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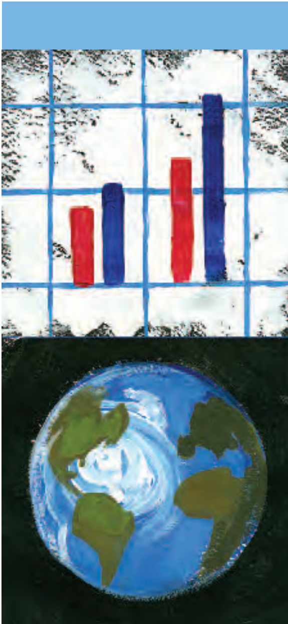


Supply-chain finance: The emergence of a new competitive landscape

Supply-chain finance (SCF) receives surprisingly little senior management attention for a market that presents such large and growing opportunities. Traditionally dominated by banks, the market has more recently been entered by fintechs: specialist financial technology companies that provide platforms and software-based services to support SCF operations. These challengers are changing how buyers and suppliers think about the market, disrupting incumbent financial systems and providers, and starting to command a sizeable proportion of value pools. Success in this new environment will depend on understanding what banks and fintechs are offering, working out what customers value, and quickly planning—and acting on—an appropriate response.

Ganaka Herath

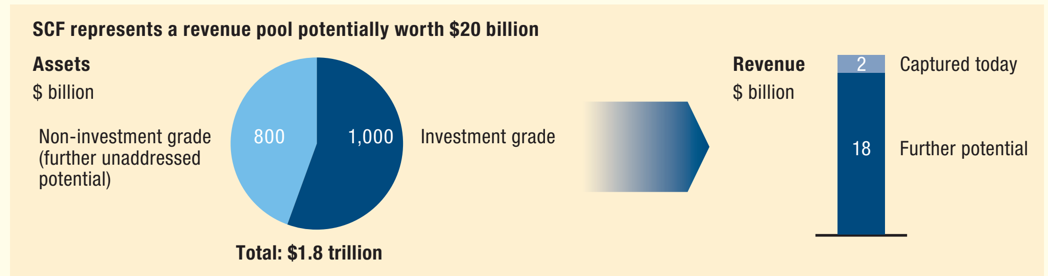
Strong growth, untapped opportunities

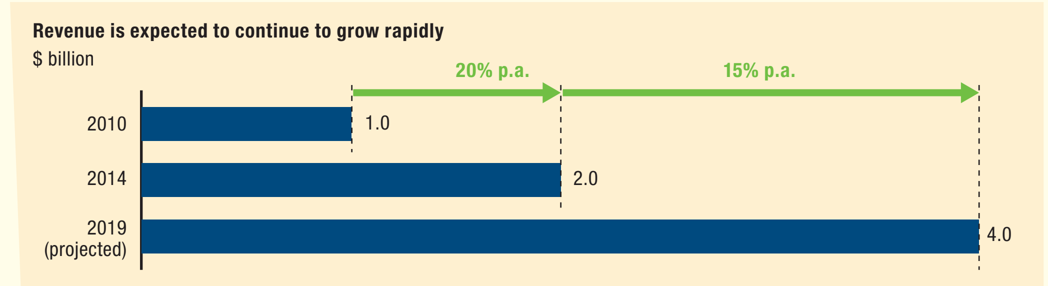
SCF is a big business, with $2 trillion in financeable highly secure payables globally and a potential revenue pool of $20 billion (Exhibit 1). Revenue has grown at 20 percent per year since 2010 and is expected to continue growing at around 15 percent for the next three to five years. Revenue pools are largest in Europe and the United States, but buyer programs are growing rapidly in Asia and Latin America. (See sidebar, "The evolution of supply-chain finance," page 12.)

