



Supply Chain Finance

The Li & Fung Management Book Series

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Key takeaways

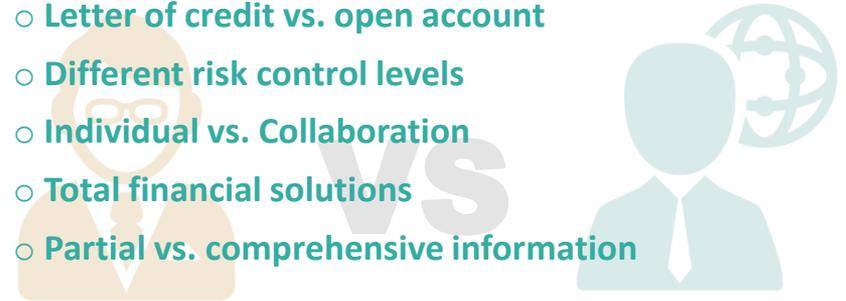
Key drivers of the development of supply chain finance in **CHINA**

- Trade globalization
- Demand from SMEs
- Reinvention of business models in China's banking industry



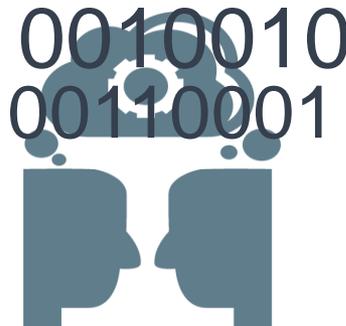
Differences between trade finance & supply chain finance

- Letter of credit vs. open account
- Different risk control levels
- Individual vs. Collaboration
- Total financial solutions
- Partial vs. comprehensive information



Characteristics of supply chain finance

- Modern supply chain
- Big data
- High growth SMEs
- Release of working capital



Risk factors

- Supply chain structure
- Benefit-sharing & compensation mechanism
- Policy & regulatory environment
- Upstream & downstream networks
- Credit history

...and more...

Risk management

- Healthy supply chain ecosystem
- Checks and balances
- Self-liquidating
- Informatization
- Design of total financial solutions

Key drivers pushing forward the development of supply chain finance

- Trade globalization has given rise to new trade financing models



- China's SMEs show huge appetite for supply chain finance solutions

- Commercial banks reinvent their business models
 - Interest rate margins have been shrinking along with financial market liberalization in China
 - Homogenous competition among banks is eroding the profitability of the industry
 - As financial reform deepens in China, more and more well-established large enterprises are opting for direct financing by issuing stocks and bonds



Definition of supply chain finance

A management process that **integrates logistics and business operations with financial management initiatives** to closely link buyers, sellers, third party logistics service providers and financial institutions **with the ultimate goal of facilitating cash flow and supply chain operations.**



Characteristics of supply chain finance

- Modern supply chain management as the guiding principle of supply chain finance
- Financial service providers can estimate the future cash flows generated by less liquid assets* and financial risk through assessing the entire supply chain ecosystem

* *Less liquid assets: inventory, prepayment, account receivables*

- Big data holds the key to unlock the potential of increasing amounts of data available to supply chain
 - Increasing supply chain visibility
 - Reducing supply chain risk
 - Enhancing demand-planning capabilities

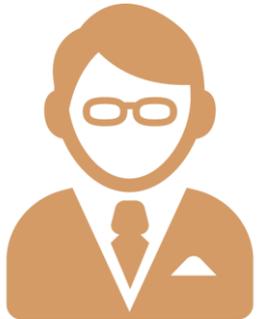


- High growth SMEs are the key targets of supply chain finance service



- Supply chain finance strives to release working capital tie-up in less liquid assets
- Supply chain finance service providers offer customized financial solutions to fulfill different needs of supply chain players, and to simultaneously facilitate supply chain collaboration and reduce operating cost

Trade finance vs. supply chain finance



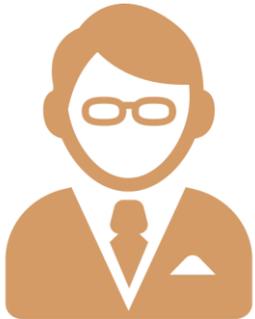
Trade finance model

<ul style="list-style-type: none"> • Letter of Credit 	<p>The most common settlement method</p>	<ul style="list-style-type: none"> • Open account
<ul style="list-style-type: none"> • Loose in risk control 	<p>Risk control level</p>	<ul style="list-style-type: none"> • More stringent risk control <i>This model takes into account the stability of cooperation between upstream & downstream players</i>
<ul style="list-style-type: none"> • Generally led by commercial banks <i>Commercial banks need to evaluate each deal</i> 	<p>Role of commercial bank</p>	<ul style="list-style-type: none"> • Commercial banks offer collaborate with logistics and insurance companies to provide services
<ul style="list-style-type: none"> • Single trade process 	<p>Coverage</p>	<ul style="list-style-type: none"> • 'End-to-end' financial solutions covering the production, supply & sales processes
<ul style="list-style-type: none"> • Partial information about the supply chain operations 	<p>Information</p>	<ul style="list-style-type: none"> • Obtain comprehensive information about the supply chain processes



