CHAPTER 10

NEW DIRECTIONS IN SCM IN THE NEW ECONOMY

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10.1. Collaborative Business for Value Chain Management

Introduction

We are now in a market-driven economy, where the individual consumer is the ultimate channel master. The transfer of power from manufacturers to retailers sparked a series of paradigm shifts in how products are developed, introduced, distributed, serviced and retired. In the multi-enterprise global economy of today and the future, the supply chain is the common denominator across all of these elements. In order to understand these shifts, we must understand the megatrends that directly influence them. *(Levi, M., Caudill, J, 2007)*

Megatrend 1: Mass Customization **-** In a commoditized world, consumers will increasingly satisfy both their basic and their non-essential needs through their consumption patterns.

Megatrend 2: Globalization and Micro-segmentation **-** The aging populations of the United States, Europe and Japan will create new marketing challenges and service opportunities.

Megatrend 3: Rapid Innovation **-** Competitive advantage can be gained by focusing on product leadership, customer intimacy and operational excellence. Central to this focus are product innovation and supply chain collaboration.

Megatrend 4: Collaboration Among Multiple Enterprises **-** In the new paradigm, companies are no longer single enterprises. They are members of specialized teams consisting of vendors, service providers and customers--all of whose roles are symbiotic and whose responsibilities are interdependent.

It appears that everywhere in the world where we meet leaders of the business and political world, practically everybody feels that *this age is different,* **new type of normality: chaotic** *(Kotler,Ph., Caslione, A.J., 2009)*

Blue ocean strategy challenges companies to break out of the red ocean of bloody competition by creating uncontested market space that makes the competition irrelevant. Instead of dividing up existing – and often shrinking – demand and benchmarking competitors, blue ocean strategy is about growing demand and breaking away from the competition. *(Kim, W., Mauborgne, C., 2005)*

Value innovation is a new way of thinking about and executing strategy that results in the creation of a blue ocean and a break from the competition. *(Rother, C., 2010)* Importantly, value innovation defies one of the most commonly accepted dogmas of competition-based strategy: the value-cost trade-off. It is conventionally believed that companies can either create greater value to customers at a higher cost or create reasonable value at a lower cost. Here strategy is seen as making a choice between differentiation and low cost. In contrast, those that seek to create blue oceans pursue differentiation and low cost simultaneously. *(Kim, C.W., Mauborgne, R., 2005)*

Supply – chaining is a method of collaborating horizontally – among suppliers, retailers, and customers – to create value. Supply-chaining is both enabled by the flattening of the world and a hugely important flattener itself, because the more these supply chains grow and proliferate, the more they force the adoption of common standards between companies (so that every link of every supply chain can interface with the next), the more they eliminate points of friction at borders, the more the efficiencies of one company get adopted by the others, and the more they encourage global collaboration. *(Iyer, A., Seshadri, S. 2009)*

When the world is flat, our company both can and must take advantage of the best producers at the lowest prices anywhere they can be found. If you don't, your competitors will. So global supply chains – that draw parts and products from every corner of the world – have become essential for both retailers and manufacturers. *(Friedman, T., 2005)*

10.1.1. A New Model for Enhanced Collaboration

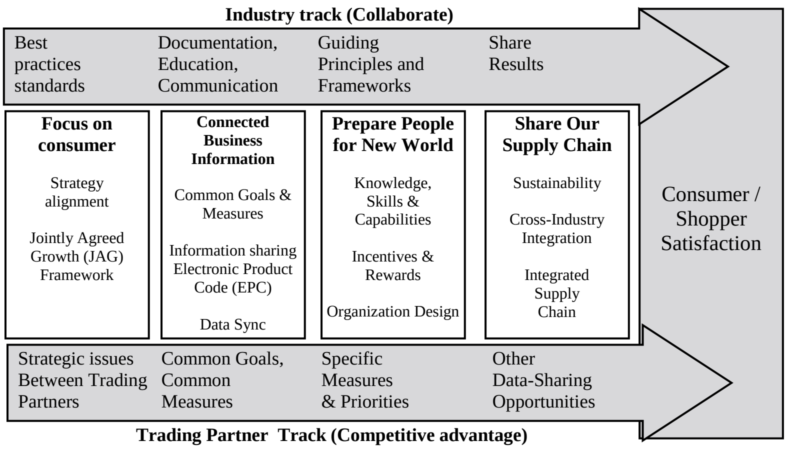
Integrating these improvement solutions together with collaboration concepts into a cohesive model will provide the future supply chain architecture that will help bring new efficiency and cost reduction for the industry. Researches in this domain demonstrates how the different solutions should be considered in relation to each other, and makes it clear that a big impact on the parameters can be made when the following concepts are merged and implemented: Information sharing – driving the collaborative supply chain; Collaborative warehousing; Collaborative city distribution (including home delivery and pick-up); Collaborative non-urban distribution (including home delivery and pick-up).

New Ways of Working Together

New Ways of Working Together (Figure 10.1) is about developing new ways for vertical trading partners to work together – including sustainable changes in culture, collaborative business planning and new measures and rewards. For a bilateral trading partner relationship, it offers an integrated roadmap for getting alignment and commitment on four key strategic choices in the collaboration of trading partners, which can ultimately lead to more satisfied shoppers and the elimination of waste, both of which should, in the end, produce better business results. *(GCI, 2008)*

- *Focus on the Consumer:* involves trading partner bilateral collaboration to better meet the needs of our consumers and shoppers. One breakthrough concept, ECR Europe Jointly Agreed Growth (JAG) methodology, addresses the fact that, in more strategic relationships, annual business planning is simply insufficient. Business plans must allow for longer time horizons.

Figure 10.1 New ways of working together – Eliminate Supply Chain Disruptions, Enable Growth



Source: GCI – 2018: The future value chain

- *Connect Business Information:* addresses transparency and information sharing by establishing common goals, common measures and a common language. Key components include the establishment of GS1 standards for key performance indicators and the use of Global Data Synchronization.
- *Prepare People:* addresses the organizational structures, capabilities, measures, people performance incentives and rewards that either facilitate or create barriers to collaboration.
- *Share Supply Chain:* is all about how the industry and trading partners must do things differently to address volatile energy costs and the need for more sustainable business practices.

Four collaboration concepts are at the heart of the overall future supply chain architecture:
- Information sharing - driving the collaborative supply chain
- Collaborative warehousing
- Collaborative city distribution, including home delivery and pick-up
- Collaborative non-urban distribution, including home delivery and pick-up.

Trend: What Is Driving the Objectives

The first phase of the 2020 Future Value Chain project involved identifying and analyzing the trends that will have the greatest impact on our industry in the coming 10 years. Twelve global root trends were identified that address change in society, shopper behavior, environment and technology. *(GCI, 2010)*

1.Increased Urbanization and the rise of megacities will impact the size of stores, logistics and the supply chain, and distribution infrastructures, among other factors.

2.Aging Population will have economic and political consequences related to the amount of money spent on necessities like food and drink, and the type of delivery services, store formats and locations offered to older consumers.

3.Increasing Spread of Wealth will lead to a growing middle class in developing regions, impacting consumption and availability of food items and providing a source of growth for manufacturers and retailers.

4.Increased Impact of Consumer Technology Adoption will be reflected not only in consumers' own behavior but also in their ability to influence the buying behavior of other consumers as the use of social and digital media continues to spread.

5.Increase in Consumer Service Demands will define new service models, offered via the Internet, that move beyond selling individual products and will bring different types of "solutions" to consumers and shoppers.

6.Increased Importance of Health and Wellbeing will have significant ramifications as sales of healthful products and services are expected to nearly quadruple in the coming five years.

7.Growing Consumer Concern about Sustainability will lead consumers to look to governments and companies to play a major role in combating climate change.

8.Shifting of Economic Power to countries like China and India will cause trade areas to evolve and a new generation of globally competitive companies from these developing markets to emerge.

9.Scarcity of Natural Resources like energy, water and food will become a growing issue as demand is projected to outstrip easily available supplies over the next decade, resulting in increasing production costs.

10.Increase in Regulatory Pressure will be seen particularly for hot-button areas like the environment, sustainability and food safety.

11.Rapid Adoption of Supply Chain Technology Capabilities will enable a more synchronized value chain with greater visibility and traceability.

12.Impact of Next-Generation Information Technologies like cloud computing will lead to a new way to deal, jointly, with business and technology in the consumer goods industry

The *objectives* for collaborative business for value chain management:
1.Make the Business More Sustainable
2.Optimize a Shared Supply Chain
3.Engage with Technology-Enabled Consumers
4.Serve the Health and Wellbeing of Consumers.

