FOR THE WIN: ACCOUNTS RECEIVABLE FINANCING VS. SUPPLY CHAIN FINANCING

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"THE DELL THEORY OF CONFLICT PREVENTION ARGUES THAT NO TWO COUNTRIES THAT ARE BOTH PARTS OF THE SAME GLOBAL SUPPLY CHAIN WILL EVER FIGHT A WAR AS LONG AS THEY ARE EACH PART OF THAT SUPPLY CHAIN"- THOMAS FRIEDMAN

With the boom of industries all around the world; the rise in trading has also gone up and with this arrived many factors like buyers, sellers, FINANCIERS, etc. In this article let us take a walk through two topics; Accounts Receivable Financing and Supply Chain Financing and how they have taken the financing industry by a storm.

What is Accounts Receivable Financing?

Accounts receivable financing, also called factoring, is a method of selling receivables to obtain cash/loan for company operations. In simpler terms, it is using amount owed by a customer as collateral in raising a short-term loan which can be a one time or continuous affair. In case there is a default, the lender has the right to collect receivables directly from the firm's debtor.

How does Accounts receivable financing work?

Let us understand this with an example; suppose Company ABC is a dealer of toys and has around a million dollars in receivable from a client (XYZ) who hasn't paid yet.

Now Company ABC is short of funds and requires immediate funding to keep their daily operations running smoothly. Here is where an Accounts Receivable Financing firm, or also called as a "factor" comes into the picture. The Factor provides company ABC with the money they require against the receivable from the Company's client (XYZ).

A factoring company is not a collection company, but rather a valued business partner and hence requires a few steps to be followed before financing a company:

- Due diligence and account setup
- Getting your receivables ready
- Accounts receivable verification
- Financing the batch of receivables
- Payments and settlement

What is Supply Chain Financing?

Supply chain finance, also known as "supplier finance" or "reverse factoring" helps suppliers sell their invoices or receivables at a discount to banks or other financial service providers, often called factors. As a trade, the suppliers get faster access to the money they are owed, enabling them to use it for working funds, while buyers generally get more time to pay.

Two types of Supply Chain Financing that are widely used by companies worldwide are:

1) Supplier financing

Supplier financing is a form of supply chain financing that allows manufacturers and distributors to buy raw materials or goods to build inventory or fulfill orders. It works by partnering with a supply chain finance company that extends trade credit, and it acts as an intermediary between the company and suppliers.

2) Reverse factoring

This is the most commonly used method of supply chain financing. Here is an example of how to reverse factoring works, a large company (e.g., Company ABC) enters a reverse factoring agreement with a supply chain finance company. The supply chain finance company then intermediates the accounts receivable process for this company which helps enable the supplier to get early payments for inventories due to their customer.

Accounts Receivable Financing Vs. Supply Chain Financing in the current market scenario:

Perhaps the biggest difference between accounts receivable factoring and supply chain finance are a few as below:

1) Who uses the service

The decision rests solely with the supplier. Here the buyer has no say in whether or not an invoice is factored. With supply chain finance it is the buyer's choice to offer quicker payment on an invoice, and it is up to the supplier to accept that offer. Here, a supplier cannot rely on supply chain finance to fund their business since it may or may not be granted to them.

2) Buyers and funding

Factoring companies will work with all buyers, regardless of how large or small they are. Supply chain finance is typically only offered by principal retailers as they can afford enough volume to make supply chain financing affordable.

3) Fee

Here the fee is part of the agreement that a company has with a factoring company and it does not vary. With supply chain finance, the fee is not fixed, the company need to make an offer to the buyer and the buyer needs to accept it.

4) Timing

Many buyers who offer supply chain finance may have to wait for a few days to do so as they need to review the products and ensure nothing is damaged before they can authorize it for payment. Factoring companies offer to fund the same day that the product is shipped and invoice the customer.

CONCLUSION:

While supply chain finance can potentially be cheaper than factoring with stronger retailers, it can also be more expensive and does not offer all of the benefits that you receive with factoring. One must make the right choice keeping in mind the risk factors involved while dealing with both factoring and supply chain financing. Write to us for more information on these services and a detailed analysis of the risks involved.