

# The Role of the CFO in a Globalized Economy: Navigator of the Supply Chain Ecosystem



UPS Capital®

**Our Insight.**  
A UPS Capital White Paper

After all, today's supply chains are complex with many different players...

The chief financial officer is best positioned to optimize a company's supply chain as he or she has the authority to oversee – and combine – the physical and financial supply chains. Logistics providers, buyers, suppliers and financial services firms should all work together to provide the global supply chain finance solution that the Chief Financial Officer (CFO) needs to achieve this aim. There is also a need for another entity – a supply chain finance “translator” – whose expertise in both logistics/transportation and financial services will facilitate the supply chain process.

At Walt Disney World's Magic Kingdom theme park in the United States there is an attraction called “It's a Small World.” On this ride the passenger takes a journey around the globe with hundreds of international dolls singing the same song.

During the ride you travel from one nation to another with landscapes and buildings indigenous to that country. The dolls are dressed in attire appropriate to their homeland and each sings in his or her native language the song, “It's a small world after all.” Regardless of the country represented, it is very clear they are all singing the same tune – on key and in harmony.

If only today's global supply chains were like this, and if only global commerce were this easy to conduct. Wouldn't it be great if vessels carrying goods could seamlessly travel from country to country? Or, even better if everyone operated under the same rules and regulations for conducting trade?

Unfortunately, managing and optimizing supply chains in today's global economy are no walk in a theme park. For some companies, supply chain management more closely resembles the “Haunted Mansion” attraction at Disney World.

After all, today's supply chains are complex with many different players – buyers, suppliers, banks, and logistics providers – all located in different parts of the world, governed by different laws and regulations, and striving to achieve different objectives. As a result, no one seems to be singing from the same song sheet. The tune is off-key and not harmonious.

For companies struggling with supply chain management issues, who is the best person to provide the leadership? Which executive is best positioned to serve as the supply chain “conductor” – striving to have everyone singing on key and in harmony? The answer: the CFO.

Our experience has shown that the CFO is best positioned within a company to optimize the supply chain which research has shown can significantly impact shareholder returns. He or she is tasked with optimizing the deployment of capital throughout the entire order-to-collection cycle and across multiple parties. Ultimately, it is the CFO who the analysts and Wall Street turn to when questioning company results.

...the elongated supply chain has created a host of difficulties.

### How Did We Get To Where We Are Today?

Understanding the complexity of today’s supply chains and the role of the CFO in untangling these complexities requires a brief historical look at supply chains. In other words, to understand where supply chains are today, we first need to understand how they were in the past.

Decades ago, the manufacturing, warehousing, and sale of goods usually took place in a company’s home country – say, the U.S. With the goods made, warehoused, and sold locally, the supply chain was shorter. Since the goods were located in the same country as the company, it could borrow money from local banks by using the inventory as collateral (which is advantageous from a cash-flow perspective).

But in today’s global economy with goods made and warehoused all over the world, the elongated supply chain has created a host of difficulties. For instance, multiple modes of transportation and logistical operations may now need to be hired to move the goods from country to country. Additionally, the elongated supply chain makes it more difficult for the company to fund working capital and improve their net cash conversion cycle. For instance, U.S. banks are cautious about lending against foreign-domiciled inventory because visibility into the “ownership” and disposition of the goods becomes blurry, as many countries don’t yet have fully defined laws surrounding collateral perfection and enforcement rights.

With the supply chain lengthening as a result of globalization and offshore production, many companies have experienced a reduction of borrowing base collateral availability. In some cases, the pressure

The merger and associated optimization... is what we call global supply chain finance.

faced by companies to improve their net cash conversion cycle has resulted in increased pressure on overseas suppliers. Specifically, overseas suppliers receive pressure in the form of extended payment terms and/or extended inventory ownership imposed on them by large buyers. The general trend toward using open account instead of letters of credit (LCs) has further contributed to the problem.

Trading partners have historically relied on document-intensive LCs to facilitate global trade transactions. At the start of a relationship, LCs are effective because they minimize risk for all. Unfortunately, they are also time and labor-intensive and tie up critical working capital by reducing availability under asset-based lending's borrowing base formulas.

What has emerged as a result of globalization are two separate supply chains – the physical one for the movement of goods, and the financial one for the payments of those goods. Unfortunately, today's trading partners continue to navigate these two supply chains separately. As a result, overall costs are greater in both of these supply chains.

It's time to connect these interdependent supply chains. It's time for the CFO to lead the effort to help optimize the physical and financial supply chains. The merger and associated optimization of these two supply chains is what we call global supply chain finance.