10.1.2. The Consumer Centric

Serving Consumers in a Sustainable Way

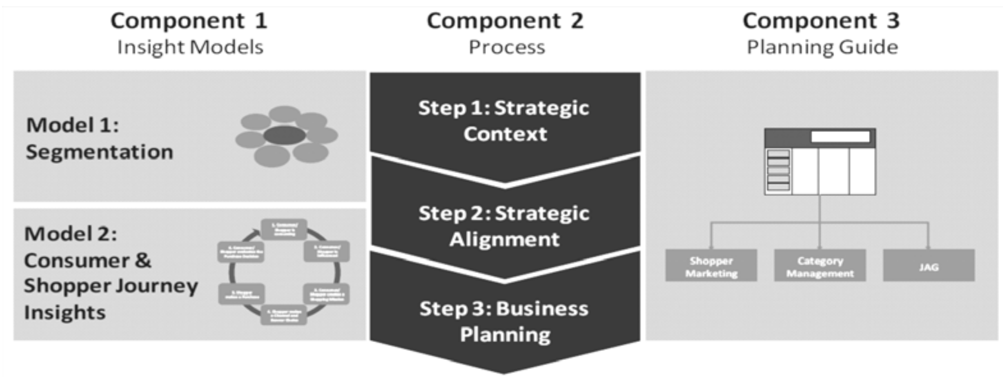
Current supply chain designs are primarily aimed at improving on-shelf availability, reducing cost and supporting sound financial figures (like ROI or return on brand equity). In the future, the industry must design for additional parameters like CO2 emissions reduction, reduced energy consumption, better traceability and reduced traffic congestion. The impact of these new parameters on the current bottom line may not yet be substantial but will grow in the coming years and efficiency improvements will almost certainly be realized. Supply chain strategy needs to look ahead and give priority to these parameters. All stakeholders in the supply chain will need to play their part to accomplish this change. Consumer awareness and demand for new products and services will also accelerate the adoption of new practices.

In recent years, the term *"shopper/consumer centric"* has become popular to describe decisions by retailers and manufacturers that focus on influencing shopper behavior to improve business results. New approaches, such as "*shopper marketing*", have emerged as the new statement of what innovative "shopper centric" business processes look like. However, retailers and manufacturers seem to have different views on what a "shopper centric" business approach means and what it encompasses. These differences are not difficult to understand: both retailers and manufacturers put shoppers/consumers at the center of the process, but the difference is that retailers typically think of stores/categories first while manufacturers typically think about their brands first. Clearly there is a big opportunity to bring these two complementary perspectives together around an integrated consumer/shopper approach.

Consumer and Shopper Journey Framework

The central idea that drives the C&SJ Framework is the concept of the *Consumer & Shopper Journey*. This is defined as: *"The mapping of the behavior and decisions of a group of consumers/shoppers, from Consumption through to Purchase and Post Purchase."*

Figure 10.2. The components of the C&SJ Framework



Source: ECR Europe: The Consumer and Shopper Journey Framework)

The fundamental proposition of the C&SJ Framework is that the insights generated from the C&SJ lie at the heart of a collaborative shopper-centric business approaches, including Category Management and Shopper Marketing. (Figure 10.2)

Once these insights are uncovered, a collaborative business process and a set of business tools then leverage these insights to develop superior value propositions for target consumers and shoppers. The complete C&SJ Framework as shown in Figure 10.2 consists of three components:1. The Insights Models; 2. A Collaborative Business Planning Process; 3. A Business Planning Guide and Tools that enable and apply this process. *(ECR Europe, 2011)*

Steps in the Process (Component 2)

The most important component of the Consumer & Shopper Journey Framework (C&SJ Framework) is the Collaborative Business Process. This process consists of three steps:

- Step 1 – Strategic Context / Preparation
- Step 2 – Strategic Alignment
- Step 3 – Collaborative Business Planning. *(ECR Europe, 2011)*

Step 1- Strategic Contex

The essential starting point for any successful collaborative initiative is for each partner to clearly define the internal requirements for a successful collaborative effort and to complete the internal tasks needed to prepare for collaborative work. This work must be undertaken independently by the retailer and the manufacturer to ensure that each of their organizations is prepared to begin the joint business planning and implementation work. To complete this preparation, as shown in Figure 10.3, three specific tasks should be completed:

1.*Set the Internal Direction* – the retailer and manufacturer, working independently, answer key questions to ensure that the collaborative work will deliver results that are consistent with each firm's business objectives and strategies;

2.*Select Target Consumers and Shoppers* – the retailer and manufacturer gain internal agreement within their respective organizations on the consumer and shopper segment, or segments, to target through collaboratively developed programmes;

3.*Select and Engage Target Partner* – each partner defines the criteria to be used to select the appropriate partner for the collaborative effort and uses these criteria to elect and engage the selected partner.

Step 2 – Strategic Alignment

The next step in the collaborative process is to achieve strategic alignment between the retailer and the manufacturer partners on the targets, scope and direction to follow, and the desired outcomes of the collaborative initiative. This involves the completion of three tasks:

1.*Aligning on Consumer/Shopper Targets* – In Step 1, each partner defines independently their target consumer and shopper segment, or segments. Subsequently, the partners need to agree on which target segments will be the focus for their collaboration. This alignment is essential prior to beginning the detailed work of developing a business plan to deploy strategies and tactics against the selected target segments.

2.*Merging Consumer & Shopper Journey Insights* – The retailer and the manufacturer bring different consumer and shopper insights into the collaborative work. A major goal of the C&SJ Framework is to synergies these insights in the development of segment-focused value propositions and programmes. This task identifies these insight synergies and also any significant information gaps that should be addressed to better understand and influence the consumer and shopper journey for the selected segment, or segments.

3.*Setting High Level Shopper Strategies* – Based on the opportunities identified through these combined insights, the retailer and manufacturer develop a set of preliminary, high level strategies that provide guidelines for more detailed tactical programmes.

Step 3 – Collaborative Business Planning

The final step is business planning and implementation. The key tasks completed in this step are: *1. Identify the Scope of the Plan; 2. Develop and Revise Shopper Marketing; 3. Implement and Evaluate.*

10.1.3. Best practices for New Generation SCM Model

Integration across functions: new-generation SCM processes automatically combine this cross-functional information, analyze it, identify exceptions, recommend changes and then rapidly communicate these changes to supply chain partners and customers.

Acceleration of processes: with the latency of integrating the necessary information greatly reduced, supply chain management can become a real-time process.

End-to-end management: end-to-end supply chain management requires the integration of information from many applications.

Demand-driven supply chains: one of the most important characteristics within end-to-end supply chain management is the ability to drive the supply chain from actual customer demand instead of from sales forecasts.

Integration of planning and execution: in new-generation supply chain management, planning and execution are increasingly integrated.

Collaboration : in the new generation, we see collaboration evolving from the slow and linear Collaborative Planning, Forecasting and Replenishment (CPFR) model to a rapid-response, synchronous approach that proliferates multi-enterprise supply chain information to all partners in near real time.

Process innovation: in the new generation, SCM systems can be quickly and easily modified to support process innovation, encouraging new practices.

Focus on business processes, not software applications: companies are buying business process platforms, with standard process workflows from a workflow library, and then modifying and extending these workflows to create unique business processes.

10. 2. Corporate Social Responsibility (CSR) in Collaborative Supply Chain of Consumer Goods Industry and Retail

10.2.1. Introduction

Corporate social responsibility (CSR), also known as corporate responsibility, corporate citizenship, responsible business, sustainable responsible, or corporate social performance, is a form of corporate self-regulation integrated into a business model. Ideally, CSR policy would function as a built-in, self-regulating mechanism whereby business would monitor and ensure their adherence to law, ethical standards, and international norms. Business would embrace responsibility for the impact of their activities on the environment, consumers, employees, communities, stockholders and all other members of the public sphere.

For each business, different measures are taken in consideration to classify a business as "socially responsible". Each business attempts to reach different goals. There are four areas that should be measured regardless of the outcome needed: Economic function, Quality of life, Social investment and Problem solving that is trying to be achieved should be ok measured to see if it meets with the cost guidelines that the business is willing to contribute [*http://en.wikipedia.org*].

Consequently, business would embrace responsibility for the impact of its activities on the environment, consumers, employees, communities, stakeholders and all other members of the public sphere. Furthermore, CSR-focused businesses would proactively promote the public interest by encouraging community growth and development, and voluntarily eliminating practices that harm the public sphere, regardless of legality. Essentially, CSR is the deliberate inclusion of public interest into corporate decision-making, and the honoring of a triple bottom line: people, planet, profit (*http://en.wikipedia.org*).

