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Supply Chain Finance Programs: A COVID-19 Working Capital Solution

The economic impact of COVID-19 is placing tremendous strains on supply chains, with corporates of all sizes struggling to maintain production and manage liquidity and working capital. Supply chain finance programs can play an important role in supporting and preserving supply chains and managing risk.

This is a summary only; please contact a Seyfarth attorney for any legal advice or guidance needed.

Supply Chain Finance Programs Overview

The way that trade transactions are documented and settled has undergone a period of rapid innovation and change over the past 10 to 20 years. The automation of purchase orders, accounts payable, and accounts receivable processes has not only generated considerable corporate efficiencies, but has also given companies access to a tremendous amount of supply chain data that has led to an increased focus on managing the working capital costs associated with supply chains.

With this increased focused on working capital, Supply Chain Finance (SCF) programs have become an increasingly important funding tool for CFOs and treasurers with hundreds of billions of dollars of trade financed through these programs at any given time.

Supply Chain Finance Programs 101

In their simplest form, SCF programs are used by buyers to extend payment terms and provide working capital assistance to suppliers, while suppliers are able to convert receivables to cash on an accelerated basis and manage buyer credit risk. The programs are operated by banks and non-bank intermediaries and automate most of the payment processes associated with trade transactions. Invoices are uploaded onto the SCF program by the supplier, the invoice details are communicated to the buyer and the buyer approves payment which is communicated back to the supplier. The supplier can then elect to either wait until the invoice due date to receive payment from the buyer or submit the invoice to the bank/non-bank intermediary through the program for discount and immediate payment. Credit risk on the discounted invoice is assumed by the bank/non-bank intermediary, and the buyer pays the bank/non-bank intermediary direct on the invoice due date.

SCF programs are widely used across almost all sectors of the economy, including in the consumer packaged goods, telecommunications, chemicals, retail and aerospace sectors. Prior to the COVID-19 pandemic, losses on trade finance portfolios have been very low, even during the 2008-2009 global financial crisis.

How will COVID-19 Affect Global Trade?

The World Trade Organization forecasts that global trade flows are set to fall dramatically as COVID-19 disrupts the global economy. World merchandise trade is set to plummet by between 13% and 32% in 2020, and while a recovery in trade is expected in 2021, nearly all regions will suffer double-digit declines in trade volumes this year. Supply chains that rely on multiple jurisdictions and multiple providers may be the most adversely affected.

How Will the Current Regulatory and Accounting Policy Climate Affect SCF Programs?

Rating agencies have recently brought into question how corporates account for SCF programs, suggesting that the proper treatment is bank debt versus trade debt. The Securities and Exchange Commission has also highlighted the risks associated with the use of these programs in its 2019 Investor Advocate Report. In October 2019 the big 4 accounting firms jointly authored a letter to the Financial Accounting Standards Board questioning how SCF programs should be represented on balance sheets and cash flow statements. There is currently no specific US GAAP guidance on the classification of SCF programs and continued scrutiny on this issue is expected.

How SCF Programs Can Help With the Economic Recovery After COVID-19

As buyers and suppliers focus on preserving supply chains and maintaining liquidity, SCF programs are an exceptionally important tool. The efficiency and size of SCF programs suggests that they could be used to kick-start the US economy, delivering financial assistance in a fast and direct manner to suppliers to meet purchase orders and manage risk and to buyers to manage working capital and support their supply chains.

Material is Summarized From a Presentation By:

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