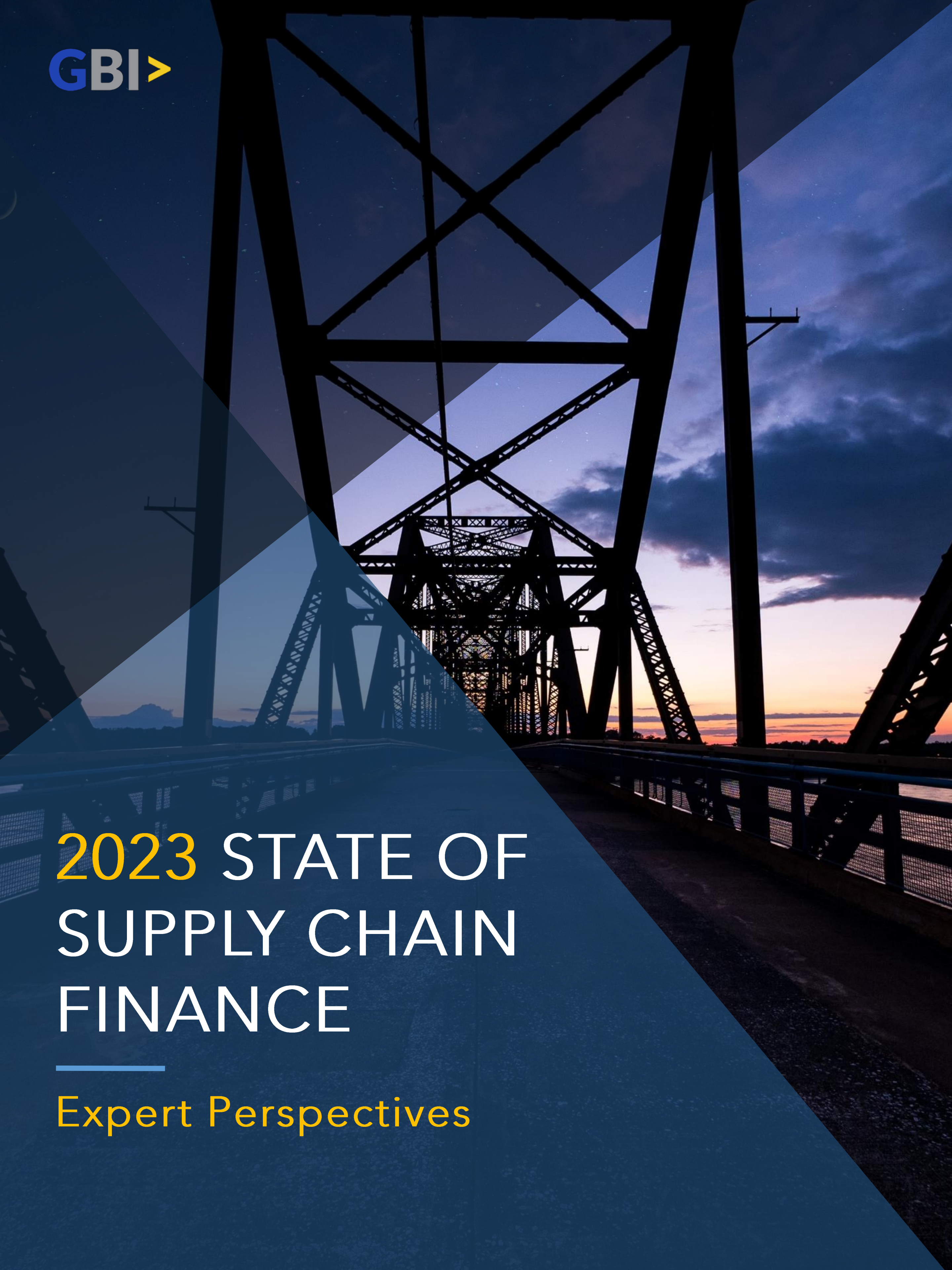

2023 STATE OF SUPPLY CHAIN FINANCE

Expert Perspectives

David Gustin
President
Global Business Intelligence and CoFounder Trade Financing Matters

David Gustin is the founder of Global Business Intelligence and has deep expertise in working with Corporates and Banks around Supply Chain Finance, International Treasury and Trade finance issues. For 26 years, he has been running Global Business Intelligence, which provides insights to companies, vendors, and financial companies around global trade, financial supply chain and alternative business finance matters.