Most programs are in the automotive, manufacturing and retail sectors. However, McKinsey interviews with buyers, suppliers and industry experts suggest there are significant opportunities to be captured in technology and capital goods (Exhibit 2). Revenues generated from current programs are focused on the investment-grade (IG) space, but McKinsey research suggests that

Exhibit 1

The revenue potential from supply-chain finance is huge and largely untapped

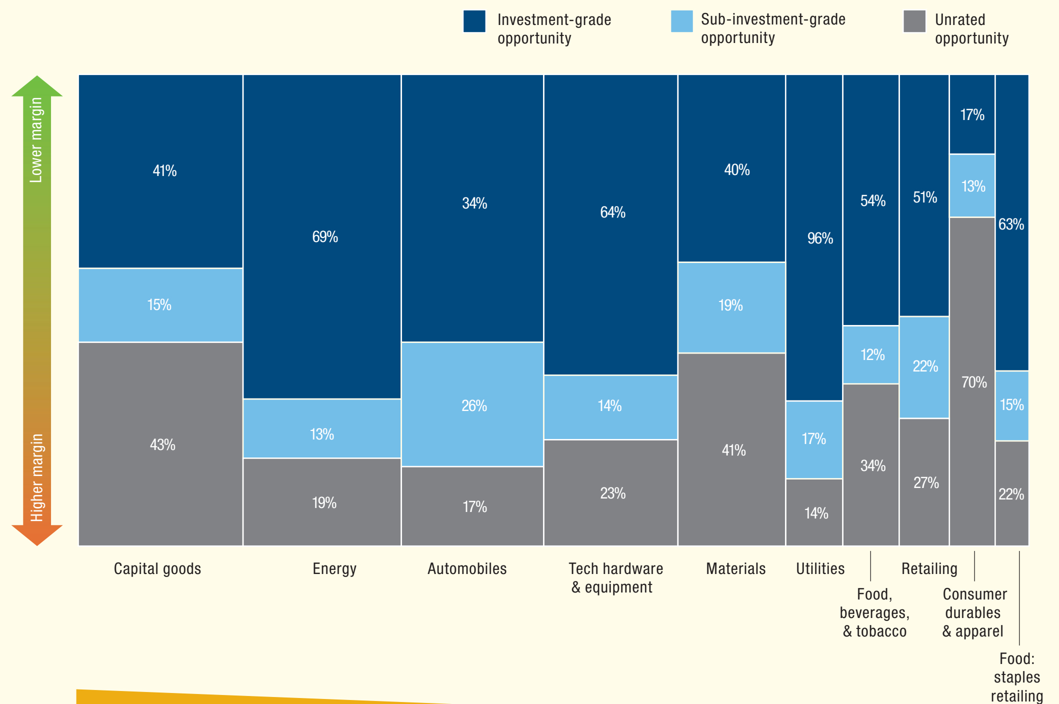




Source: Capital IQ; McKinsey analysis and expert interviews

Exhibit 2

Some industries offer considerable scope for supply-chain finance



Source: Capital IQ; McKinsey analysis

The evolution of supply-chain finance

Although the SCF market has been around since the early 1990s, it did not really take off until after the economic crisis. A number of economic, technological and regulatory forces have spurred its growth.

The globalization of the economy has lengthened supply chains, increasing the number of suppliers and boosting the number of transactions. In addition, the development of direct sourcing has made supply chains more complex and created a need for integrated solutions.

The scarcity and cost of capital in the wake of the credit crunch created an incentive to explore SCF programs as the spread between investment-grade and noninvestment-grade rates widened. One of the main advantages of SCF programs is that they enable noninvestment-grade suppliers to benefit from investment-grade financing rates.

Regulatory changes have meant that SCF has been favored over traditional trade. The Basel II Capital Accord heralded harsher treatment for trade finance overall, with a minimum duration of one year for loans and a focus on counterparty risk rather than performance risk. By reducing overall counterparty risk, SCF represents a lighter-capital strategy than other traditional instruments.

The maturing of technology, coupled with network effects, has also contributed to the take-up of SCF (Exhibit A). The automation of the full procure-to-pay (or account-payables) and order-to-cash (or account-receivables) cycles has enabled event-trigger financing services. For instance, a preshipment financing discussion can be triggered by an order confirmation. The availability of procure-to-pay automation on independent third-party platforms allows buyers and suppliers to insert financial services and allows easy access to multiple liquidity providers, including small banks.

