

Supply

MANAGEMENT
INSIGHTS

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SUPPLY CHAIN FINANCE

A win-win situation for all



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Dear Readers,

As uncertainty rises in the world market, flexibility is the order of the day. To achieve this, companies are now more than ever dependent on cooperation with suppliers – one of the most important tasks for procurement now and in the future.

In our focus topic, we show how you can create financial flexibility by implementing supply chain finance programs and at the same time take the relationship with your suppliers to a new level: Towards close cooperation which is beneficial for both parties.

Another way to optimize working capital is to reduce lead times and thus avoid tying up capital in transit. The new Silk Road offers this possibility – we have investigated the acceptance and potential of the route.

We interviewed Tony Yu, our General Manager in China, about this and other current events affecting the supply relationship between European companies and their suppliers.

We hope you enjoy reading it,

Thibault Pucken
on behalf of the Managing Directors



p. 4

Supply Chain Finance

Creating flexibility and optimizing cash flows together



Road and belt initiative

Shorter lead times and lower capital commitment

p. 18



Raw materials study

Economic slump expected

p. 22

Procurement transformation

Awakening to cooperation

p. 26



Interview

Economic developments in China

p. 30



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WIN-WIN-WIN

Everyone is a winner with
supply chain finance

These uncertain times in the global market call for flexibility. But to be able to respond flexibly, it is essential to have large cash reserves available. Companies and their suppliers are coming to a head as they both seek to optimize their working capital. So, what's the answer? Reverse factoring.



The German car industry was once the shining beacon of the stock market, and served as a role model for many other sectors. Thanks to superior engineering skills, the big corporations enjoyed fantastic growth, high profit margins, and expansion into more and more countries. Suppliers benefitted from the knowledge of experts in their field and gained loyal partners. One company's ideas would fuel another's, and vice versa. There was a time when an economic crisis in the sector was unfathomable.

But just a few years later, top managers at automotive manufacturers and suppliers started to become agitated. Companies have been rocked by the diesel crisis, the trade war is stepping up in the Asian and US export industries, Brexit is creating uncertainty in the European Union, and billions of dollars are needed to invest in innovations such as electro mobility.

Now, it is all about savings, leaner processes, and liquidity. Even in sectors with well developed supply chains and firm interdependencies between manufacturers and suppliers, nothing is possible without close cooperation based on mutual trust. This is true, not least for the automotive industry at the moment, but also for practically every sector – from the chemical and consumer goods industries to mechanical engineering. >

Even in sectors with well developed supply chains and firm interdependencies between manufacturers and suppliers, nothing is possible without close cooperation based on mutual trust.





/ Supply Chain Finance

The use of financial instruments to **manage working capital and liquidity more effectively**. This method, involving the various stakeholders along the supply chain, is not based on the traditional format of lending. Supply chain finance first emerged in the early 1990s, but has been growing in popularity worldwide since the 2008 financial crisis.

But financing solutions are available to help suppliers, companies, and investors alike: **supply chain finance**, or more precisely reverse factoring. It is intended to secure a company's own liquidity as well as the strategic supplier's. As the financial crisis came to an end, the new way of optimizing financial structures gained popularity for the first time. Supply chain finance has since become a firm favorite for many firms.

With reverse factoring, a company outsources its supplier's receivables to an investor, which then assumes the interim financing for a fee that is lower than the refinancing rate.

For example, a supplier charges its customer, a mechanical engineering company called Techlife, €100,000 for 100 tons of steel. In order to work with the €100,000 for as long as possible, the customer seeks to secure a payment term of 90 days. Yet, the supplier needs the money as quickly as possible to replenish its stock of raw materials. >

Payment terms often pushed back to 90 days

Ultimately, it is about creating high cash reserves and low stock supplies. Investing smartly can work for companies and generate returns, despite the low interest rates. Liquid reserves are also needed for procuring at the right times, such as when the price of a raw material drops in the short term, therefore reducing risk and making procurement much more flexible.

Suppliers are also striving to create the highest possible cash reserves and optimize their working capital. Since the financial crisis, it has become increasingly difficult for SMEs to obtain a loan at an interest rate they can afford, as a result of new regulations for financial institutions, such as Basel III or the upcoming Basel IV, this makes issuing capital considerably more difficult.

Customers seeking to extend payment terms are causing more problems for suppliers. When payment is delayed, this negatively affects working capital, creating bottlenecks in liquidity and, in the worst case, bankruptcy. One of the most feared risks for customers is non-delivery.

