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*Strategic, Advanced Content for Today's Finance Leaders*

*Session: 120*

**Supply Chain and Logistics in China -  
Merging the Physical and Financial  
Supply Chains**

**Mr. David Leong  
Director**

**Head, Trade Sales & Supply Chain China  
Standard Chartered Bank**

**Mr. Patrick Whalen  
Global Financial Risk Manager  
E.I. DuPont**

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# Supply Chain and Logistics in China

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## China - Merging the Physical and Financial Supply Chain

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# Introduction to Standard Chartered

- 1853 - The Chartered Bank was founded by James Wilson by grant from Queen Victoria
- 1862 - The Standard Bank was founded by John Paterson in South Africa
- 1969 - Friendly merger of the two banks leading to the forming of Standard Chartered Bank
- 2005 - Total Assets: US\$ 215Bn  
Net Revenue: US\$ 6.7Bn  
NPAT: US\$ 2Bn  
Presence in 56 countries  
1,200 branches + offices  
44,000 staff worldwide  
Long term credit rating A2 (Moody's) and A+ (S&P)  
Top 25 FTSE 100 company with a market cap in excess of US\$30Bn



“Leading the way in Asia,  
Africa and the Middle East”

# Standard Chartered Bank China

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- **Oldest foreign bank in China, continuous presence since 1858**
- **Leading foreign bank network in China**
  - Presence in *14 cities*
  - 11 branches in China
  - *RMB licenses in 7 branches*
  - 6 rep offices
- **Deep local knowledge & strong relationships with regulators**
- **Ranked the “Most Competitive Bank” in Beijing by PBOC in 2004**
- **Consumer Banking business in Shanghai & Shenzhen since 2002**
- **Made 19.9% investment into Bohai Bank, a new National Bank**

# Standard Chartered Network in China

## Current RMB Business Territories:

Shanghai, Jiangsu, Zhejiang, Shenzhen, Guangdong, Guangxi & Hunan, Tianjin, Dalian, Qingdao, Wuhan, Zhuhai, Guangzhou, Nanjing, Jinan, Fuzhou, Chengdu, Chongqing, Kunming, Beijing, Xiamen, Shenyang, Xi'an, Shantou, Ningbo



Branch  
Branch with RMB license  
Rep Office

# Physical v Financial Supply Chains?

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- **Physical Supply Chain**

- Information and processes related to the status and movement of the physical goods in transit or storage
  - E.g. Procurement, supply, logistics, Customs, quality inspection and regulatory aspects of the physical movement

- **Financial Supply Chain**

- Information and processes related to the status and compliance stages of the financial aspects of Supply Chain Management
  - E.g. Supplier and Buyer Finance process progress status, DC and Open Account term and progress monitoring

**Customer demand for the sharing of information and the collaborative use of common data e.g. the PO, Invoice and the BOL by all parties to a trade are driving the convergence of the processes**

# The Physical and Financial will merge!

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- **Changing trade patterns**
  - Free delivered duty paid on Open Account terms.... with slow demise of the Documentary Credit
- **VMI**
  - Vendor has responsibility to point of sale with some liability sub-contracted to the Logistics Provider
  - Collaboration in sourcing, financial services and logistics processes
- **Visibility**
  - Improved Quality Inspection; Track and Trace data and use of RFID techniques offers timely status and problem alert information
- **Collateral Management**
  - Visibility also gives the lender more control of the physical assets
- **Risk mitigation**
  - Closer relationships with the Logistics players now offer security and certainty over inventory through collaborative collateral management

# Different Zones...What do they mean?

***There are thousands of MNCs located in FTZs, EPZs and BLPs. These are strategic places for Supply Chain management in China***