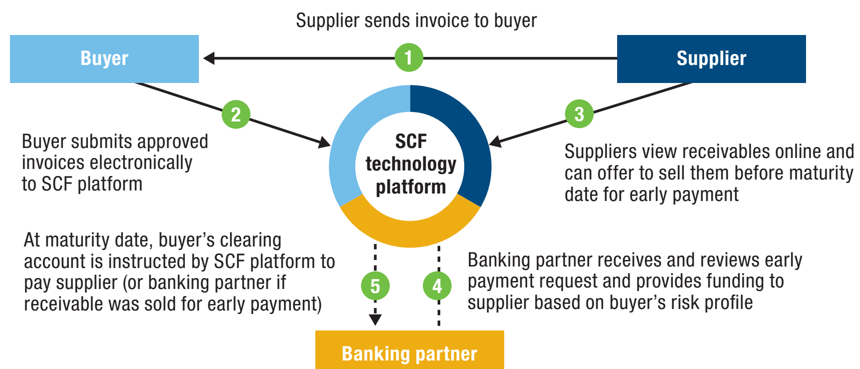
Global universal banks have traditionally dominated SCF's competitive landscape, holding more than 95 percent of programs as recently as 2005, with the remainder split between platform providers such as Orbian and PrimeRevenue. But over the past few years, a multitude of fintechs have entered the market or revamped their value proposition, offering innovative business models (C2FO, Taulia); improved digital interfaces and tools (PrimeSCI); simplified implementation and onboarding (Orbian); and rapid innovation in response to buyer and supplier feedback.

By addressing the operational and technology challenges that prevented banks from growing the business, these fintechs are attracting a lot of interest from private-equity and venture-capital investors. As one fintech executive put it, "There are lots of opportunities for nonbank players to innovate and provide solutions that are needed in the market, but that banks are not willing to provide. A noninvestment-grade offering is just one of them."

Exhibit A

The emergence of technologies to connect counterparties has enabled the growth of SCF

Example: open technology platform



Source: Prime Revenue; McKinsey analysis

the noninvestment-grade (NIG) market is set for rapid growth.

Traditional strengths, new demands

Success in SCF has traditionally depended on four factors:

- an easy-to-use and resilient platform that can be integrated into buyers' enterprise resource planning systems and sellers' accounts receivables systems
- geographic reach that provides decent coverage to programs, most of which are regional
- adequate credit capacity or distribution capability to support program growth
- the operational capability to ramp up programs and ensure they are profitable

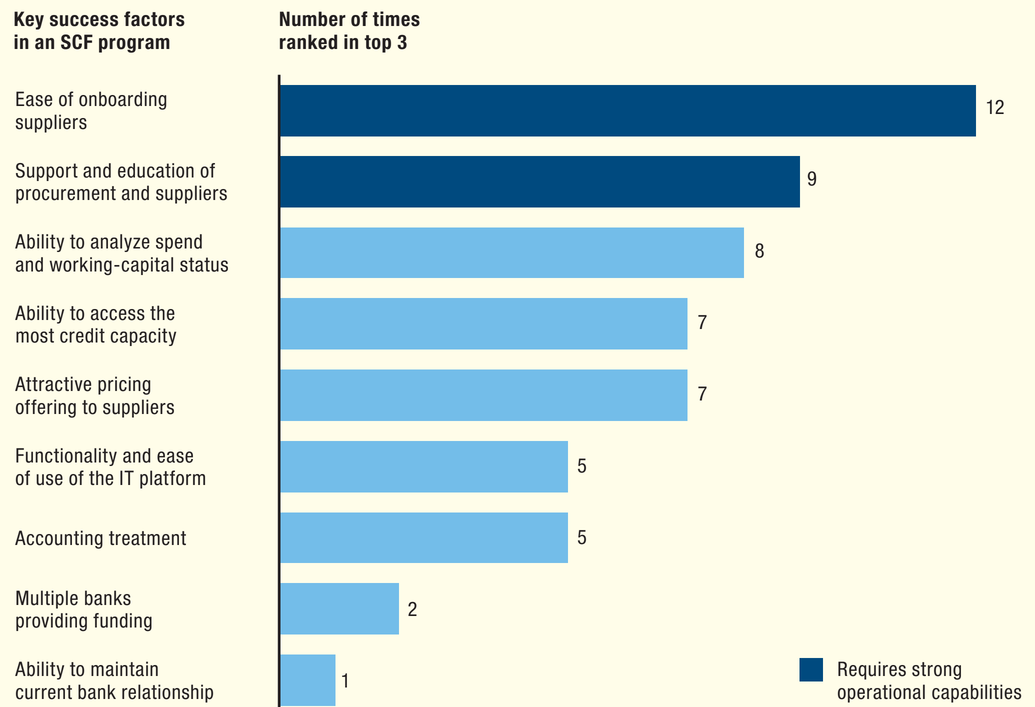
Banks have traditionally focused on the first three of these factors. For buyers and suppliers, though, these are really table stakes. What they look for most is operational capability to minimize complexity, get programs going quickly and rapidly onboard suppliers (Exhibit 3).

