News and Views

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Receivables Servicing and Financing – Here we go again!

This is our first news and views letter as a reunited group. Looking back in time, the sector concerning receivables processing and financing is more or less where it was some 15 years ago. Banks have through time increased their interest in the product, receivables, and payables financing. They not only developed some technologies to handle the required processes but also collaborated with providers – fintech companies – wherever they could find them. Most of the latter have a technology which is more developed than the banks' own technology but still not quite adaptable to the new forms and shapes of processing receivables and payables. The traditional fintech companies in the receivables and payables sector, which we can also refer to as supply chain finance platforms, SCF platforms, SCFPs, reverse factoring or supplier finance service providers, have appeared and disappeared over time. Some reached an ongoing concern, but many survived only thanks to the capital injection from mainly their users, mainly banks, who needed to react to keep things going for their clients. Is this accurate or ideal? No, but it is what it is. Will this change in the near or mid-term? Possibly not. The companies engaged in supplier finance, basically handling the discounting of receivables from small and mid-sized suppliers on trades with acceptable or well-rated (larger) buying groups (buyer-sponsored program) will be able to keep earning some income. But as long as their pricing remains competitively thin in consideration of the technology and solution, as it will remain easily replicable. It is what it is - certainly not too innovative and little sustainable. Despite this, it is a service which can be easily approved by the ever-complex product and credit committees of main financial institutions - banks.

Credit insurance companies were originally not enchanted with this service but with time they gave in and started supporting it by providing credit capacity to some few programs and later to more programs. Then when an accident happens, i.e., the obligor in the program is downgraded or files for bankruptcy, the insurers rapidly contract, usually securing the collapse of the program and increasing the claim level. Will this change in the future? Based on recent experiences, most probably.

Is there a future, a modern and innovative secure future, in the receivables and payables processing and financing space? Possibly. But it must be approached differently. It must be redefined with the consideration of focusing on seller sponsored programs and using more technology, enabling "painless" handling of client/customer onboarding, flexible eligibility processing, accurate credit methodology, automated notifications and alerts, automated credit actions, flexible pricing according to portfolio type, as well as industry and the management of counterparty risk aspects. Funders, especially banks, asset managers, insurances, pension funds must rely on a technology as the one described above. It could be owned by a fintech, a bank, a securitization management company, or other entities. Product committees must grow in this thinking direction to create the path of this more complex but rewarding business model.

Whilst fronting the services, the owner of the technology might opt to also front the financing and at times offer participation to other funders, syndicate of investors. Well, this could be tricky. If not controlled, some fronters of larger programs will practice skimming the spreads, leaving the return to the participating investor barely to an "acceptable" level. Ideally, this should be handled differently. The originator, the seller of receivables, should be responsible for approving the return to investors,

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participants, in consideration of a pre-agreed and disclosed spread kept by the fronting funder in consideration of the overall service provided.

If the originator wants to link its relationship funder, usually a bank, to the program, that is fine, but it must be able to handle the servicing risk appropriately – ideally, by using the bank's own technology or platform. If this is not possible, when outsourcing the servicing of an originator, seller, sponsored program (the opposite of a supply chain type program which would be buyer-sponsored), one should really take the business model of the servicer (fintech), financial situation, products managed, credit management capabilities (dunning and claim management functionalities), ownership structure, reputation, etc. into consideration. If we were to filter them all today, few would make it, if any.

Credit insurers do appreciate now engaging in the receivables and payables financing business, and usually if the premium is right. How much is a "right premium"? Too much hardly ever is good, right? We have seen cases where the credit capacity was "excessive" and the premiums as well. This lasted for a while until the first collection cases were triggered and then, bang! Program dead. It is imperative that the team and in general the credit committee at the insurer also understands the benefit of the specific business model and equivalently, yes equivalently, the quality of the administration of the programs, particularly taking into consideration the operations related credit criteria and management capabilities. Once, discussing the onboarding of a credit insurance onto a challenging but not bad credit program and highlighting the importance that the entire relationship and dependencies spectrum had to be understood to be able to judge the overall risk with the CEO of a very large industrial group he said, "just be patient and keep on explaining". There is nothing else one can do, particularly if one requires that the credit insurance takes real credit risk whilst becoming a valuable partner in the program.

What is fair, "fair pricing". This is really a delicate subject and its definition is usually not well managed. Even when it all could be very straight forward. Basically, if the program has access to a well-structured, credit sensitive, flexible, and sufficiently automated processing platform, the pricing should be based on an overall credit assessment of the components of the program, e.g.:

- Supplier (Originator selling receivables)
- Portfolio of buyers (region, payment history, number of relationship years, product, individual and sovereign risk)
- Product (receivables based, payables based, both – "distribution financing", who pays the fees)
- Platform (security, flexibility, automation, credit reactiveness, level of automation, all based on the level of service complexity and also the owner, location, profitability)

It would be relatively easy, based on the above parameters, to rate the overall program (GPR – Global Program Rating) and recommend considering, mainly to the good participants, funders and credit insurers. We have developed a formula for this, and it can be used upon a requested case. Ultimately, we can define a premium, a financing fee depending on the capital quality of the funder, and an implied servicing fee which will ultimately need to consider the level of automation of the servicer.

Here we go again!

Kendall Stevens, President & CEO of KS-TF AG

After having built reputable and sustainable operations which became market leading, KS-TF AG, Switzerland based, was created as a consulting company and consists today of professionals with expertise in the trade processing and financing space, covering the disciplines of legal, credit, operations, strategy, structuring and software development. The latter in cooperation with suppliers of software dedicated to our services.