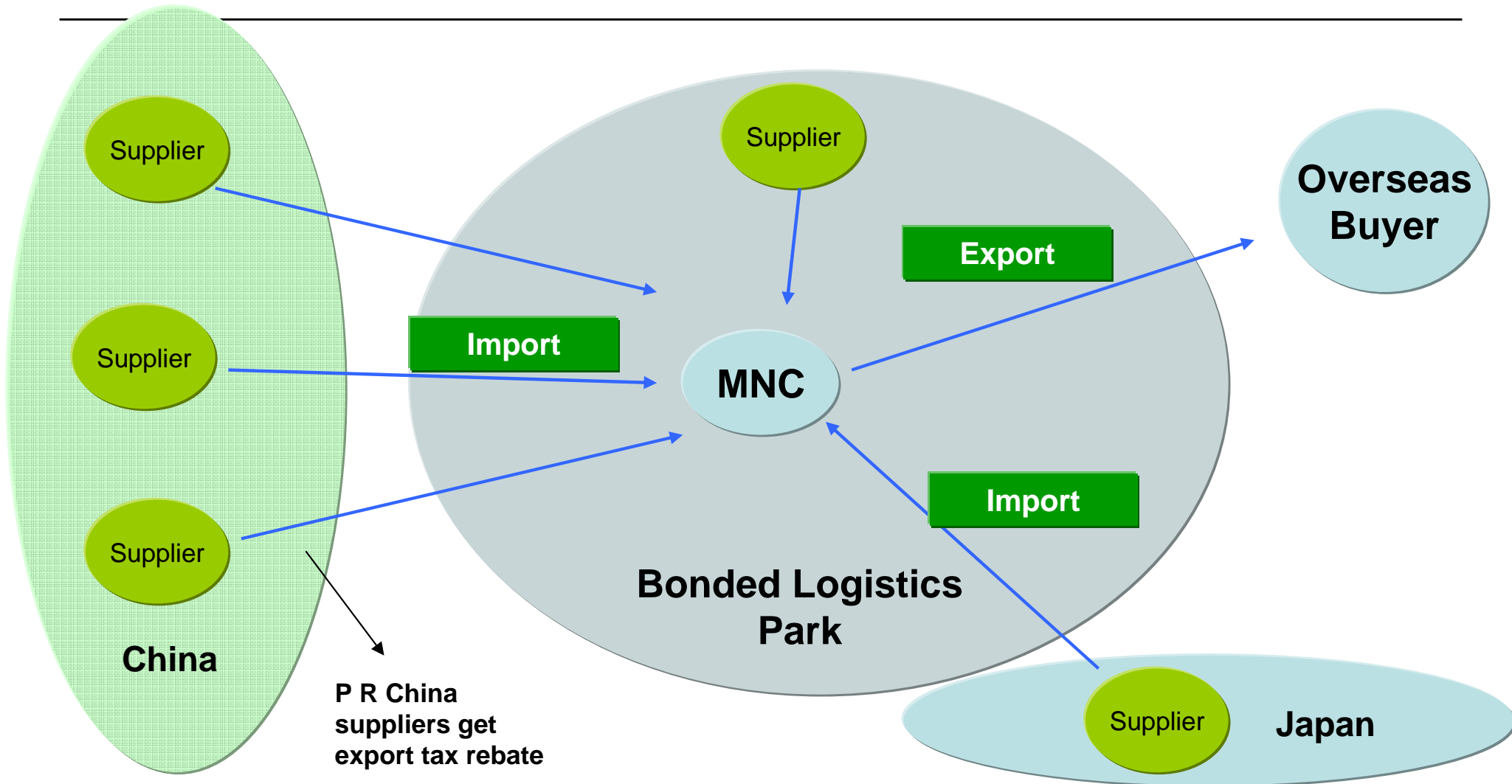
Free Trade Zone (FTZ)	Export Processing Zone (EPZ)	Bonded Logistics Park (BLP)
<p>Bonded</p> <p>Outside of China Customs Territory</p> <p>VAT rebate for domestic purchased goods only at the time of goods exit from China</p> <p>No import duty unless goods are sold domestically into China</p>	<p>Bonded</p> <p>Outside of China Customs Territory</p> <p>No VAT and import duty for buyers and <b><i>companies selling to buyers in an EPZ enjoy export tax rebates</i></b></p>	<p>Bonded</p> <p>Warehousing, Logistics, Simple Processing</p> <p><b><i>Companies selling to buyers in a BLP will enjoy export tax rebates</i></b></p> <p>BLP companies enjoy VAT rebates for sales to domestic customers</p>