### **Need for Supply Chain Finance Solutions from the CFO's Perspective**

There is a need for a global supply chain finance solution, and CFOs are uniquely positioned to handle this key strategic imperative. CFOs are in a position of authority that allows them to oversee both the physical and financial operations of their businesses. They understand the capital structures and the costs involved in the processes. Their position allows them to optimize the global supply chain for their companies, suppliers, and valued customers.

The market opportunity for a supply chain finance solution is significant. The total worldwide market for receivables management is \$1.3 trillion. Payables discounting and asset-based lending add an additional \$100 billion and \$340 billion, respectively.<sup>1</sup>

<sup>1</sup> Sources: Financial Consultants, Inc, World Trade Organization, UPS Product Research and Evaluation (June 2005 –and CeltSoft)

Broadly defined, supply chain finance optimizes both the availability and cost of capital within a given buyer-supplier supply chain ecosystem. It does this by aggregating, packaging, and utilizing various information generated during the supply chain process and linking this information with the physical control of goods. The third-party independent linking of information with the physical control of goods enables lenders to mitigate financial risk within the supply chain. The mitigation of risk allows enhanced levels of capital deployment, greater velocity of capital, and a lower cost of capital within the supply chain ecosystem.

The need to increase capital or inject capital into the supply chain more quickly is being caused by several factors:

- Market trends with respect to the global supply chain have caused companies to demand an integrated approach/solution to physical and financial supply chain challenges.
  - Buyers are looking to optimize their balance sheet by delaying inventory ownership.
  - Suppliers are looking to obtain funds earlier in the supply chain at favorable rates, given buyers' desires to delay inventory ownership.
  - Middle-market companies are looking to monetize non-U.S. domiciled inventory to increase liquidity.
  - There is wide interest in integrated supply chain finance solutions.
- Globalization of the U.S. and Western Europe's manufacturing bases has resulted in fewer domestic assets that can be leveraged to generate working capital.
- Most small and medium suppliers to U.S. and European businesses are located in countries that lack well-developed capital markets. Without access to efficient and cost-effective capital, production and inventory carrying costs increase significantly or the suppliers go out of business.
- Letters of credit, a long-standing method of obtaining capital for suppliers in less-developed countries, are on the decline as large buyers are forcing suppliers to move to open account.
- There is a desire to ensure stability of capital as supply chains elongate. Another Asian financial crisis (such as the one in 1997) would severely disrupt U.S. buyers' supply chains by making capital unavailable to their suppliers.

The need to increase capital or inject capital into the supply chain more quickly is being caused by several factors.

## The Role of the Global Supply Chain Finance ‘Translator’

Physical control and information are keys to a global supply chain finance solution. There is a need for logistics providers, buyers, suppliers, and financial services firms to work together to share the information captured by the visibility tools tracking the goods. These risk-mitigation tools provide CFOs and global supply chain managers with the data they need, and lenders with the collateral security required to provide collateral advances.

The starting point for information about goods being transported must be the entity transporting them, i.e., the supply chain services provider, transportation company, and/or logistics partner. These are the entities that have the physical control of the goods moving throughout the supply chain. For instance, UPS Supply Chain Solutions, the supply chain services unit of UPS, already has robust visibility technologies in place that track the disposition of goods in the supply chain. As such, UPS can deliver the visibility information to buyers, suppliers, and partner banks, eliminating the need for these entities to create their own systems. Access to this real-time information is critical from a demand-planning perspective. Knowing where the goods are in transit allows the financial services provider to more confidently extend financing at various milestones along the supply chain.

The starting point for information about goods being transported must be the entity transporting them...

We believe there is a critical role missing in this equation. That is the supply chain finance “translator” – the entity that is experienced in both logistics/transportation and financial services. The translator is the subject matter expert that can bring all entities to the table – transportation and logistics, banks, buyers, and sellers. The translator speaks the various languages and understands the needs of each party. In addition to participating in the financial transaction, the translator can help bridge the information divide between the physical and financial worlds, providing critical analysis about the information being collected from the supply chain.

The following chart explains this translator role:

Activity	Logistics/ Transportation Provider	Translator	Financial Services Provider
<b>Goods</b>	Deliver transportation, logistics, and supply chain services, i.e., move the goods.	N/A	N/A
<b>Information</b>	Collect and provide information about goods status to customer, translator, and financial services provider.	Verify data transfer; aggregate, analyze, interpret, and provide data; authorize financial transactions.	Receive data from translator in order to execute financial transactions.
<b>Funds</b>	N/A	Participate in funding for transaction and assume a proportionate share of the risk.	Participate in funding for transaction and assume a proportionate share of the risk.
<b>Sales &amp; Marketing</b>	Identify prospects, participate in sales calls, and stem commoditization.	Identify prospects, market solutions, participate in sales calls, identify financial risks, and assist in structuring credit solutions.	Identify prospects, participate in sales calls, and assist in structuring credit solutions.
<b>Financial Benefits</b>	Transportation revenue, deeper relationship with customer and with translator.	Interest income; fee income; deeper relationship with customer, financial services providers, and logistics/transportation providers.	Interest income; deeper relationship with customer, translator, and logistics/transportation providers.