Ultimately, it is about creating high cash reserves and low stock supplies. Investing smartly can work for companies and generate returns, despite the low interest rates.



What to bear in mind when considering a fintech platform?



Portfolio of banks & investors

A more diverse portfolio means more competition, which could mean better conditions



Level of internationality & coverage of your procurement markets

It must be able to work with all your strategic suppliers



Software & interfaces

The platform must connect to your own IT infrastructure as well as your strategically important suppliers'



Customer service & support

Implementation and ongoing processes should be supported by the fintech, including support for suppliers



Refinancing is significantly cheaper

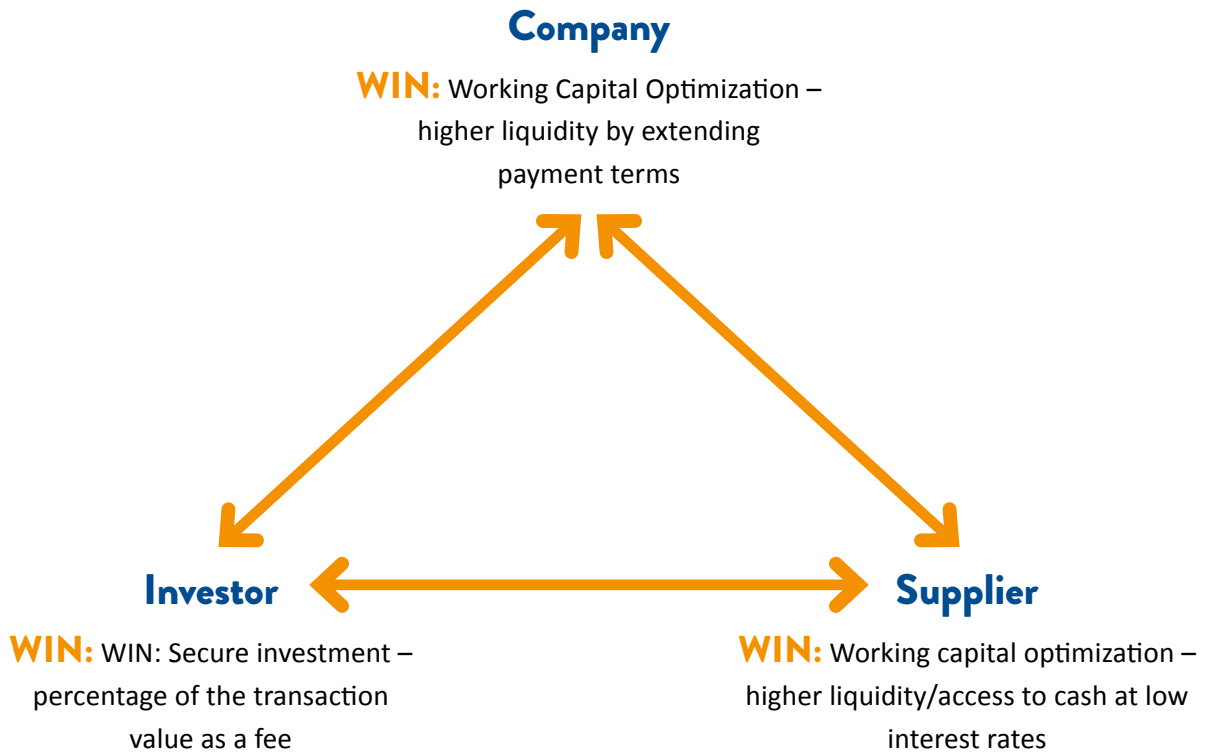
Instead of using its position of power and making the supplier wait for the money, the customer can arrange reverse factoring with the supplier. A **fintech** or a bank uses a platform that brings investors, suppliers, and customers together. The supplier now issues an invoice to its customer, which uploads it to the platform, functioning like a virtual marketplace. This has the advantage that several investors, mostly banks, are available for refinancing. They are now vying to pay the money to the supplier as quickly as

possible for a fee, and in doing so they accept that the end customer will only pay the invoice to them much later. Using the platform means companies operate independently from a single bank, which reduces the fee to be paid. It also massively reduces red tape for suppliers and customers. >

/ Fintech

Young companies have been disrupting the financial sector for some time. Fintechs are start-ups that operate between finance (fin) and technology (tech). One of the world's first fintechs was Paypal, now worth more than \$130 billion. Since then, a large number of specialist providers have cropped up, focusing entirely on supply chain finance.