# Advantages of Bonded Logistics Parks

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- VAT export rebates available to sellers to buyers in BLP
  - E.G. No need to move goods physically into Hong Kong and back again to qualify
- Lower logistics costs as a result
- Less paper work in terms of customs forms and declarations
- Better control of supplier delivery, performance and quantity

# Transactions in BLPs



# Global MNCs Supplier Management Direction

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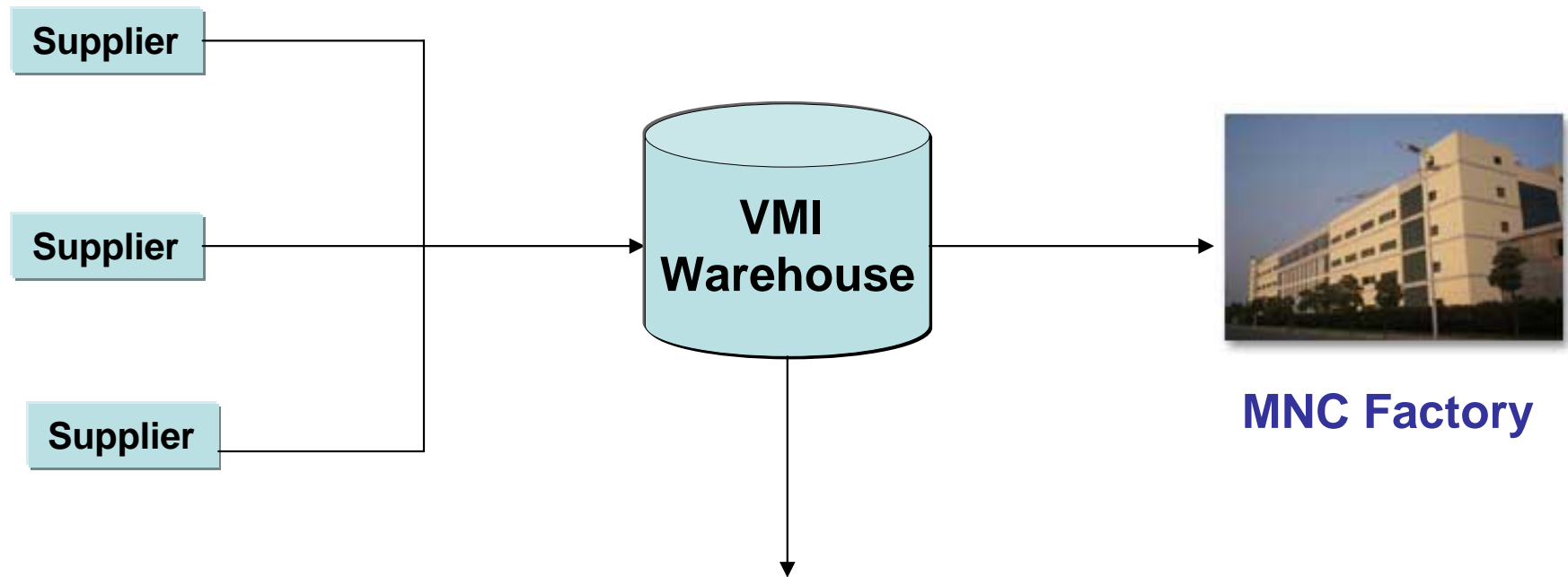
- Single or fewer key strategic suppliers
- Almost exclusivity in key product lines if possible
- Commitment of volumes of production
- Logistics collaboration including supplier warehousing and inventory holding
- VMI.....