Supply chain finance model

Views toward SMEs



**Traditional credit
service provider**

Individual SME...

-  Insufficient information disclosure
-  High credit risk
-  Moral hazard
-  Poor cost benefits

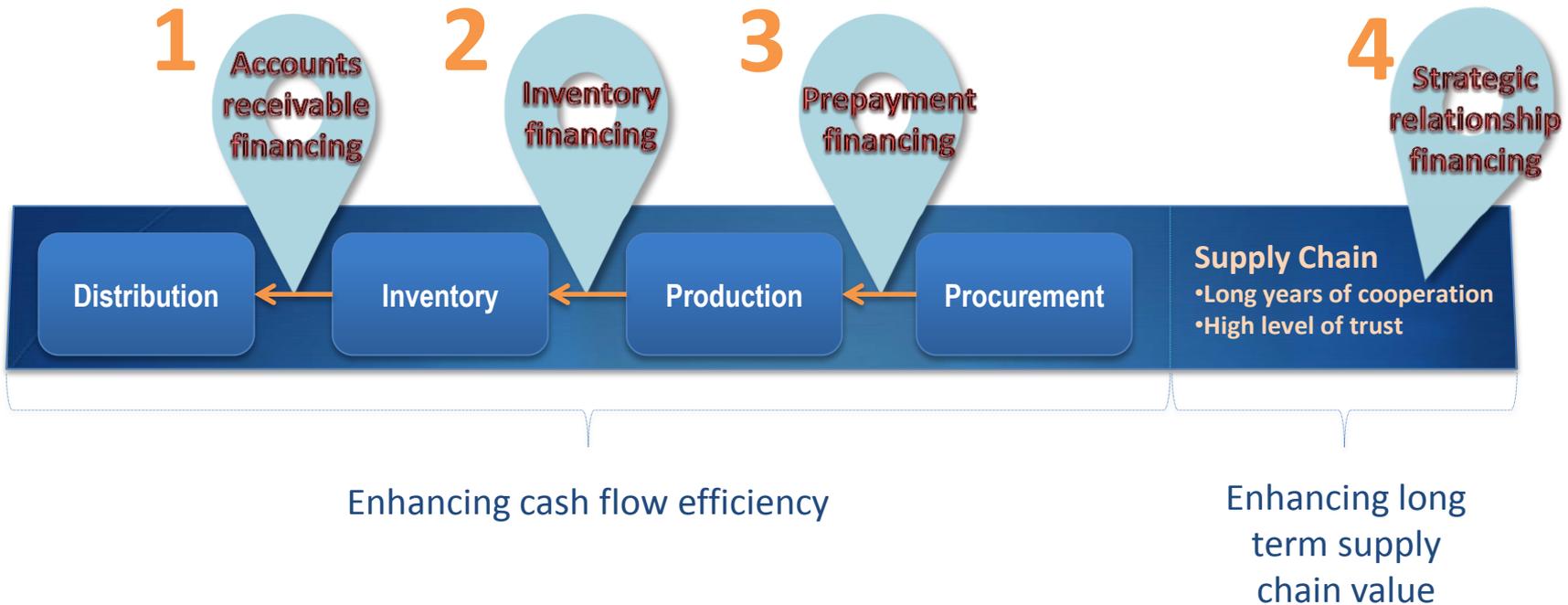
Through supply chain collaboration,

-  Compensated by transaction information of supply chain
→ lower information cost
-  Stringent screening efforts by upstream and downstream players
→ arguably lower credit risk
-  Reputation and exit cost considerations
→ lower moral hazard
-  Digital technology and outsourcing
→ reduce cost



**Supply chain
finance service
provider**

Four forms of supply chain finance



3 categories of supply chain finance risk factors

External risk factor

- Economic cycle
- Policy & regulatory environment
- Upstream & downstream networks
- Industry environment
- Market analysis
- Product nature

