, such as delayed payment schedules. Suppliers benefit from the ability to move merchandise more quickly and the guarantee of immediate payment.

Supply chain finance, also known as reverse factoring or supplier finance, is something like a B2B version of buy now pay later (BNPL) that uses software to automate transactions. These transactions range from initiation and invoice tracking to approval and settlement, with short-term credit automatically initiated for buyers, once transactions are initiated. Unlike factoring, where suppliers accept a larger discount in exchange for immediate payment, the percentage a supplier pays to lenders in exchange for payment through supply chain finance is lower. This is because it is tied to the buyer's credit rating instead of the supplier's.

The combination of inflation, rising interest rates, and ongoing supply chain issues related to the pandemic have made supply chain financing more appealing. As supply chain finance has become more popular, both fintechs and financial institutions alike have been quick to jump on the business opportunity it creates. According to a 2022 survey from Taulia, since the company began surveying such activity in 2017, the number of suppliers taking early payments has doubled to 38%. In fact, supply chain finance activity has nearly doubled over the past two years, reaching $995B in 2021, a sharp increase from $530B in 2019 and $726B in 2020, according to the *World Supply Chain Finance Report 2022*.

With the growth in supply chain finance, larger institutions are starting to focus on new targets. For example, Citigroup has recently stepped up its own version of supply chain finance, expanding such lending beyond major suppliers to mid-sized business. Now that the big players in finance have their eyes set on what are typically target markets for CFIs, it might be a good time for CFIs to start jumping into the fray of supply chain finance.

An Increase in Oversight

While supply chain financing is an area that CFIs may want to consider adding into their offerings, particularly since it is a good way to both strengthen ties to existing business customers and create relationships with their suppliers, the practice is not without its risks. Following the recent bankruptcy of supply chain financer Greensill Capital, coupled with the added risk of delinquencies created by soaring inflation, the SEC has stepped up its oversight of the practice. This change is due to concerns that supply chain finance practices interfere with painting an accurate picture of companies' debt. The Financial Account Standards Board (FASB) also recently approved a set of disclosures that companies will have to adhere to regarding their supply chain finance activities.

Despite heightened regulatory oversight surrounding supply chain financing, the additional revenue possibilities of offering such services may be worth assuming a bit more risk for CFIs. With a growing number of financial institutions moving into this business line, digging into the practice to determine whether it makes sense for your CFI may be worth the effort.

ECONOMY & RATES

Rates As Of: 01/19/2023 06:38AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	4.69	0.27	0.27
6M	4.79	0.03	0.03
1Y	4.63	-0.08	-0.08
2Y	4.10	-0.33	-0.33
5Y	3.47	-0.53	-0.53
10Y	3.40	-0.48	-0.48
30Y	3.57	-0.39	-0.39

FF Market	FF Disc	IORB
4.33	4.50	4.40
SOFR	**Prime**	**OBFR**
4.30	7.50	4.32