# Sourcing Strategies and the Role of China

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- China IPO's – increasing role being played
- 36% of IPO's in China are by US Companies, Germany is second with 17% *(source Jamie Bolton – Accenture)*
- Major 3PL players are working closely with MNC's on “end to end” logistics and supply chain management processes that now include the financial aspects of the trade cycle

# Vendor Managed Inventory (VMI)



Inventory in 3PL VMI Warehouse “belongs” to Suppliers

1. Typical inventory period of 3 – 4 weeks
2. Suppliers require financing during inventory storage
3. A large number of such transactions in Bonded warehouses

# Sales Distribution Trends in China

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- Interlink between distribution and logistics
- Logistic companies branching into Fulfillment and Distribution Companies – taking on client sales and risk management as well
- MNC's largely still reliant on local distributors for almost 30 – 100% of sales in China
- MNC's prefer to keep distributor/dealer numbers lower for cost and supply control management
- Miss-match of interests between Sales and Finance in MNC
- Working capital squeeze on distributor
- Distributors require financing on inventory and AR

# Impact on Financing the Supply Chain

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- Financing Models need to be innovative to meet the changing demands of the physical supply chain flow
- Open Account trade is growing fast. Banks need to adapt to meet this need while still serving the documentary trade market.
- They need to understand the regulations and the different trading patterns that are emerging in order to structure trade finance
- Paperless, electronic and cross border capabilities are required
- Working capital needs will shift from the MNC to the Supply Chain Partners and their trading partners

# Example of Growth Impact on a Supplier

White Goods Electronics Supplier wins exclusive contract manufacturing business from MNC to supply world wide.... but terms have changed....

USD'000	DSO / ratio	Amt	DSO / ratio	Amt	% growth
Sales		15,000		30,000	100%
COGs	0.8	12,000	0.825	24,750	106%
AR	60	2,465.75	120	9,863.01	300%
Inventory	60	1,972.60	90	6,102.74	209%
AP	15	493.15	15	1,017.12	106%
<b>WC GAP</b>	<b>105</b>	<b>3,945.21</b>	<b>195</b>	<b>14,948.63</b>	<b>279%</b>
WC Financing Cost	8%	315.62	12%	1,793.84	468%
Equity		2,000.00		2,000.00	0%
Gearing		1.97		7.47	279%
Gross Profit less Finance Cost		2,684.38		3,456.16	29%
Gross Profit Percentage		17.90%		11.52%	

**Supplier needs to raise additional WC financing as required, accept lower gross profit, longer credit terms and the higher interest rate cost of borrowing.**

# Traditional Credit Evaluation By Banks

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- Historical financial performance and standalone credit analysis still the main method of evaluation
- Minimal or no formal evaluation method on the supply chain linkage
- Collateral or guarantees driven lending to SME and Middle Market segment
- Most global banks still operate Supply Chain models focused on LCs or Cash Management systems to provide traditional cash management solutions.

# Traditional Credit Evaluation By Banks

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- In traditional form of credit evaluation, the following factors are viewed negatively:
  - High Gearing or Debt / Equity ratio
  - Concentration risk on Supplier or Buyers
  - High debtors days turnover
  - High inventory or stock levels or turnover

# Can This Be Done Differently?

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- Supply Chain Finance Programs need to be developed
- Supply Chain Scorecards based on supplier or distributor selection and monitoring policies
- Higher points for stickiness of SC partners to the MNC and vice versa
- Lower risk of credit default as linkage with leading MNC supply chains is strong
- “Visibility” is used as a risk mitigant. Shared data is the key.

# Supply Chain Financing Solutions

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- Vendor (Supplier) Financing
  - Post Shipment Financing
  - Pre Shipment Financing
  - Inventory Financing (VMI)
- Distributor Financing
- Receivables Financing and Risk Management

# Financial Industry Landscape in China

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- Local bank dominated with BOC, ICBC, CCB.
- Foreign Banks restricted at the moment but with WTO liberalization at the end of 2006 (2% market share)
- Expected to see more influx of investments by foreign banks into local banks
- Limited unsecured lending to SMEs in China and expected to continue