Internal risk factor

- Supply chain structure
- Supply chain processes
- Supply chain management components
- Goal alignment between supply and demand sides
- Benefit-sharing & compensation mechanism
- Length of cooperation between supply chain members

Principal risk factor

- Resource & capacity
- Financial conditions
- Credit history
- Trading background
- Operating conditions
- Capacity to fulfill supply chain obligations

Volume
Value

Duration

Supply chain finance
service provider

5 principles in supply chain finance risk management



- 1** Building a healthy supply chain ecosystem, which
- enables supply chain players and the financial service providers to work together on collaborative planning, forecasting, and process management to mitigate risk, and
 - facilitates the effective launch of supply chain finance solutions

- 2** Establishing a system of checks and balances

The separation of approval and operational processes	The separation of transactional and logistics monitoring processes
The separation of powers in the organizational structure	Business units and corporate HQ set up committees to review different projects

- 3** Careful design of supply chain finance solutions to mitigate risk and uncertainties

Insurance coverage	Guarantee by stakeholders
Mutual agreement on the undertaking of supply chain responsibilities	Holding risk reserves for high-risk businesses as a buffer

- 4** Informatization facilitates up-to-date and accurate information exchange, both internally and externally

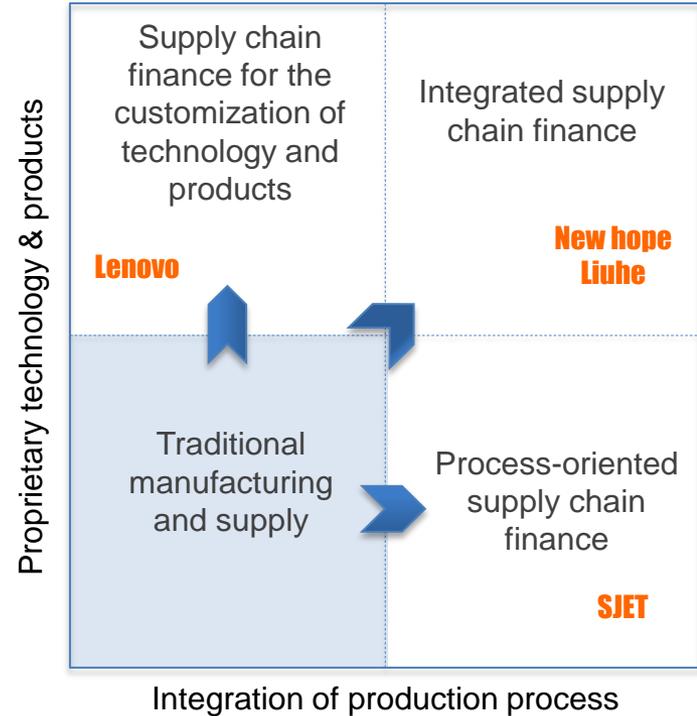
- 5** Transactions must be self-liquidating. The future cash flows generated from supply chain operations provide the source of repayment



FORTHCOMING SERIES

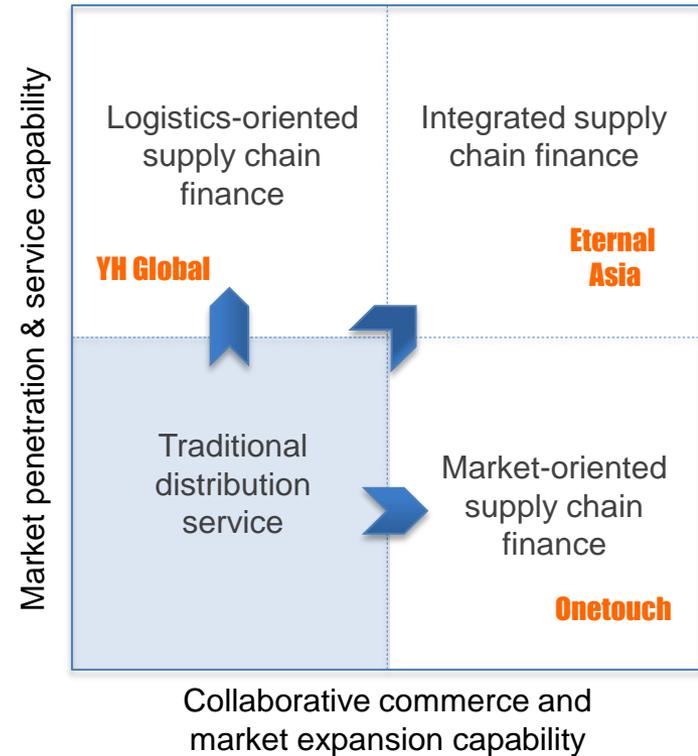
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Supply chain finance innovations in manufacturing industry