Global asset-based lending  
...results in increased  
liquidity

### Global Supply Chain Finance Solution Set

With banks, translators, and logistics providers teaming up to offer global supply chain finance solutions, we envision a product set that could include:

- Global asset-based lending (GABL): enables middle market companies to monetize off-shore or in-transit inventory. This results in increased liquidity to this class of borrower.
- Inventory finance: enables companies that supply goods to large buyers to secure financing on inventory that they are required by buyers to hold. This results in an improvement in the net cash conversion cycle for the buyer while providing the supplier with capital at a reduced rate.

- **Receivables management services:** provide third-party outsourcing of receivables management and collections process. It also provides financing of those supplier receivables and guarantees on the payment of those receivables from the buyer.
- **Payables discounting:** provides third-party outsourcing of the payables process and leverages a buyer's credit quality to obtain favorable financing rates for suppliers. This results in lower cost of capital for the supplier, which will likely reduce the overall cost of inventory. A portion of these carrying costs savings may eventually be passed on to the buyer.
- **Insurance:** further mitigates trade risk through cargo, credit, and transaction dispute insurance.

...companies should be pursuing three key areas of improvement: global supply chain financing, technology, and visibility.

Selling these solutions will require the cooperation of all parties – transportation/logistics providers, the translator, and financial services firms. Due to the strategic importance and complex nature of global supply chain finance, solutions must be sold using a consultative approach to C-level executives – especially CFOs. While financial services firms have relationships with CFOs, they cannot effectively communicate the value proposition inherent in the physical and informational components of the global supply chain. Additionally, lending has historically occurred in silos, based exclusively on the supplier's and buyer's individual credit capacity. By partnering with multinational and regional banks, logistics companies will have better access to C-level executives, while gaining potential new customers and capitalizing on the banks' global presence to sell and promote global supply chain finance. If the global marketplace continues to practice this partnering with all the interested stakeholders in the global supply chain ecosystem, it won't be long before we are all singing the same tune – on key and in global harmony.

### Marketplace Validation

Independent research from the Aberdeen Group confirms the need for global supply chain finance:

In its "Supply Chain Finance Benchmark Report" (September 2006), the Aberdeen Group found a disconnect in supply chain finance practices. While buyers are extending payment terms to their suppliers, the suppliers often have limited access to short-term financing and, therefore, are subject to a higher cost of borrowing money. This cost-shifting to suppliers results in a financially unstable and higher-risk supply base. Overall, the benchmark report showed that companies should be pursuing three key areas of improvement: global supply chain financing, technology, and visibility.

Expanding on its benchmark report findings, the Aberdeen Group in its study, “New Strategies for Financial Supply Chain Optimization,”<sup>2</sup> found that best-in-class companies are more likely than their peers to have a cross-functional team of purchasing, supply chain, and finance professionals managing their global supply chain finance programs. Best-in-class companies also are achieving better performance, such as a 10-day advantage in their cash conversion cycles. In other words, these companies are unlocking the trapped value in the financial supply chain by implementing new global supply chain finance techniques and taking advantage of the knowledge of third-party global supply chain finance experts.

<sup>2</sup> “New Strategies for Financial Supply Chain Optimization: Rethinking Financial Practices with Your Suppliers to Maximize Bottom Line Performance,” Viktoriya Sadlovska and Beth Enslow, The Aberdeen Group, November, 2006.

Best-in-class companies...are unlocking the trapped value in the financial supply chain...

---

## About UPS Capital

UPS Capital addresses the financial needs of the supply chain. Our services combined with the broad capabilities of UPS help enhance operations as well as improve bottom-line results. From protecting companies against the various risks associated with trade to assisting businesses with expansion into new markets, UPS Capital has a wide variety of financial solutions available for today’s growing enterprise.

UPS Capital  
35 Glenlake Parkway  
Atlanta, GA. 30328  
1-800-637-0620

[www.upscapital.com](http://www.upscapital.com)

© Copyright 2007 United Parcel Service of America, Inc. UPS, UPS Capital, the UPS brandmark, and the color brown are registered trademarks of United Parcel Service of America, Inc. All rights reserved.