# Case Study

## Electronic Cross-Border Supplier Finance

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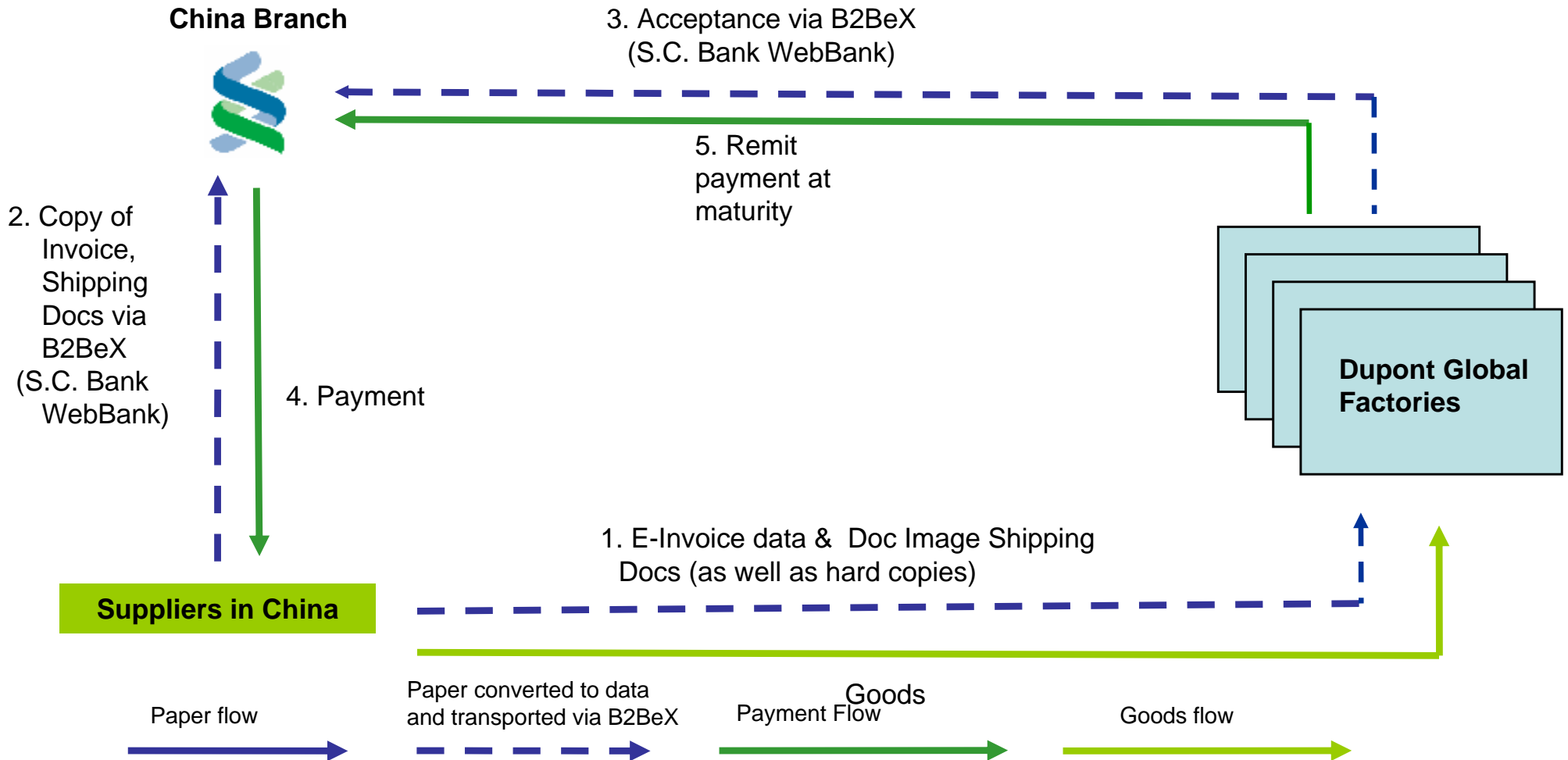
- First electronic (paperless) and cross-border deal for financing of Dupont's suppliers in China supplying to Dupont's entities around the world
- Transaction Live and Dupont targets to put through US300M worth of purchase through the program by end 2006
- Expanding to Domestic Supplier Program
- *Structure on next page*