In fact, research shows that anchor buyers (those who set up an SCF program) consistently rank supplier onboarding as the single most important factor in a successful program. Similarly, 80 percent of suppliers rate onboarding support through documentation, training and tools as key to determining their participation in a program.

As a result of this mismatch in perspectives between banks and their customers, many banks have SCF businesses with live buyer

Exhibit 3

Onboarding is key to a successful SCF program



Source: McKinsey survey

programs that are underutilized. One buyer commented, "It has been over two years, and only a fraction of the intended usage of the program has been achieved. The challenges vary from complex documentation to suppliers just not using it." Cases like this partly explain why only about a tenth of the market potential—$2 billion of the potential $20 billion in SCF revenues—is captured globally. This is a cause of concern for banks that want to maintain a thriving SCF business, because where they have gaps, other competitors have strengths.

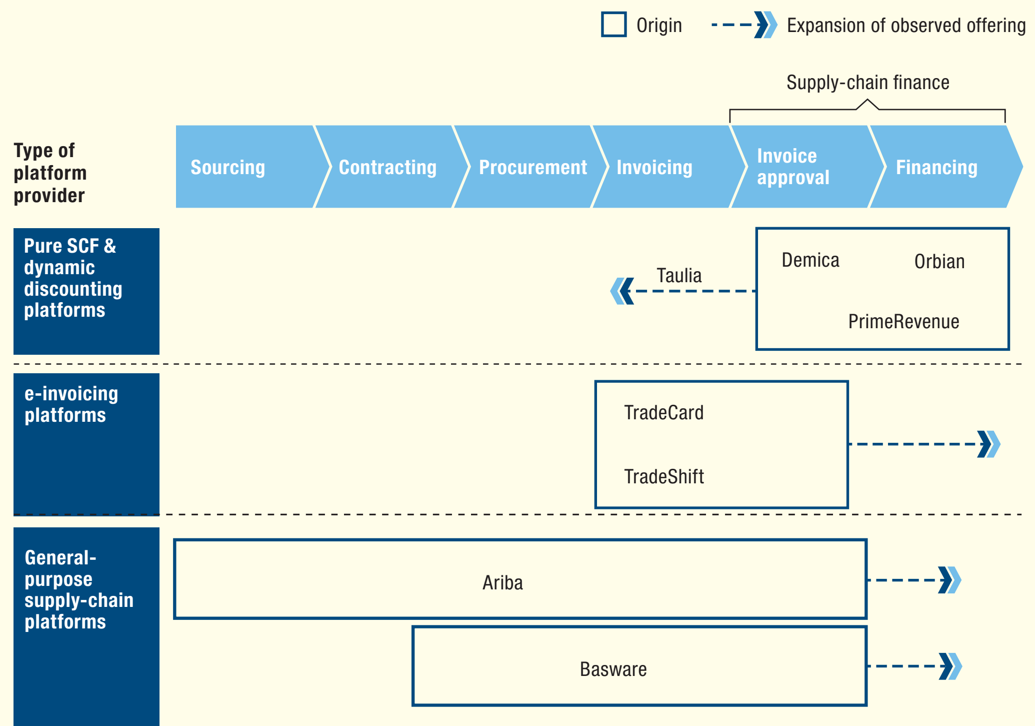
For their part, fintechs tend to focus on developing their operational capability and using technology to strengthen it, for example, by introducing online tools and training to help get suppliers on board. Beyond operations, they are also changing the way buyers and suppliers think about SCF by introducing new approaches such as programs for small suppliers and auction-based solutions.