10.2.2. Social Responsibility in Supply Chain Management

Activities Necessary to Monitor and Manage the Ethical Supply Chain

Social responsibility is defined by ISM (Institute for Supply Management) as a framework of measurable corporate policies and procedures and resulting behavior designed to benefit the workplace and, by extension, the individual, the organization, and the community (*http://www.ism.ws*).

- *Policy Creation and Ongoing Risk Assessment***.** Someone in the organization needs to be responsible for the initial and ongoing creation of a corporate ethical supply chain policy, including a value statement, appropriate codes of conduct, and a framework for analyzing and reacting to supply chain risks. In order to make that policy reflect reality, someone will need to be responsible for an analysis of the socioeconomic impacts and the relative risks that the company faces, by country, by contractors, and by product.
- *Managing the Supplier Program.* This effort, going well beyond a strategic sourcing regime, requires incorporating social and environmental selection and monitoring criteria into an ongoing supplier evaluation program. It will also require resources to create and maintain education programs, to draw up and negotiate relevant contracts, and to collect performance information through a variety of sources, including internal systems that can record historical performance data, and through both written and in-person surveys.
- *Document Management.* Establishing a central database of audit information is critical, both in terms of effective management and in providing legitimate, verifiable information to investors and NGOs.
- *Training and Education.* A supplier program also requires an ongoing-program of education and training for both company and supplier employees that covers company policy, the organization’s process for risk and supplier assessment, social and environmental performance codes and expectations, and the reporting process.
- *Communication.* A strong communication program is necessary, both internally concerning policies and resources, and externally to corporate stakeholders: NGOs, pressure groups, the media, and investment and consumer groups.
- *Gaining Internal Commitment and Corporate Alignment.* The process also requires a very important change in management effort in order to communicate the business case for supplier management and SEAAR [Social and ethical Accounting, Auditing and Reporting] to leaders throughout the organization, and to gain the endorsement and active participation of senior corporate executives in creating policy and regularly monitoring risk issues when they arise.
- *Complete the Reporting Process.* Finally, the process will require special and dedicated resources not only to manage the supplier program, but to collect accurate data and to develop the publishable corporate SEAAR report.

10.2.3. CSR in Supply Chain

Overview

Supplier management is the key to a company’s ethical supply chain. At its best, good supplier management means working with suppliers collaboratively to design safe products, with high quality standards that do no harm to workers assembling those products, to consumers who buy them, or to the environment in their manufacture or after-use disposal. That means developing a formal program that incorporates much more than just quality, price, and delivery dependability — the standard criteria for judging vendors in the past. As companies become more and more dependent upon suppliers in developing nations, it means a much closer relationship in every way — collaborative design, education, training, and supervision.

A new level of buyer – supplier cooperation is necessary for several reasons. First, because suppliers in the modern supply chain are much more strategic to success of the company. With JIT concepts and collaborative design, the better a company understands the capabilities of its most important suppliers — and increasingly these will be located in developing countries — the more likely it is to avoid quality and productivity damaging mistakes in the supply chain. Second, just as companies are organizationally closer to third-party vendors, so too is their responsibility in the eyes of investors, consumers, and activists for these suppliers' behavior. Therefore, assurance of high social and environmental standards among suppliers will become increasingly important in terms of protecting a company's reputation.

And given the costs in terms of investment, reputation, and human capital,-it makes little sense for companies to simply withdraw their contract as a punishment for suppliers that violate social or environmental standards. The entire process has become too complex for that. In the first place, to cut and run helps none of the parties — the workers, the supplier, or the buying company. In the past two years, most activist organizations have begun to call on companies not to withdraw their contracts when infringements are found, but instead to participate more closely with their suppliers in improving worker health and safety or environmental practices. In fact, in what critics describe as both unfair and ironic, large companies today that choose to immediately withdraw their contracts from factories that are found guilty of violating workers rights, are often criticized for both their failure to enforce compliance, and at the same time, for their insensitivity in withdrawing much needed work from the community.

Accordingly, a supplier program *must go beyond just setting policy and monitoring compliance.* Companies must begin to mentor favored suppliers much in the same way as they would focus improvement efforts on their own operations. This may require education, training, and coaching in management technique, in labor relations, in process efficiencies, health and safety, and environmental quality. Importantly, it may also require investment in schools, housing, or medical care that were initially seen as the responsibility of the supplier itself or the local government — something that, ultimately may be well justified on business as well as humanitarian grounds.

Supply Chain Environmental Management (SCEM) Systems and Environmental Health and Safety (EHS) Systems

Supply Chain Environmental Management systems have become popular among companies over the past decade as a means for monitoring, improving, and reporting on the environmental performance of their supply chain operations, including those of its (usually domestic) suppliers. Often based on the same reporting requirements as company-wide EHS systems (except that they focus specifically on the supply chain), most of these systems have gone well beyond being just a tool for gauging and recording environmental performance. Moreover, responding to the need for companies to provide social as well as environmental performance information, these systems have recently begun to build in a broader range of features encompassing other economic and social criteria.

European Commission

Corporate Social Responsibility, as defined by the European Commission, is a concept whereby companies commit voluntarily to go further than legislation requires in order to contribute to a better society and a cleaner environment. The voluntary approach allows for creativity and enables companies to be inspired by others' best practices and to adapt or merely adopt a best practice already undertaken by another company.

After the European Multi-Stakeholder Report in 2004, the challenge for all stakeholders was to reflect on how to put the recommendations into practice. The Commission assessed the progress made by the Forum and also prepared a new Communication on the way forward for CSR in the EU, based on the Forum's recommendations. This Communication was published in March 2006. In this Communication, the Commission announces its support for a European Alliance for

CSR. The Alliance is a political umbrella for CSR initiatives by large, small and medium-sized enterprises and their stakeholders. It is not a legal instrument to be signed by enterprises, but rather a vehicle for mobilising the resources and capacities of European enterprises and their stakeholders in the interests of sustainable development, economic growth and job creation.

Euro Commerce

"European commerce, be it large or small enterprises, or workers and their trade unions, have a common interest to defend a development which can ensure the existence of a high-quality European retail and wholesale industry also in the future, capable of competing successfully with other forms of consumption" (*http://www.uni-apro.org*).

In November 2003 the European Social Partners for commerce, UNI-Europa Commerce and Euro Commerce, organized a high-level conference entitled "How can CSR initiatives promote quality in Employment in the Commerce sector". At national and regional level commerce companies and trade unions across Europe have a long tradition of striving towards quality of employment in commerce. The CSR debate at European level was initiated by the Commission Communication on CSR in 2002 which followed up on a Green Paper on CSR in 2001.

Promoting CSR in European commerce

In line with their activities in the sectoral social dialogue the social partners for commerce have reached a joint statement on combating violence in commerce (*1995*), a joint statement on combating child labour (*1996*), a joint agreement on fundamental rights and principles at work (*1999*), a joint statement on combating racism and xenophobia (*2000*), as well as a recent joint agreement on guidelines for age diversity in commerce (*2002*). They have produced vocational training material to encourage workers and management to use new technologies, thereby promoting life-long learning, and have organised high-level seminars and conferences on CSR.

CSR is part of a concerted effort by all those concerned towards meeting shared objectives by entering into dialogue with all stakeholders, including the company's own personnel and their organisations. Therefore CSR does not only relate to external aspects, but also to internal aspects such as health and safety at work and management of human resources. Yet, CSR cannot replace compliance with national and European legislation, international labour norms or collective agreements.

EuroCommerce and Uni-Europa Commerce welcome the positive and active approach of many leading European-based international retailers and wholesalers to implement CSR policies, including through strengthening their social dialogue on the different levels of their structures, and through integrating CSR policies into the work of their European works councils. The European social partners invite all commerce companies in Europe, large and small, to share this approach.

10.2.4. Global Projects in SCM

The Global Social Compliance Programme

Buying companies have responded to the challenges around fair labour and environmental conditions in their supply chains by developing codes of conduct and monitoring systems.

However, the number of codes has proliferated and approaches have somewhat diverged. This has led to duplication (with the multiplication of overlapping audits per supplier) and sends a confused message to suppliers and to public authorities as to what is expected in terms of fundamental labour rights and of site specific environmental conditions.

To address the need for consistency, leading global buying companies have decided to work together to promote a real change in attitude through the understanding of the root causes of problems and the development of effective and sustainable remediation. They decided to collaborate, aiming at the convergence of existing systems worldwide by launching the Global Social Compliance Programme (*www.theconsumergoodsforum.com*).