# Case Study



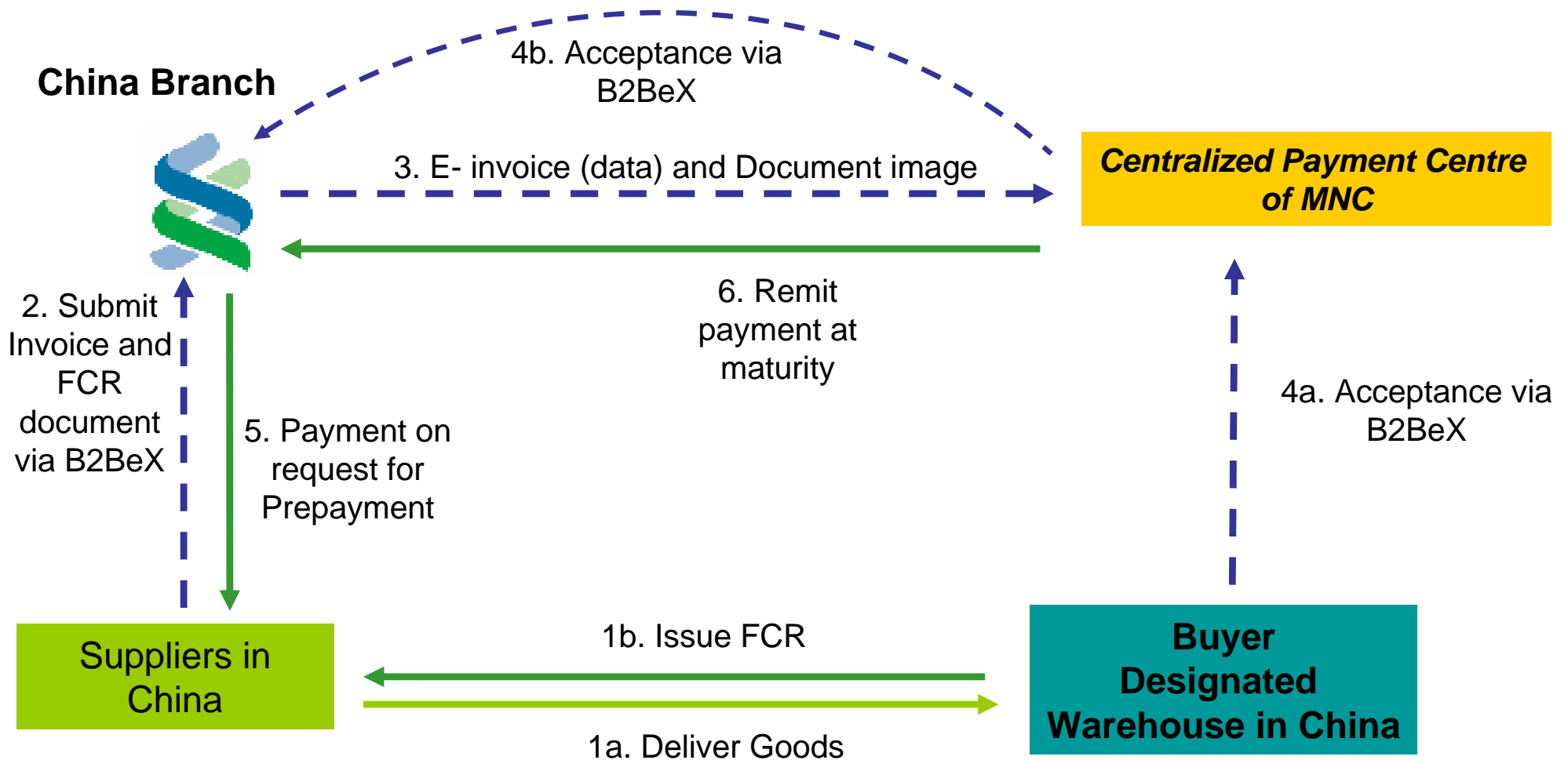
## Electronic Cross Border Supplier Finance Program



# Case Study



## Electronic Cross Border Supplier Finance Program



B2BeX Flow

Payment Flow

Goods flow

# Summary

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- The Move from Letters of Credit to Open Account Trade has happened...and is moving fast
- Sourcing and logistics strategies of MNC's and the move to VMI have had significant impact on the working capital needs of Chinese Suppliers
- Distributors of MNC's in growing consumer markets such as China and India need innovative working capital finance products
- Banks need to change and provide more innovative Supply Chain Finance Solutions that recognize the changes in global trade patterns and the convergence of the physical and financial aspects of Supply Chain Management