Supply Chain Finance stakeholders – Everyone is a winner



In our example, the supplier Techlife submits the invoice, and asks an investor to pay it. Several investors bid to finance it on the marketplace, most for an interest rate just above the base rate, e.g. 1% per annum. The key factor is that Techlife is responsible for the entire transaction, as its credit-worthiness is at stake, which suits the supplier very well; otherwise, it would have to pay 3% to 4% interest for the refinancing.

The 1% fee covers both bank and fintech platform fee, in this case €250. Either Techlife pays this fee by transferring only €99,750 to the supplier, or the supplier pays it directly to the investor. The investor pays the supplier the invoice amount after just a few days. The customer Techlife, on the other hand, does not pay the investor's invoice until 90 days later.

In most cases, the fee is paid by the supplier. However, this is a negligible amount in the grand scheme of things, since the advantages of a higher working capital outweigh the fee. In the end, it's a win-win for all parties involved. >

With reverse factoring, the supplier does not need to worry about an inability to pay or delayed payments. And thanks to the buyer's solvency, it can benefit from a better interest rate.

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Close coordination needed

With reverse factoring, the supplier does not need to worry about an inability to pay or delayed payments. And thanks to the buyer's solvency, it can benefit from a better interest rate. All in all, the financing costs can be reduced significantly. It also involves the supplier forging a close, mutually dependent relationship with the customer, which can offer a competitive advantage over other suppliers.

As the customer, Techlife can also use its working capital sensibly over a long period, and does not need to worry about the supplier failing to deliver, thereby increasing stability in its supply chain and reducing delivery bottlenecks.

Banks and investors receive a fee for the financing on top of the base interest rate; the profit is the corresponding difference. This is a particularly attractive option in these times of low interest rates, as the interest can be passed on to other buyers.

Reverse factoring is not suitable for everyone, though. If customers and suppliers have access to very high cash reserves, then refinancing invoices just does not make sense. Although reverse factoring is perhaps the most crucial method in an uncertain environment for procurement at the moment, it is very rarely used, comparatively speaking. In most cases, this is because of the high amount of coordination required, and due to a lack of specialist expertise, not least the cooperation needed with external experts who support the team for months during the long process restructuring.

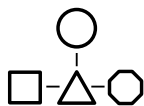




Five steps to score a triple-win in procurement



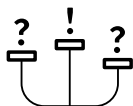
1. Get your departments on board



The department primarily responsible for supply chain finance is, naturally, the finance department. But to ensure the process is successful, this requires cooperation with other departments, such as accounting and legal. This is what makes supply chain finance so complex within a company. The procurement department's close involvement early on and a clear division of roles, with the support of management, are especially crucial for success. The procurement department coordinates with suppliers, while the finance department takes care of the conditions and the financial benefits.

Procurement is accustomed to working in cross-departmental teams, and as a networker within the company, is able to move the subject forward. Since it is this department that has the closest relationship with suppliers, it is this department that plays a key role in the process. Reverse factoring can only work if the suppliers are closely involved too.

2. Choose the platform

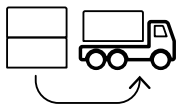


The next step is to decide which platform should be used to broker the reverse factoring. In theory, the financing could go through a single bank, but the conditions offered would not be as good as on a platform where several investors are competing against each other. When choosing the platform, it is essential to determine whether the IT system is compatible with the customer's. Is there a seamless connection via SAP, for example? In addition, the project team should check out the platform's references to see which banks it has as partners, what experience others have had with it, and how global the platform is. Whether the platform also works with suppliers from the USA or China is something that could be particularly relevant to global companies. Platform costs are usually negligible, and do not vary much, so this should have little bearing on the decision.

The procurement department's close involvement early on and a clear division of roles, with the support of management, are especially crucial for success.

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3. Select your suppliers



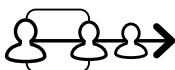
Procurement now needs to start getting in touch with suppliers. Before turning all the tried-and-tested processes on their head, it is worth first selecting a small group of suppliers to take part in a pilot. Ideally, these will be strategically important partners that have been supplying the company for a while, with whom there is already a suitable relationship of trust. Procurement must approach these suppliers systematically, and provide them with as much information as possible. A test phase is then agreed, during which both parties can familiarize themselves with the methodology and the platform, without being directly bound by an agreement. Each one of these tests initially runs as a single project, tailored to each individual supplier, and is only later summarized in an all-encompassing process. If these initial tests with suppliers are successful, additional suppliers can be contacted and incorporated. As more and more experience is gained, processes can be optimized on both sides.