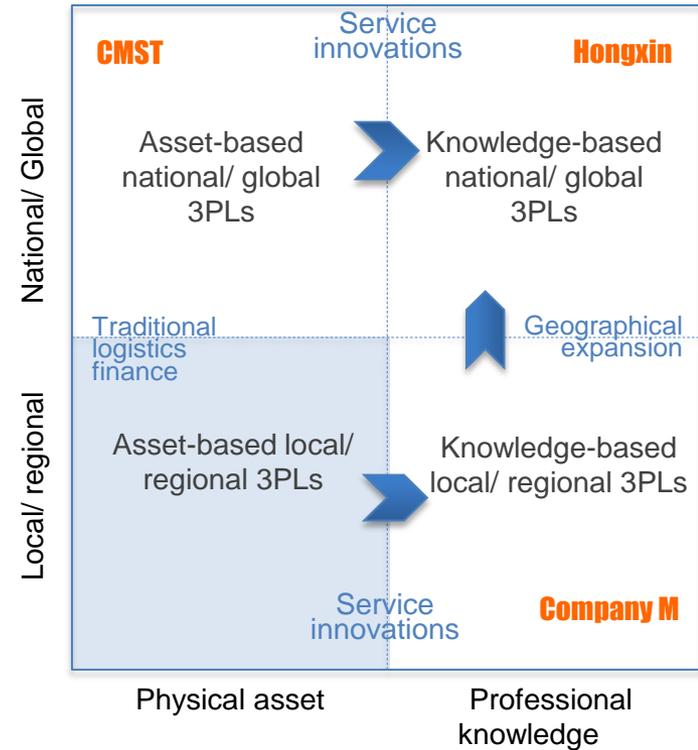
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Supply chain finance innovations in trade and distribution industry



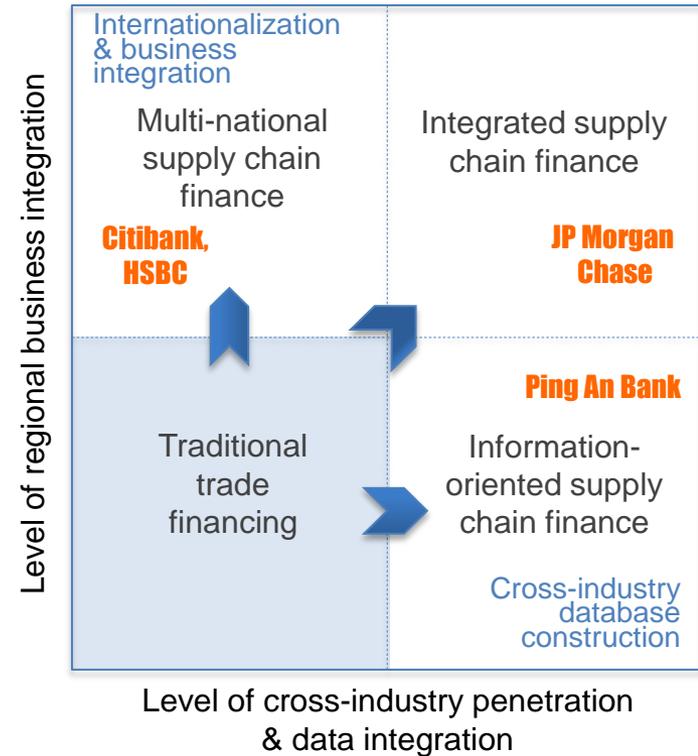
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Supply chain finance innovations in logistics industry



5

Supply chain finance management of commercial banks



6

Supply chain finance innovations in e-business

Supply chain finance innovations in e-procurement Tader Coal	Supply chain finance innovations in e-collaboration Alibaba
	Supply chain finance innovations in e-commerce JD.com

Source

This report is based on the book “Supply Chain Finance”, written by Prof. Song Hua.



Song Hua is a Professor of supply chain management at the School of Business, Renmin University of China. He is also a market research and regulative expert at the Ministry of Commerce, the Assistant Secretary General of the Chinese Society for Management Modernization, and the Chairman of the Beijing Modern Institute of Enterprises Research. His main research interests include service supply chain, inter-firm relationships, and supply chain flexibility.

Prof. Song has published over 60 papers in refereed conferences and journals including Asia-Pacific Journal of Management, Transportation Journal, Decision Sciences, International Journal of Operations and Production Management and Chinese Management Studies.



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