The programme provides a platform for building consensus on best practice in labour standards and environmental requirements in supply chains, in order to develop a single, clear and consistent message for suppliers globally. It also offers a forum to openly discuss issues and challenges among leading companies (e.g. in remediation).

The Global Social Compliance Programme is a business driven programme for companies whose vision is to harmonise existing efforts in order to deliver a shared, global and sustainable approach for the continuous improvement of working and environmental conditions across categories and sectors in the global supply chain. It offers a global platform to promote knowledge exchange and best practices in order to build comparability and transparency between existing systems. To this effect, GSCP is developing a set of reference tools and processes that describe best practices and provide a common interpretation of working and environmental requirements and their implementation.

ISM Principles of Sustainability and Social Responsibility

Principles

Community Community initiatives provide resources to support the community in which the company or organization operates.

Diversity and Inclusiveness — Supply Base Supply base diversity and inclusiveness refers to efforts to engage different categories of suppliers in sourcing processes and decisions.

Diversity and Inclusiveness — Workforce Workforce diversity and inclusiveness refers to efforts to attract and retain a workforce that represents the varied backgrounds of the customer and community in which the organization operates.

Environment Supply management actions and decisions that promote protection and preservation of the health and vitality of the environment within which the organization operates.

Ethics and Business Conduct Ethical behavior and business conduct is a critical element impacting personal, business (public and private), supplier and governmental relationships and governance.

Financial Responsibility Financial responsibility refers to understanding and applying financial concepts to supply management decisions to address allocation of funds, accurate reporting and management of risk.

Human Rights Human rights refer to the concept of human beings having universal natural rights, or status, regardless of legal jurisdiction or other localizing factors.

Health and Safety Health and safety refer to the condition of being protected or free from the occurrence of risk of injury, danger, failure, error, accident, harm or loss.

Sustainability Sustainability refers to the ability to meet current needs without hindering the ability to meet the needs of future generations in terms of economic, environmental and social challenges.

Consumers International (CI)

Consumers International (CI) is the global federation of consumer organizations, representing over 220 groups in 115 countries. Based in London, and with regional offices in Kuala Lumpur and Santiago, CI is the campaigning global voice for consumers, our mission is to build a powerful international consumer movement to help protect and empower consumers everywhere.
Consumers International is a not-for-profit company limited by guarantee in the UK and a registered charity.

Consumer organizations are also reflecting growing concern in this area by helping to provide access to more information about the social impact of their consumption choices. Several CI members in Europe now conduct CSR surveys alongside more traditional functionality tests for a number of products. CI members also support the introduction of Right to Know legislation for public or privately owned entities, imposing a duty to disclose any information which is relevant to consumers regarding sustainability, and which relates to products and production processes throughout their supply chain. CI and its members have also been active participants in developing a new international standard (ISO 26000) for a more holistic approach to social responsibility.

10.2.5. CSR in the supermarkets

Supermarket supply chains and labor conditions

Developing country supply chains are inherently more risky in terms of working conditions and socially responsible trade because the countries in which the products are sourced are less likely to have effective legislation and well-resourced systems to ensure basic labour rights.

Supermarket supply chains – buyer power

More recently concerns have also been raised about the growing concentration of the supermarket sector in Europe and the power that this gives the ‘big players’ in negotiations with smaller suppliers. There has always been an imbalance of power between large European companies and smaller companies in developing countries, however, recent consolidation and growth amongst European supermarkets has magnified this effect (*http://ecr-all.org).*

Recent examples of increasing recognition of abuses of supermarket buyer power in Europe

In France, the Secretariat of State for Commerce announced in October 2009 that French retailers were being summoned before commercial courts for improper practices with suppliers.

At EU level, supplier relations are being considered by the European Economic and Social Committee, Parliament and the Directorate Generals responsible for Enterprise, Agriculture, Internal Market and Competition and Parliament.

In January 2010, following three investigations into the food retail sector by the UK Competition Commission in eight years, the UK Government accepted the recommendation that a supermarket ombudsman be established to protect the rights of farmers, producers and consumers against abuse by larger supermarket chains.24

The introduction of a statutory code of conduct for grocery retailers and suppliers was announced by the Irish Government in January 2010.

Growth in Corporate Social Responsibility (CSR) policies

Another indication of supermarket responses to consumer concern about their social impact can be found in their development of CSR policies. At best CSR policies can be genuine cross-organizational commitments that ensure a company’s policies and practices seek to maximize benefits from their operations. At worst CSR policies can be a public relations exercise that seeks to deflect criticism and whitewash unethical practices. If not genuine, CSR stimulates dishonesty within supply chains putting suppliers in a no-win situation, as well as confusing developing country workers, and undermining their rights.

Key concerns for this report include the applicability of supermarket CSR policies (relating to labor conditions and trading practices) to specific supply chains. In particular whether policies are applied:

- To food products from developing countries.
- Beyond the group of suppliers that the supermarket is in direct contact with to include suppliers and producers in developing countries. It is also important that all policies have effective means of verification. Criteria for assessing verification include the direct involvement of a third party or preferably a multi-stakeholder group and that the results of audits and visits are publicly available.

CSR initiatives initially existed at a company level but are now increasingly developed at an industry level and in some cases with the involvement of other stakeholders such as unions, consumer groups and other nongovernmental organizations.

Supermarket commitment to CSR

CSR Guidelines and Initiatives

In order to assess supermarkets' overall commitment to fairer working conditions and trading practices, their stated support for international declarations, such as the Universal Declaration of Human Rights and the ILO Declaration on Fundamental Principles and Rights at Work, and their membership or application of different initiatives in this area were assessed, including:

- Guidelines for good practice published by multilateral institutions such as the Tripartite Declaration of Principles Concerning Multinational Enterprises, the OECD Guidelines for Multinational Enterprises and the UN Global Compact.
- Co-operative/information sharing initiatives to promote good practice such as Ethical Trading Initiatives, Business Social Compliance Initiative (BSCI), Global Social Compliance Programme (GSCP), Initiative Clause Social (ICS) and business to business initiatives such as Copernicus.
- Facility/site certification systems: (SA8000, Global GAP). A comparison of these guidelines, initiatives and systems was made on the basis of their content, operational issues, enforcement systems and their relevance to the food supply chain in developing countries to help clarify the significance of supermarkets' commitment to them in he context of this survey.

10.3. The Financial Supply Chain Management (FSCM): A Response to the New Economy

In the 90s, the initially adversarial working way, "win lose", was replaced with "working together" *(ECR Europe, 2000)*.

Efficient Consumer Response (ECR) is a strategic initiative, working to overcome traditional barriers between trading partners, thus eliminating internal barriers that result in casts and tine that add little or no value to consumers. It is focused on the application of leading edge management methods and available technologies to reduce costs and response times, while increasing the quality of products and the service that are provided to consumers *(ECR Europe, 1998).*

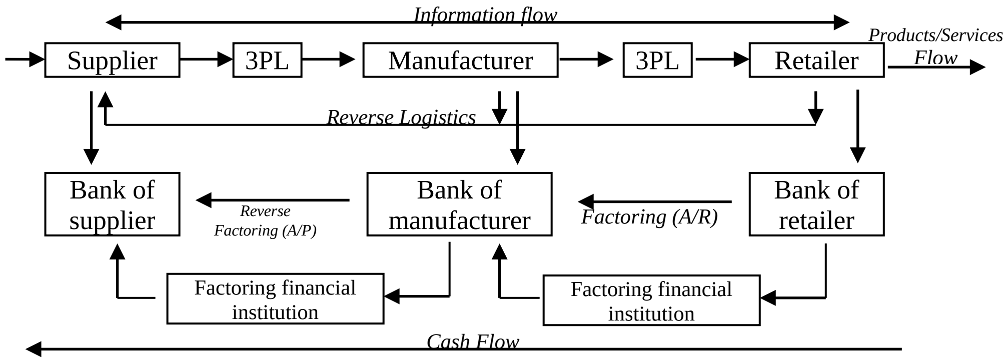
In Europe, the ECR Executive Board has defined the mission of ECR to be: "Working Together to Fulfill Consumer Wishes Better, and Faster and at Less Cost" *(ECR Europe, 1996).*

Integrated Suppliers focuses on the upstream supply chain, the relationship between manufacturer and supplier *(ECR Europe, 1997).*

In establishing upstream key concepts, it was necessary to work with a generic process model that could be used to illustrate the supply chain. Another level was the taking in account the 3PL (Third Part Logistics) with the philosophy *Working Three-Gether* (Supply Chain Management for Efficient Consumer Response is also for suppliers of ingredients, raw materials and packaging) *(ECR Europe, 1999).*

Given the current crisis and recession (haoticism) it is necessary to rethinking the collaborative management directed only on satisfying the participants on the chain, the end customer, in terms of information flows that support the transfer of logistics from raw material to final product for the shopper, by taking into account the financial flows of these actors (financial organizations: banks, factoring financial institutions, insurance companies, etc.) and introducing in a new model the financial players and the approach of financial supply chain management - Working All-Together (WAT). (Figure 10.3)

Figure 10.3 Working All Together (WAT) for Supply Chain Excellence



10.3.1. Financial Supply Chain Management (FSCM)

Overview

Despite the crisis of the past three years, the industry has continued to innovate in financial supply chain management to enhance value for trading counterparties and improve efficiency.