2023 is shaping up to be a transformational year for supply chain finance. Central Banks all around the world have raised rates numerous times. Accounting bodies, for the first time, are requiring disclosures on financial statements of reverse factoring or approved payable finance programs (commonly referred to as supply chain finance). Technology, led by cloud ecosystems, APIs, and machine learning have enabled developments around real-time B2B financing these days using transactional data (commonly referred to as "embedded finance).

In this management introduction, we briefly look at three topics that could have a major impact throughout 2023 and beyond.

Transformational trend: New Accounting Disclosure rules for Supply Chain Finance

The Big 4 accounting firms asked for clarity on supply chain finance ("SCF") programs given the recent bankruptcies and frauds from companies like Carillion, Greensill Capital, and others. On July 20, 2022, the Financial Accounting Standards Board (FASB) confirmed its intent to require all companies to disclose certain information in their financial statements regarding their use of trade finance transactions, often referred to as supply chain finance (SCF). The new disclosure requirements came into effect from January 2023. IASB's effective date is January 1, 2024.

All filers that utilize such trade finance transactions and that owe money under these arrangements—classified as debtors in accounting terms, but generally referred to as the buyers or obligors in trade finance terms—will be required to disclose the following:

- If they operate a program
- Key terms of each supplier finance program—including a general description of the payment terms (including payment timing and the basis for its determination) and the assets pledged as security, or other forms of guarantees provided for the committed payment—to the finance provider or intermediary.
- When the amount of an obligation is first disclosed, the balance sheet presentation of that program's obligations, i.e., whether the program is classified as debt or payables by the filer.

> *Any implications of the disclosures will be predicated on their interpretation by an expanded and broader universe of market parties, that now will include equity analysts, auditors, ratings agencies, brokerage research, the SEC and investors, in addition to the filer's management.*

For the first time, equity analysts that research and analyze companies will have at their disposal an ability to show the impact on cash flows by:

- Refining cash flow analysis
- Comparability analyses within industries and among industry groups
- Insight into supplier financing terms for:

    > Individual companies
    > Relative to other similar companies
    > Identification of companies not utilizing

In addition, equity analysts can assess the liquidity impact, if any on a company's credit revolver, as SCF programs are uncommitted lines of credit, such that banks can withdraw this form of credit at any time (unlike revolving lines of credit and term loans).

Any implications of the disclosures will be predicated on their interpretation by an expanded and broader universe of market parties, that now will include equity analysts, auditors, ratings agencies, brokerage research, the SEC and investors, in addition to the filer's management. As such, areas of examination may also include whether:

- There is any security interest granted to financial intermediary banks and/or whether those banks serve as depositories and/or provide credit facilities.

- Any fees paid to the debtor from the supplier finance providers, including whether fees are paid in cash or earned as a credit under compensating balance.

- If the debtor has any role in establishing the pricing for the bank/finance agent with the suppliers, in the syndication of the bank credit facility

Supply chain finance is one of several techniques utilized to generate cash by debtors. There is a potential impact on companies' liquidity if these programs were to get unwound. We all know that the majority of bank supply chain finance programs target the largest suppliers for investment grade or near investment grade companies. Why? Lots of reasons, such as cost of compliance, lack of scale, suppliers are not customers of the bank, and the tail is too small to matter to name a few.

Supply chain finance is one of several techniques utilized to generate cash by debtors. There is a potential impact on companies' liquidity if these programs were to get unwound.

But big suppliers that have come to rely on these programs from their big customers could be at risk. This is a legitimate question and is certainly on the minds of analysts I speak with. Bank-led supply chain finance works with a carrot and stick approach – the large buyer resets terms and agrees to provide an incentive to the supplier to access cash earlier off the back of its credit rating.

The new disclosure rules are a start to provide granular disclosure to determine and interpret what's really going on. There are lots of variations to how programs are run and how brokers set them up.