Challengers versus incumbents

Thanks to their success at meeting new and emerging customer needs, an estimated 10 to 15 percent of the SCF market is now with fintechs—and their growth is likely to accelerate. One buyer noted, "They are focusing on improving operational capability through online tools to help suppliers onboard, and they provide digital modules for training on how to use systems." Fintechs are also looking beyond the pure SCF product and seeking to provide solutions for needs across the procure-to-pay cycle (Exhibit 4).

Exhibit 4

Fintechs offer solutions across the procure-to-pay cycle



Source: McKinsey analysis

> **About the research**
>
> To understand the needs of buyers and suppliers in supply-chain finance, McKinsey conducted research into market participants in 21 countries, interviewing 70 treasurers and CFOs of multinational corporations, conducting a survey among more than 250 suppliers, and speaking to a number of fintechs active in SCF. In addition, 10 external experts shared their perspectives on the state of the market and its likely evolution over the next few years.

It's not all doom and gloom for banks, though: they still own corporate banking relationships. However, they need to act fast to address the fintech challenge and meet the needs of the buyers and suppliers who participate in SCF programs.

Fintechs are changing what buyers and suppliers look for in their SCF provider and addressing customer needs that the traditional banking approach fails to meet. The changing landscape and the prospect of rapid growth should act as a call to arms for banks and fintechs alike.

How should competitors respond?

As more large buyers start SCF programs and fintechs offer up innovative new approaches, banks run the risk of losing customers to competing banks that offer SCF solutions and then use their relationship with a company to secure its transaction banking business as well. Meanwhile, fintechs are changing what buyers and suppliers look for in their SCF provider and addressing customer needs that the traditional banking approach fails to meet. The changing landscape and the prospect of rapid growth should act as a call to arms for banks and fintechs alike.

Banks with an existing SCF franchise should take a three-step approach: First, review the current portfolio and identify opportunities to improve performance by perfecting operational capabilities within existing programs; look for new opportunities in specific industries, and analyze existing programs to see how they can be extended into new countries or business lines. Second, identify gaps in the technology offering and either develop innovative solutions or partner with fintechs to do so. Third, look for opportunities to move into the NIG space, starting with BB-rated credits that have only a marginal difference in impairments compared to BBB.

Banks with no SCF business but a strong franchise with large corporations and MNCs should start by developing a perspective on the overall market opportunity and conducting a portfolio analysis to tap the revenue potential in their current portfolio. To deliver an SCF offering, they first need to assess their capabilities in terms of platform, credit, geographic coverage and operations (including technical sales). Having identified any shortfalls, they should work out how much they would need to invest to reach the necessary stan-

dard for a successful SCF business. The last step is to determine the right approach to market entry, whether it is building a platform in-house, developing a white-label offer, purchasing a platform or partnering with a platform provider. In considering the business case, it is important to assess the transaction-banking revenue that would be at risk if customers started working with competitors.

Banks with no SCF business but a strong franchise with small and medium-sized enterprises and midsize corporations also have an opportunity to participate in the SCF market. They have relationships with potential SCF suppliers and deep networks to onboard and implement solutions effectively. That makes them natural partners for large SCF providers that lack capabilities in certain countries or face competition from peers with networks in those markets. Banks should look for partnership options to develop a supplier base to protect their SME franchise and boost cross sell.

Fintechs should ensure they have strong funding partnerships to support growth. Some have already done so—PrimeRevenue already has more than 40 funding partners in place, for instance—but others will need to expand their access to funding. By providing domestic and smaller regional banks with access to platforms, fintechs can help grow the overall SCF market as new markets and customer segments are opened up. They also need to continue to innovate in operational capabilities and business models to improve buyers' and suppliers' experience of SCF. Finally, they should explore NIG opportunities, as some fintechs are already starting to do by accessing institutional funding.

* * *

With increasing interest from banks and fintechs, and growing investments from venture capital and private equity, SCF has reached an inflection point. The winners will be the banks and fintechs that develop strong operational capability; partner with each other to leverage geographic, funding and technological strength; and continue to innovate with a deep understanding of the needs of both buyers and suppliers.

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