Banks recognize that the tightening of credit globally represents both a short-term challenge and a medium term business opportunity. Although the majority of cross-border open account trade is conducted corporate-to-corporate, evidence suggests that a significant percentage will migrate to a bank-assisted model over the coming years. Corporates and in some countries regulators have voiced their demand for banks to provide greater innovation through bank-intermediated supply chain solutions *(Casterman, A., 2010).*

There are different definitions of the term *financial supply chain*, which appeared for the first time in 2000 and 2001. According to the research company Killen & Associates (2001), the financial supply chain "parallels the physical or materials supply chain and represents all transaction activities related to the flow of cash from the customer's initial order through reconciliation and payment to the seller." The Aberdeen Group, a research company, calls the financial supply chain "a range of B-to-B trade-related intra- and inter-company financial transaction-based functions and processes begin before buyers and suppliers establish contact and proceed beyond the settlement process." The two definitions emphasize different topics. Killen's focuses on the parallelism between the physical and the financial supply chain, and it stresses a section of the cash flow cycle that. The Aberdeen Group's definition focuses on the collaborative nature of financial supply chain management and reveals that the financial value chain isn't limited to the inner walls of a company but includes communication and cooperation with business partners *(Weiss, J., 2012).*

The short definition that includes three aspects is the following: Financial Supply Chain Management (FSCM) is the holistic and comprehensive planning and controlling of all financial processes which are relevant within a company and for communication with other enterprises.

The financial supply chain is different from the physical supply chain because it deals with the flow of cash instead of goods.

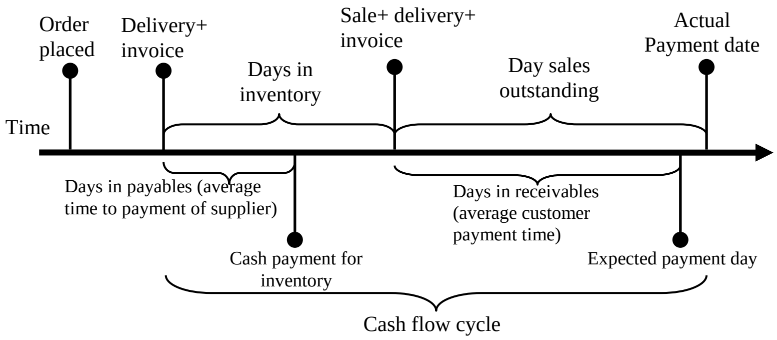
The order-to-cash process includes, from the perspective of a supplier (or creditor), the following business process steps: 1. Creditworthiness check; 2. Invoice creation; 3. Cash forecast; 4. Financing of working capital; 5. Processing of dispute cases; 6. Cash collection; 7. Settlement and payment; 8. Account reconciliation.

From the perspective of a customer (or debtor), the purchase-to-pay process consists of the following business processes: 1. Procurement; 2. Cash forecast; 3. Financing of working capital; 4. Receipt of invoices; 5. Resolution of discrepancies or exceptions; 6. Invoice approval; 7. Settlement and payment; 8. Account reconciliation *(Weiss, J., 2012).*

Cash Flow Cycle of Financial Supply Chain Management

There are various key performance indicators that are relevant for measurement in financial supply chain management. One key metric is the cash flow cycle, which defines the period from delivery by suppliers until the cash collection of receivables from customers (Figure 10.4). It is the time period required for the company to receive the invested funds back in the form of cash.

Figure. 10.4 The cash flow cycle of FSCM



*Source: Weiss, 2012. Juergen Bernd: How to better Manage Your Financial Supply Chain***:** *Q-Finance*

The cash flow cycle can be divided into the *operating cycle*—which is the time period between delivery by suppliers and the actual cash collection of receivables, and the *cash flow cycle*—which is the time period between the cash payment for inventory and the cash collection of receivables. The longer the cash flow cycle, the greater is the working capital requirement of a company, which means that a reduction of the cash flow cycle will immediately free up liquidity.

Within the cash flow cycle we can differentiate the following parameters, which are delimited in Figure 10.4. *(Weiss, J., 2012)*

- *Days in inventory:* This is the length of time between the delivery of the goods and the invoice from the supplier, and the sale of the goods and the invoice to the customer. It describes the average number of days the goods of a company remain in inventory before being sold. This metric is the focus for all activities around classical supply chain management (inbound logistics and inventory management).
- *Days in payables:* This is the length of time between delivery of the goods and the invoice from the supplier, and the actual payment for the inventory. This figure describes the average time it takes to pay a supplier. The parameter considers the outstanding receivables of a company, and is an important metric for debtors concentrating on their efforts to optimize the purchase-to-pay cycle.
- *Days sales outstanding (DSO):* This is the length of time between the sale of the goods and the invoice to the customer, and the actual payment date of the customer. This metric measures the average number of days companies need to collect revenue after a sale has been made. A high DSO number means that an enterprise is selling to its customers on credit and taking longer to collect money.
- *Days in receivables:* This is the length of time between the sale of the goods and the invoice to the indicates the average time, in days, that receivables are outstanding. Days in receivables can also be called best possible DSO, since the company would collect all receivables before the due date.

Within the cash flow cycle there is potential to reduce both days in inventory and days sales outstanding. Days in payables can be reduced but should be monitored carefully to avoid putting supplies at risk. Days in receivables can be reduced by optimizing cash collection. One of the key objectives of financial supply chain management is to optimize the working capital by reducing, for instance, outstanding receivables *(Weiss, J., 2012).* As FSCM is a rather new approach in logistics and only recently recognized in literature.

Perspectives of FSCM

Pfohl & co. cited by Breuer *(2009)* differentiates between three perspectives on the FSC. The functional perspective examines particularly finance, investment and accounting. Whereas the institutional perspective deals with the actors in the FSC. The connection between relevant low and stock figures is explained in the financial perspective. The most important elements of the three perspectives are illustrated in Table 10.1.

Table 10.1 Established and enhanced understanding of the SC from Different Perspectives

Perspectives/Elements	Functional	Institutional Micro/Macro Actors	Financial
Established understanding of the SC	-procurement - production - distribution - marketing - logistics	- Logistics providers - Industrial enterprises - Commercial enterprises - Customers - Suppliers - Department of the service division	- Process costs - Contribution margin - Current assets - Capital assets
Enhanced understanding of the SC	- Accounting - Finance - Investment	- Investors - Financial service providers	- Capital costs - Cash flow - Return

Source: Breuer, K, 2009. Financial Supply Chain Management, ePubWU, The Institutional Repository of the WU Vienna University of Economics and Business, p. 25-34

Functional Perspective. Logistics with its interface and interdependencies with procurement, production, distribution and marketing combined with finance, accounting and investment build the functional perspective.

Finance. With every investment another inevitable question arises: how to finance that investment. Finance is divided into equity and debt capital.

Accounting. Accounting collects, organizes and systematizes inventory on a quantity and value basis and financial lows and output lows according to type, volume and value.

Institutional Perspective. Fourth-Party-Logistics-Providers

In the FSC (Financial SC) the circle of actors is expanded by financial service providers, banks and investors (4PL – information providers and finance providers). Financial service providers are especially leasing corporations and insurances, which offer financial services, forward contracts for commercial papers and underwriting. Moreover M&A-service agencies and rating agencies, although providing solely information and advice services, are part of financial service providers in the FSC. Banks are major banks, virtual banks, state banks, investment banks and savings banks. Venture capital enterprises, public-law lenders, institutional investors, private investors and funds are among the investors. A special form of capital appropriation, indeed the exclusive allocation of equity capital is the corporate objective of venture capital enterprises

The Financial Supply Chain is organized into two subprocesses *(Breuer, K. 2009).*

1. Financial Trade Enablement. The first part of the subprocesses deals with business initiation.

Qualification. The qualification process is the beginning of the FSC with a check of identity and creditworthiness of the customer. Finance after qualification, finance and therefore primarily the different financing forms are evaluated. A first step in the PTP-cycle is the decision whether to finance the goods with own funds, called in-house financing or outside financing with a supplier credit or by borrowing from financial institutions. Finance decisions can only be made if the procuring corporation has an overview of the current and prospective liquidity situation.