Transformational trend: Embedded Finance applications and promises

There are many business-to-business areas where embedded payments and finance are being intertwined to business processes. Here are a few examples:

1. B2B Marketplaces and eCommerce sites have added payment term functionality to the check-out experience, creating buyer terms for purchasing equipment, supplies, etc.

2. Funders are becoming fully integrated with ERP systems such as NetSuite or SAP, enabling digital receivable finance solutions to propagate the market.

3. Source-to-pay and AP automation platforms offer suppliers a dynamic way to get paid early, and are looking at ways to go beyond receivables on their platform to include off-platform receivables (ie, a supplier to Coke may only have 5% of their receivables on Coke's AP platform)

4. B2B SaaS subscription companies are offering finance at POS and POS payment processors are offering merchant cash advances.

These are just a few examples. All the above situations require data to make some real-time or near real-time credit risk decision.

There is also a growing interest in the B2B SaaS subscription space. This will certainly be a continued area of investment and effort in 2023.

According to Bain Capital, in 2021, embedded finance for the consumer market accounts for $2.6 trillion, or nearly 5% of total US financial transactions. B2B embedded finance offers far more challenges to overcome than consumer, including:

1. **Legal construct** (ie, are receivables purchased, lent against, are you doing a merchant cash advance, structured vehicles , etc.)
2. **Credit underwriting expertise**
3. **Payment capabilities** to manage notice of assignment and reconcilement of buyer payments and the cash dominion process (note: don't belittle this one, it's big)
4. **Servicing** – KYC, onboarding, supplier questions, etc.
5. **Technology** –cloud ecosystems, APIs, etc. to manage the real-time information needs of underwriting models.

Putting all the above together to create a scalable solution that is sustainable is a monumental challenge for embedded finance. There are some B2B verticals currently having success, particularly payment processors that control the POS and can offer merchant cash advances. There is also a growing interest in the B2B SaaS subscription space. This will certainly be a continued area of investment and effort in 2023.

Transformational trend: Capital constraints of banks and its impact on the supply chain finance

SCF programs are uncommitted lines of credit, and banks can give notice to clients that they will withdraw this form of credit versus revolving lines of credit and term loans, which are typically committed.

There has been limited disclosures to date to understand how these programs affect companies' operating cash flow. When supplier finance programs are used to extend the due dates of working capital obligations, the outflow to settle the invoice is deferred and operating cash flow improves. If the market believes this improvement in operating cash flow is more akin to financing, then a better understanding is required to understand a company's access to liquidity timing needs through banks.

Tightening credit markets could induce banks to minimize exposures by reducing credit to these programs, or, make companies pay for these programs and add them to their revolver. This can impact a company's revolver availability after adjusting for SCF outstanding. For example, when equity analysts review revolvers and see that a Single A- company has $5bn in payables of which $2bn are covered under SCF program – or 40% of its payables, it will look at how this can potentially impact the access to the revolver given some unforeseen event. In addition, if companies experience credit downgrades, buyer and suppliers would be forced to revisit their payment arrangements.

All of this could mean that brokers and non banks play an even more important role as a broker/platform going forward.

ABOUT GBI

Global Business Intelligence, founded in 1997, conducts consortium and proprietary research and advisory services around financial supply chain, working capital, trade finance and global trade. We work with senior executives at importers, exporters, banks, credit insurers, global transportation and logistic companies, and software vendors interested in global financial supply chain and B2B issues.

We asked several thought leaders in the industry to provide their perspectives on supply chain finance in 2023. We want to thank them for taking the time to share their insights.

Trade Finance Digitization: The Path to Better Business

LiquidX

LiquidX

Trade Finance Digitization: The Path to Better Business

Dominic Capolongo
Chief Revenue Officer
LiquidX

Dominic Capolongo, Chief Revenue Officer of LiquidX, brings over 25 years of industry experience managing and directing financial service teams, along with expertise in building sustainable revenue production.

The trade finance industry has experienced significant digital innovation in the last 15 years, yet old manual, paper processes still prevail. Profits are suffering unnecessarily due to disorganized management, greater risk, and underutilized staff pushing paper around.