4. Clear the legal hurdles



To prevent legal or even accounting difficulties, involving the legal and financial departments is a must. The agreement needs to be based on trade accounts payable and not become a financial service, because then there is a reclassification risk. This means that the contracts have to be rewritten early on to include an extended payment term. Refinancing is then independent of the actual contract. The supplier joins the fintech platform, and is paid through that platform, but has no written guarantee that it will actually be paid any earlier. The deal and the many advantages that come with it are based on trust instead. So, it is important to involve your company's own departments and suppliers in the planning as closely as possible.

5. Monitor the process



To make reverse factoring successful, it is important to clearly define the responsibilities and KPIs. Once all framework conditions have been agreed, the process is then managed by the finance department, but there must be rules on which issues involve procurement. After all, it is always the procurement department's job to communicate with suppliers. If the first pilot projects are successful, it is up to procurement to build trust with new suppliers and convince them of the benefits of supply chain finance. Finally, feedback is routinely required from each supplier to help identify any potential for improvement in processing.

CONCLUSION: Everyone is a winner

A supply chain is only as strong as its weakest link. If there is a weak link in the chain, this can harm business and, in turn, the company. These risks are difficult to predict and counteract, especially in these uncertain times. The key here is flexibility, especially in financial terms. A high working capital can be achieved through reverse factoring and subsequently boosted with other supply chain finance methods, such as dynamic discounting.

But supply chain finance done right can do much more for procurement. The intensive discussions and personal coordination needed help take the relationship with your suppliers to the next level – toward close cooperation that benefits both sides and can be extended to other areas in the future.



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Experts

on
**WORKING
CAPITAL**

Interview with **CEO Frank H. Lutz** on **working capital**

“Interest in working capital is on the rise”

Many companies are apprehensive about optimizing their working capital. This is where financial service provider marketplace CRX Markets can help. CEO Frank H. Lutz discusses why working capital has become such an important topic and which sectors can take advantage of it.

What do CRX Markets actually offer, Mr. Lutz?

We are a platform that facilitates working capital solutions. We work with companies looking for these solutions and banks offering financing. We receive a commission for our service, which depends on the amount financed. It is a very attractive proposition for companies, as they can see more quickly which provider provides the best conditions and can therefore reduce their administrative burden.

Companies understandably appreciate the improved transparency, but were banks critical of this at first?

Yes, of course. They were rather skeptical at the start. What helped, though, was that we were soon able to get some major customers on board. These acted as pioneers for us, as they told their banks that they would only be able to conduct their business through our platform in future.



Since then, however, most banks have realized that they have to remain flexible in order to be fit for the future and also be open to new concepts such as our platform. We also offer added value, opening a door for many banks that previously had nothing to do with working capital financing. They can now move into new business areas, all thanks to us.

What kind of financing solutions do you offer specifically?

We offer an all-inclusive package that takes care of everything, with solutions for both the asset and liability sides of the balance sheet. A major area for us is factoring: both classic and reverse factoring, with third-party financing. There are also offers based on discounts, such as dynamic discounting in which customers leverage their own solvency in our marketplace.

Is it worthwhile?

Absolutely. Interest in optimizing working capital is constantly on the rise. It has slipped under many companies' radars until now. I honestly don't know why it has taken them so long to become interested. But admittedly, when I was a CFO at other leading companies, it was always a side-issue.

Why are so many companies suddenly showing interest in this area?

Working capital financing frees up assets for use in other investments. In other words, in order to remain competitive, companies have to drive forward innovations that typically involve large investments. There is hardly any sector where this would not be relevant. The automotive industry is switching to new types of drive, the chemical industry is changing, and food manufacturers are increasingly focusing on sustainability and fair working conditions. There is also a lot going on in retail as well, such as supermarkets having to work with new delivery methods.



Is working capital optimization particularly suitable for industries undergoing transformation?

Yes and no. It certainly does help those types of sectors, but even in more stable sectors, working capital optimization is a responsible form of risk management. When I was CFO at MAN during the financial crisis, our bank told us one day that it was no longer able to carry out any transactions. We had to write the checks out for our suppliers ourselves. The only reason we could do this was because we had the funds we needed, and our capital was not tied up elsewhere. Maybe we didn't call it working capital financing back then, but it was what saved us.

Is crisis management the sole driver behind this?