Pricing. Prices as well as discounts, sales terms and delivery conditions are determined in the pricing process. The supplier consults financial accounting and Enterprise Resource Planning (ERP) Systems, like CRM (Customer Relationship Management) to get information about ordered quantity of goods, paid prices, number and reasons for claims, payment history and exhaustion of credit lines in the OTC-cycle. Based on that information the vendor is able to allocate customized prices. For instance, a customer who settled an account rather quickly can be granted better conditions and prices than a customer who took advantage of or even exceeded the payment target.

Hedging. Every business involves risks, for example logistics risks as product, quality or damaging risks and financial risks as currency, credit or payment risks. It is obvious that hedging against risks is inevitable. Therefore the contracting parties are trying to limit risks in the hedging process with the goal to quantify risks and compare them with the costs of risk hedging.

2. Financial Trade Settlement. The second part of the subprocess deals with handling the business.

Invoicing. After the physical fulfillment is completed, that is the buyer received the order, the vendor generates an invoice and forwards it to the buyer. The quality of invoicing is of great importance for the following process steps, as it facilitates the auditing and claim management. Moreover DSO are influenced by the formal and material accuracy of the invoice.

Auditing. Auditing follows invoice. The buyer checks the invoice for accuracy in the PTP-cycle.

Claim. If invoicing errors are detected in the auditing process, claim management is responsible for handling.

Payment. Payment is the last subprocess in the Financial Chain. In the PTP cycle payment follows auditing. Payment is made predominantly via check or bank transfer.

The main purpose of netting is to reduce bank fees due to a reduced number of external payments and an internal cost decrease by automation and acceleration of workows. On the one hand intra-group accounts receivables and accounts payables are balanced to reduce transfers between the group.

Financial Flows in the Supply Chain

Invoices and Payments

The financial flow in a typical supply chain includes thousands of invoices and payments in a given year. The scale of this problem is challenging corporations to find ways of streamlining their processing. There are also considerable savings to be obtained in other categories besides processing improvements.

Any single organization in the supply chain has both Accounts Payable (A/P) and Accounts Receivable (A/R) activities. Each invoice is an A/P from the downstream buyer's perspective and an A/R from the upstream seller's viewpoint. Multiple invoices, however, are often paid by a single payment. This requires information as to which specific invoices are covered by a remittance. Also, when invoices are reconciled prior to payment, the three-way match of purchase order (P.O.), shipping receipt, and invoice may fail if all documents are not precisely consistent. Both of these potential failures can often be dealt with by innovative payment solutions with pre-established tolerances for automated processing.

Table 10.2 Challenges in Financial Flows and improvement opportunities for financial flows

Challenges in Financial Flows	
Challenges:	Causes:
Slow processing	Manual and stand-alone processes

Unreliable, unpredictable cash flows	Lack of timely information
Costly processes	Lack of employee empowerment and compliance
High days sales outstanding (DSO)	Delays in invoice reconciliation
Suboptimal credit decisions	Manual processes for setting optimal limits
Results:	
High working capital needs, high costs, high Days Sales Outstanding (DSO), lower revenues	
Improvement opportunities for financial flows	
Challenges:	Causes:
Slow processing	Manual and stand-alone processes
Unreliable, unpredictable cash flows	Lack of timely information
Costly processes	Lack of employee empowerment and compliance
High days sales outstanding (DSO)	Delays in invoice reconciliation
Suboptimal credit decisions	Manual processes for setting optimal limits
Solutions:	Results:
Purchasing and distribution cards for payment and collections	Better visibility, transparency and speed
EIP + e-payment = EIPP	Fewer errors and improved processes
Reporting and data consolidation services; integration with back office systems	Reduced costs and DSOs
Outsourced credit and collection processes	Increased revenues
	Streamlined reconciliation

Source: processed from Hausman, W., Financial flows & Supply Chain Efficiency, Executive Summary, Visa Commercial Solutions

Information Transfer

Financial flows also include information transfer via Electronic Invoice Presentment (EIP) and electronic payments. This combination constitutes the Electronic Invoice Presentment and Payment (EIPP), an advanced payment application that automates specific financial tasks, as well as provides the opportunity to collect, aggregate, and share valuable information across the supply chain.

Financial Flow Management Challenges

Most companies require significant amounts of Working Capital to deal with variable and somewhat unpredictable financial inflows and outflows.

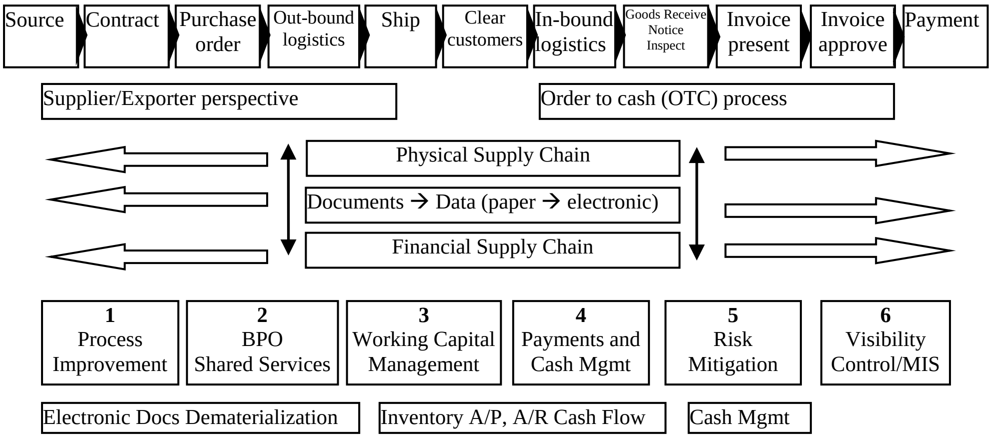
When viewed collectively, the financial flow management challenges such as slow processing, unreliable and unpredictable cash flows, costly processes, high Days Sales Outstanding (DSO), and suboptimal credit decisions require higher Working Capital than necessary.

If these challenges were removed, the money saved could be shifted to more valuable uses. In order to strategically address and minimize financial flow challenges and take appropriate action, one must first identify and evaluate the common causes.

10.3.2. Supply Chain Finance

As a result of the current situation where pressure on supply chains is mounting because of the economic downturn, but where refinements to the physical supply chain no longer have a significant impact, interest has been mounting in Supply Chain Finance techniques to ease the burden. Banks, in particular who are keen to lend but are very reluctant to damage their risk profiles further, are exploring imaginative methods of extending credit secured against robust assets, such as invoice debt.

Figure 10.5 Key elements of FSCM



Source: The 2007 guide to Financial Supply Chain Management, HSBC

According to the Aberdeen Group, the definition of Supply Chain Finance is: "A combination of Trade Financing provided by a financial institution, a third-party vendor, or a corporation itself, and a technology platform that unites trading partners and financial institutions electronically and provides the financing triggers based on the occurrence of one or several supply chain events." *(cited in Supply Chain Finance. A third report from Demica: Strengthening the Links, Issue no. 10, Demica, April 2009).*

Supply Chain Finance is generally viewed as the province of a commercial bank's lending arm. Relationship banks offer a working capital management facility for their large corporate clients (product/service buyers, "Buyers"), while at the same time providing prompt payment facilities for their suppliers ("Suppliers"). (Figure 10.5)

This is essentially the same as a closed user group factoring arrangement, the main difference being that the facility is arranged with the Buyer, who then introduces the service to its Suppliers, to the benefit of both parties. In industries where efficiencies in the physical supply chain have been refined to the utmost level, attention has now moved to the financial supply chain. The result is abundant activity around vendor finance and supplier finance that allow Buyers to ease payment terms while also ensuring that their Suppliers' cash flow is improved, thus reducing or avoiding instability in the supply chain.