Continuing to invest in these complex manual processes is now a choice – not a requirement. Instead of relying on an employee to key in data, there are machine learning and automation solutions available to manage trades. These solutions allow for better back-office management by digitizing cumbersome documents.

Already, companies are investing in digitization or automations to improve efficiency. Statista reports that the global investment in digital transformation is expected to grow from 1.8 trillion USD to 2.8 trillion USD between 2022 and 2025. Further, Gartner found that 91 percent of businesses are engaged in a digital growth strategy, and 87 percent of senior business leaders are prioritizing digitization.

However, these new technologies can backfire easily despite the best intentions to solve inefficiencies. Major issues, like risk and high costs, can actually rise when digitization and automation tactics are spread across multiple, disconnected vendors. This is also the case when "digitization" is simply applied to ERP data that was manually entered in the first place, and not truly a digital asset to begin with.

Mitigating financial and technical challenges continues to remain in the spotlight. As we see it, disruption creates opportunity. Innovation is the catalyst for growth and sustainable returns. In order to achieve this, one partner who can truly digitize and scale your trade finance front -, middle- and back-office operations is required.

Today's True Digitization Opportunity: Effective Solutions Built to Last

Traditionally, trade involves manual processes driven by spreadsheets, endless emails between multiple counterparties, and heavy paper trails that slow down the entire business process. These inefficiencies lead to restrictions and operational workforce management issues that increase costs and institutionalize human error into operational processes.

LIQUIDX®

> *The next step towards achieving a frictionless global trade ecosystem is the digitization of all documents across the entire trade journey.*

Our industry is built on technology solutions to solve financial issues, so we must harness digitization's power to revolutionize efficiency and maximize business resilience. In the face of disruption, this is imperative.

The next step towards achieving a frictionless global trade ecosystem is the digitization of all documents across the entire trade journey.

Trade and trade finance today are document-intensive processes. Effective management of all this paper, emails, and PDFs is the key to success – while the inability to efficiently process them is the path to failure.

The Impact of True Digitization on Business

True digital transformation requires taking a holistic approach that considers the entire ecosystem instead of siloed pieces. One of the greatest lifts in efficiency comes when advanced tools automate large portions of middle and back-office workflow. According to PTC, executives say one of the top benefits of digital transformation is improved operational efficiency by 40 percent.

This creates significant savings for trade finance investors, banks, asset managers, while improving access to real-time information to make smarter investment, risk, and compliance decisions. Ultimately, a singular solution creates seamless communication between banks and suppliers that reduces costs.

Digitization provides a turnkey middle and back-office operations solution that allows for business to be done faster, smarter and more efficiently through optimization – with better investment returns. Engineered using the most advanced AI and analytics technologies, digitization connects the entire ecosystem to put actionable, accurate data at one's fingertips.

Digitization Is Already Turning the Tide

A recent study by Broadridge Financial Solutions found that over 60 percent of CEOs and COOs agree that digital transformation is the most important strategic initiative at their company.

These leaders are increasing digital investments and deploying the tech necessary to drive revenue, maintain compliance, increase customer acquisition, and boost resilience.

Foundry also asserts that 89 percent of companies have already or plan to adopt a digital-first business strategy. Minimizing manual processes maximizes efficiency and business outcomes. Digitization opens the pathway to building a flexible trade business, especially in today's volatile supply chain environment. Human error and time consumption are eliminated once all of your assets are digital, maximizing your back office productivity and trade management capabilities.

True digitization, in its most evolved state, supports the entire supply chain – not just one sector – addressing all needs and pain points holistically, to help transform business and drive growth.

ABOUT LIQUIDX

LiquidX is a leading global trade finance technology company that enables finance professionals and institutions to transact faster, smarter, and cheaper by digitizing trade finance and working capital management. The company's flagship solutions incorporate AI and machine learning analytics to greatly enhance transparency, reporting, and forecasting. LiquidX brings a broad spectrum of clients access to the turnkey front-to-back trade finance solution that streamlines transactions between suppliers, buyers, banks, and insurance providers.