Not at all. Corporate social responsibility also comes into it. We often view working capital purely through a financial lens. But you can also set other standards, such as fair working conditions with suppliers.

How can working capital financing help there?

As a customer, you could choose to offer your suppliers more attractive financing terms if their production methods are fairer, as we are seeing in the fashion industry.

Are there sectors you can see that are lagging behind?

I wouldn't call it lagging behind, but there are of course areas where working capital is not that important. Government agencies are one example, but there has also been little interest in the health sector so far.

So, there is good growth potential for CRX Markets?

Our growth does not just depend on gaining more and more customers. We also look at whether it is worth expanding our product portfolio. We built the platform as a marketplace, and now, in principle, we can offer almost anything through it. But of course, we always look at which products actually suit us. //

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Working capital optimization is not just a crisis management tool. It can also be used to make a company more competitive in the long term. Dr. Oliver Vogler, Managing Director for Western Europe at lighting manufacturer Ledvance, explains how.

Interview with Managing Director Dr. Oliver Vogler on **working capital optimization**

“Active working capital management makes any firm more resilient.”

Working capital optimization is nothing new of course, Dr. Vogler. But it is something that Ledvance has been focusing intensively on recently. Why is that?

The lighting business is a tough market. The transition from conventional technology to LED is shaking up every company. When we were spun off from Osram, 80% of our products were non-LED – now, just 25% are. Our LED light bulb suppliers are mainly located in China, which means long delivery routes. That, in turn, means capital is tied up for a long time. In order to remain profitable, we had to make some changes. We could work on increasing revenue and improving the profit margin, of course, but working capital is a very effective lever, particularly for a company like ours.

How so?

A core part of working capital optimization is mastering the product phase-in and phase-out over the life cycle, so you always have enough stock in the warehouse, without having too much. If you get it wrong, you will very quickly find yourself having to get rid of stock at marked-down prices. The main reason is that there are very short product cycles in the world of LED; many products, especially light bulbs, become obsolete after just a year, or even a few months. If we have a lot of models of a certain generation in stock, then we have to sell them at high discounts or, in the worst case, scrap them, which also costs money.

How do you avoid excess stock now?

Proper planning is very important. The ramp-up, i.e. the start-up phase, of a product must be launched early enough to give as much time as possible to sell a product before the next model comes out. Another important step was to change our corporate culture.



What was the problem there?

A large number of our sales managers were projecting too high quantities, because they were measured primarily by their sales figures, not by working capital indicators. It didn't matter to them whether the light bulbs were sat in the warehouse or even had to be scrapped in the end, as long as they achieved their sales targets. I couldn't really blame them. After all, like most companies, we were motivated by sales. Working capital optimization only works if the whole company is on board. Every single employee needs to keep track of the total cost of their decisions and we as management must clearly communicate the relevant KPIs and cash effects to everyone. Plus, we have to drill effective KPIs into everyone, and get rid of the old sales or growth-driven way of thinking.

But excess stock wasn't the only reason why LEDVANCE needed to optimize its working capital, was it?

No, of course not. There were other factors. We had to close some of our factories and make severance payments, which reduced our cash flow.

Our product range during the transition from traditional to LED-based products was also too wide. But we have fine-tuned the range over the past year or two, and focused on the products that are profitable. We have also completely streamlined our supply chains. Our new owner helped us a great deal with that.

Since 2018, you have been part of the Chinese lighting group MLS ...

Yes, and we have been through some major changes over the past few years. For a long time, we were part of Siemens, before being acquired by Osram in 2013. We then operated independently from 2016 onward, but now, we are part of MLS.

What major changes is the new owner bringing to your supply chain?

Firstly, there is a new geographical focus for us. More and more of our products are being manufactured in China, as production in Western Europe is on the decline. This is partly driven by the switch to LED technology, which is primarily manufactured in China, though of course this will also be optimized even further by our new owners. We increasingly rely on suppliers in China that can supply us with finished components; we then only assemble the lights. We are currently trying to bundle our suppliers, which is also where working capital comes in.

How so?

If we have just four suppliers instead of ten, we can give them more orders, which makes us a more valuable customer to them. That gives us more leverage in the negotiations, for example when it comes to negotiating prices or significantly extending our payment term and it has worked. Sometimes, we have agreed on more than 100 days, which gives us more breathing space in our payment process.

Isn't there a certain risk to that? What if one of your few suppliers stops trading or experiences problems on the long delivery routes to Europe?