For banks, FSCM as a concept was initially a marketing umbrella to repackage such traditional products as trade, insurance, payments and cash management. More recently, banks have reviewed traditional trade and cash management services and identified those elements of the value proposition that could be developed to better serve their customers' physical and financial supply chain. In this context, banks tend to define FSCM services in terms of five interrelated groups: payments and cash management; working capital management and supply chain finance; risk management; process improvement (either through dematerialization or managed services); and business intelligence. *(The 2007 guide to Financial Supply Chain Management, HSBC)*

Introduced in the 1990s, the first model of SCF combined domestic trade finance with supply chain management through an innovative invoice financing arrangement known as "reverse factoring," a three-way agreement by which the bank (or "factor") purchases the receivables of the supplier with legal recourse to the buyer. In this earliest model, reverse factoring was purely a domestic service offered within select industries, especially the automotive sector. A large, investment-grade company could extend its days payables outstanding while allowing its suppliers to reduce their days sales outstanding at a favorable rate. Thus, reverse factoring is a form of credit arbitrage: by relying on the stronger credit rating of the buyer, SME suppliers get liquidity at better terms. The second model of SCF emerged as many large companies began sourcing their raw materials from SMEs around the world. The key enabler here was the development of technology platforms with two innovative features. First, these platforms connected all counterparties around the world, and second, they made it possible for multiple credit providers to connect and compete on financing, with the expectation that lower cost receivables financing would attract more suppliers. Despite these innovations, participation in SCF has never fulfilled expectations, due to a number of inhibiting factors. First, legal and accounting standards in many countries do not recognize e-invoices and other electronic documents as legally binding. Second, the low cost of capital in the mid-2000s virtually eliminated the marginal advantage of credit arbitrage between large corporate buyers and SME suppliers. Third, linking suppliers with banks' proprietary platforms proved to be cumbersome and expensive. While the second model of SCF reached a modest level of success in previous years, the failure to achieve critical mass has prompted many companies to abandon SCF programs. Ultimately, the third model will integrate the pieces of the financial supply chain from end to end, fully automating the buyers' procure-to-pay and suppliers' order-to cash cycles. This new level of integration will support event-triggered financial services along the physical supply chain (e.g., purchase order tracking, invoice matching services, e-invoicing, open account payments, import/export financing, reverse factoring) and afford full transparency into each transaction. The integration of procurement, invoicing and financing within a single platform represents he full convergence of cash management and trade finance.

Win-Win-Win: Better liquidity, more efficient capital allocation

SCF is a rare example of a tripartite value proposition for banks, buyers and suppliers. First, it helps banks optimize use of capital by reducing the consumption of risk-weighted assets, as counterparty risk shifts to larger buyers with a better risk profile Second, the credit differential among investment grade buyers and their SME suppliers is wide enough in the current funding market to make the credit arbitrage of reverse factoring an attractive way to improve liquidity for both buyers and suppliers. Third, the more efficient, automated credit mechanism of SCF strengthens each link of the supply chain, thus decreasing buyers' operations risk. Finally, elimination of paper processing can reduce processing times of 30 to 60 days to approximately 10 days, enabling suppliers to offer better discounts for early payment.

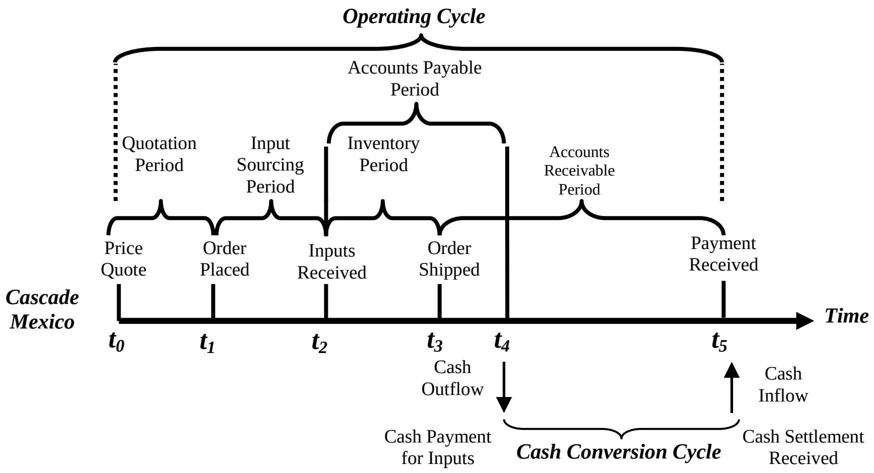
10.3.3. Working Capital Management

Working Capital Management and Commercial Lending

Working capital management in a multinational enterprise (MNE) requires managing current assets (cash balances, accounts receivable, and inventory) and current liabilities (accounts payable and short-term debt) when faced with political, foreign exchange, tax, and liquidity constraints *(Halpern, P., Weston, F., Brigham, E., 1998).*

The overall goal is to reduce funds tied up in working capital while simultaneously providing sufficient funding and liquidity for the conduct of global business. Working capital management should enhance return on assets and return on equity and should also improve efficiency ratios and other performance measures.

Figure 10.6 Operating and Cash Cycles for Cascade Mexico



Source: Working Capital Management in the MNE, Pearson Addison-Wesley, 2004

The operating cycle of a business generates funding needs, cash inflows and outflows (the *cash conversion cycle*) and foreign exchange rate and credit risks. The funding needs generated by the operating cycle of the firm constitute *working capital*. (Figure 10.6)

The cash conversion cycle, a subcomponent of the operating cycle (working capital cycle), is that period of time extending between cash outflow for purchased inputs and materials and cash inflow from cash settlement. This is decomposed into five different periods (each with business, accounting, and potential cash flow implications): Quotation period, Input sourcing period, Inventory period, Accounts payable period, Accounts receivable period.

If *Cascade Mexico*'s business continues to expand, it will continually add to inventories and accounts payable (A/P) in order to fill increased sales in the form of accounts receivable (A/R).

These components make up *net working capital* (NWC):

NWC = (A/R + inventory) – (A/P)

The previous exhibit illustrates one of the key managerial decisions for any subsidiary: Should A/P be paid off early, taking discounts offered by suppliers?; The alternate form of financing for NWC balances is short-term debt.

A common method of benchmarking financial management practice is to calculate the NWC of the firm on a "days sales" basis. An analysis of this metric in a global context shows that US firms have a typical days sales of 29, while the European group has a day's sales of 75. Clearly, European-based (technology firms in this example) are carrying a significantly higher level of net working capital in their financial structures. The MNE itself poses some unique challenges in the management of working capital. Many multinationals manufacture goods in a few specific countries and then ship the intermediate products to other facilities globally for completion and distribution. The payables, receivables, and inventory levels of the various units are a combination of intra-firm and inter-firm. The varying business practices observed globally regarding payment terms – both days and discounts – create severe mismatches in some cases.

Net Working Capital (NWC) is the net investment required of the firm to support on-going sales. NWC components typically grow as the firm buys inputs, produces product, and sells finished goods (NWC is not the same Current assents and Current liabilities) *(Pearson Addison-Wesley, 2004).*

Essential Indicators of FSCM

1.Days Inventory Outstanding: Inventory/(total revenue/365) - *DIO*: *Year-end inventory plus LIFO reserve, divided by one day of average revenue.* A decrease is an improvement, an increase a deterioration.

2.Days Payables Outstanding: AP/(total revenue/365) - DPO: *Year-end trade payables divided by one day of average revenue.* An increase in DPO is an improvement, a decrease a deterioration. For purposes of the survey, payables exclude accrued expenses.

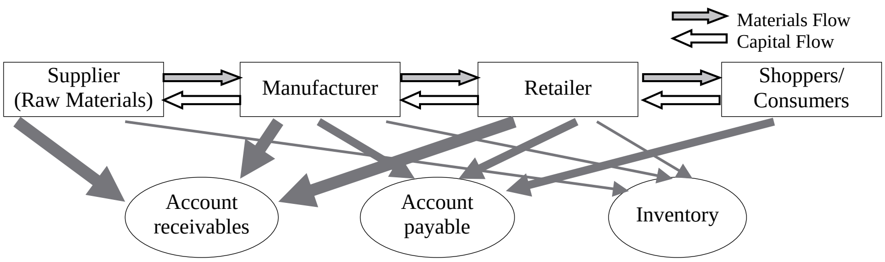
3.Days Sales Outstanding: AR/(total revenue/365) - DSO: *Year-end trade receivables net of allowance for doubtful accounts, plus financial receivables, divided by one day of average revenue.* A decrease in DSO represents an improvement, an increase a deterioration.

4.Days Working Capital: (AR + inventory - AP)/(total revenue/365) - DWC: *Year-end net working capital (trade receivables plus inventory, minus AP) divided by one day of average revenue***.** The lower the number of days is, the better. The percentage change is marked N/M (not meaningful) if DWC moved from a positive to a negative number or vice versa *(Pearson Addison-Wesley, 2004).*

10.3.4. A new financial solution: Factoring and Reverse Factoring vs. Commercial Credit

Factoring classic and normal financial collaboration between supplier-manufacturer-retailer is made by commercial credit. Factoring is a new comprehensive finance business including commerce financing, credit survey, receivables administration and credit risk guarantee. It refers to a finance business in which the seller sells his receivables to the factor who will press for the receivables. We can divide the factoring business into domestic factoring and international factoring according to whether the supplier and the buyer being in the same country or territory. In international factoring, the domestic factor asks the factor in the corresponding country to convey the credit of the buyer and give according to the order between the exporter and overseas buyer through international factoring organization. The domestic factor buys the receivables of the seller, and granting financing to the seller in advance in his bound, and then press for the receivables. As the domestic enterprise credit system has not been built, it would be difficult to develop domestic factoring business, next we will discuss the international factoring business with the supplier in China for example and the buyer abroad. *(Li, L., Wei, G.)*

Figure 10.7 Typical supply chain financing



1. Financing from Cash in advance. This means companies may collect cash in advance from the buyers to create a short term cash inflow/financing. This method is based on the companies' commercial credits. Funding cost is lower. Usually it's adopted in the long production cycle, higher selling price, highly demanded products. For instance, real estate developer often requires the resident/buyer to pay a certain percentage of the total selling amount in advance, so as to borrow money from the buyers to partially release the funding pressure. But this method is seldom applied by SMEs on the supply chain.

2. Logistical warehousing financing. This means companies pledge the inventories or the products in transit to the financial institutions to generate financing. At present, logistical warehousing financing could be divided into two categories. One is vertical credit-authorizing model. Commercial banks analyze the logistic companies business performances and grant credit facilities to those logistic companies. Logistic companies have to be responsible for the credit administration and risk control. Under this model, commercial banks may reduce their credit operating costs and transfer out the credit risks. The other one is inventories financing model. Commercial banks cooperate with logistic companies and jointly provide inventories financing to the companies. The banks must provide special service platform and management account to inventories financing, as well the credit risk evaluating abilities. Logistic companies provide logistical and information support to companies.

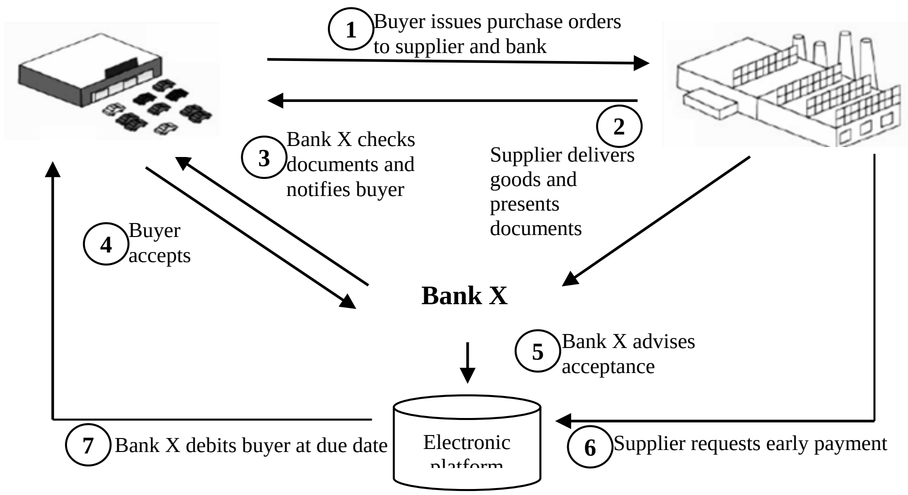
3. Account receivables financing. This means to obtain financing from financial institutions against account receivables, including two methods: a) Pledge the account receivables. That is the Borrower pledges the account receivables to the bank to get financing in advance, and repay the bank once it receives the payments; b) Factoring. That is packing the account receivables to commercial banks or factoring agents to get financing and the borrower, meanwhile, give up the reimbursement rights.

While it seems firms generally adhere to industry norms, there is evidence they vary credit terms from customer to customer *(How Working Capital Works, The 2011 Working Capital Scorecard – CFO, July 2011).*

The win-win approach

The win-win approach in particular has received much attention at recent finance and academic conferences. Going beyond the simple adaptation of payment terms, finance professionals have combined financial insights with electronic payment platforms and thus created *reverse factoring* solutions. As the name reveals, reverse factoring solutions are based on factoring – a transaction in which suppliers sell receivables to factors for immediate cash *(Seifert, 2011).* Because the receivables are sold rather than pledged, traditional factoring is different from borrowing – there are no liabilities on the suppliers' balance sheet.

Figure 10.8 Going into reverse



Source: Seifert, R.; Seifert, D., 2010. Financing the chain - ECR Journal, Volume 10, No. 1, Spring 2011, p. 33-44.

Typically, suppliers sell receivables from more than one buyer. Thus, factors have to evaluate buyer portfolios before entering an agreement. This has made factoring an expensive source of finance in emerging markets. A lack of historic credit information or credit bureau, as well as fraud and weak legal environments, have meant high operating costs.

Reverse factoring, however, is different in three important aspects *(Seifert, 2011).* First, since the technique is buyer centric, factors do not have to evaluate heterogeneous buyer portfolios and can charge lower fees. Second, since these buyers are usually investment grade companies, factors carry less risk and can charge lower interest rates. Third, as the buyers participate, factors obtain better information and can release funds earlier. As a process, reverse factoring is slightly more complicated than traditional factoring. Bank X's process, for example, involves seven steps. First, the buyer sends a purchase order to the supplier and notifies Bank X. Second, the supplier delivers and presents documents to Bank X. Third, Bank X checks the documents and notifies the buyer. Fourth, the buyer approves or rejects. Fifth, Bank X notifies the supplier of the buyer's acceptance. Sixth, if the supplier requests early payment, Bank X credits the supplier's account. Finally, when the invoice is due, Bank X debits the buyer's account. (Figure 10.8)

10.3.5. Good Practices in Romania and Community acquis

The Directive 2000/35/EC was transposed by the Government Emergency Ordinance regarding measures to combat late payment obligations resulting from the execution of commercial contracts, adopted in 24 October 2007.

The directive adopted by UE in 24 January 2011, replacing the Directive 2000/35/EC mentions that, if the payment due date or time is not set in the contract, the creditor is entitled to charge the interest on late payments after 30 calendar days from the date of invoice or an equivalent request for payment. As a general rule for businesses, the payment deadline specified in the contract should not exceed 60 days.

According to the document, in case of public organizations or public institutions that provide medical services, for payment terms can be extended by 60 days. The Directive also provides compensation for recovery costs, represented by a fixed amount of 40 Euros; the creditor is entitled to obtain from the debtor as the minimum compensation, without being necessary a notice.

The commercial relationship

The commercial relationships between economic agents open the possibility of a mutual credit relationships, also called commercial credit, that can appear when selling the merchandise, as the delay of payment or when buying the raw materials and necessary materials for producing the goods.

A mutual transfer of resources takes place and the commercial credit covers an important part of cash flow in the economy.

When closing a commercial contract, the parts can negotiate, aside from other conditions, the payment term. It is as important as the other commercial conditions.

In the daily practice, the seller accepts, maybe more easily, the solicitation for extending the payment term made by the buyer. It is a very commune practice when negotiating with the big commercial chains. For contracts with fixed object or limited to a single commercial operation, increasing of the period for payment may be accepted by the seller, the commercial implications being minimal.

The situation is completely different in the case of long term commercial contracts. Here, any additional slip may have long term negative effects for the producer

We have met many situations where the seller or his representative accepted more easily the request of the retailer for the extension of the payment term. There have been situations where this point has been the first one from the list to be accepted, without any attempt to negotiate.

For the moment or during the year, the effects of the extension are not noticeable. In time, they can be damaging for the seller. To deal with an increasing term each year, he will have to search for additional funding sources or to operate on reducing the production costs.

On the other side, for the reseller, the increase of the payment term can be a strong source for refunding.

The advantages for the retailer: Wining an image in front of his clients offering fresh products always; The increase of the products rotation speed; Reducing the stocks in the store; Reducing or maybe even eliminating the lost.

The advantages for the seller: The repartition of production capacities on the whole duration of the day. In this way it is eliminated the augmentation of work time in the morning. In addition you can use production capacities thus released to serve new customers; Largest rotation of its products; Reduce or eliminate returns; Financial savings.