We aren't naive. The more we depend on individual companies, the more difficult a problem would be for us. For a company like ours, having a second source is essential for every component. That's why we have a back-up plan for every product.

Our healthy working capital balance also comes in handy here. The more cash we have available and not in unused stock, the better we can cope with delivery problems.

So, ultimately, working capital is useful not only for responding to crises, but also as a means of prevention?

Definitely. That is one of the most important lessons we have learned in the transformation. A good working capital balance sheet makes any firm more resilient. That's why the process is still ongoing: there are always new approaches to consider. //



Uptake on **Chinas Belt** and Road Initiative

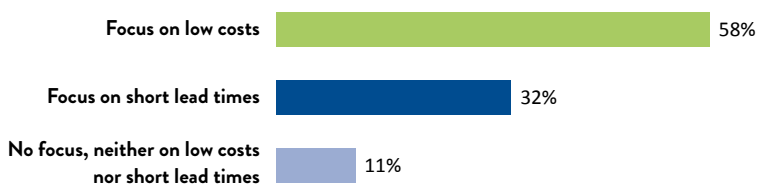
All aboard for the cargo train

Train travel between China and Europe along the New Silk Road continues to grow unabated. In 2018, more than 370,000 containers were carried on the route between east and west. With the train being substantially quicker than the cargo ship, the overland route offers faster lead times and a significantly lower capital tie-up: yet another building block in working capital optimization.

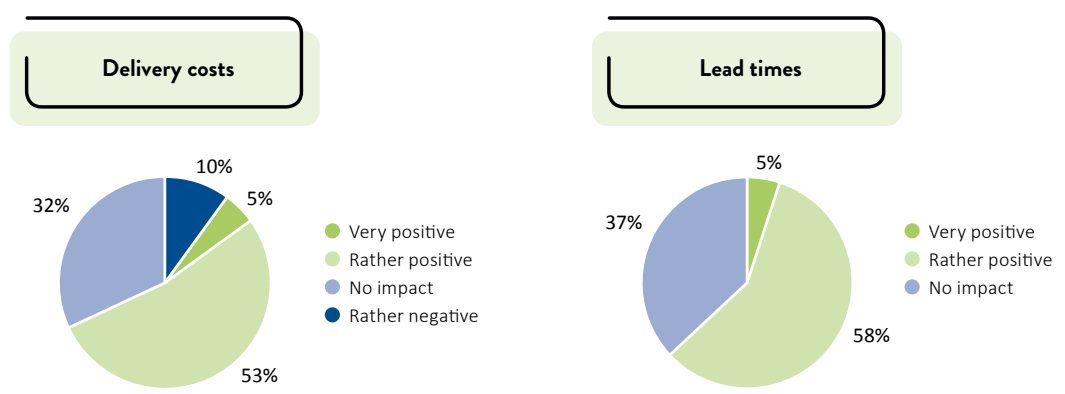
The Road and Belt Initiative does not refer just to a single railway line, but to an entire network of connections to northern China via Russia or Mongolia, as well as another route to central China via Kazakhstan, Russia, and Belarus. Destinations in Europe also include London, Madrid, Stockholm, and Hamburg.



/ What is more important to you - low costs or short lead times?



/ How do you rate the potential of the “New Silk Road” for your business in terms of ...?



Source: INVERTO Lead Times Study 2020

Trading consumer goods for construction materials

The most common items exported to Europe are textiles and consumer goods, such as domestic appliances. Then for the return journey, containers are typically loaded with primary products for the mechanical engineering and automotive industries. It is no secret that VW, Audi, and BMW send components to their Chinese sites by rail.

Depending on the origin and destination, train journeys take between 11 and 20 days, making them much quicker than cargo ships, which take a good month to arrive. Only air travel is faster, but also 80% more expensive than surface-based modes of transport. The cost of rail versus sea travel, however, cannot be compared so easily. The online calculator of the Eurasian Railway Alliance Index, ERAI (www.index1520.com) – a consortium of the Kazakh, Russian, and Belarusian state railways – does provide some indication,

though this does not replace a binding offer. The number 1520 in the URL refers to the former Soviet broad gauge.

Cost savings over lead times

We asked around 40 experts about how many companies in German-speaking countries use or would like to use the New Silk Road, and what their priorities are in the supply chain. 58% of respondents said that cost is the most important factor when choosing a method of transport. 32% said their focus was lead times. Most respondents looked

favorably on the New Silk Road overland route, with 58% believing it would bring cost benefits and 63% citing better lead times. A majority of 58% also said they would use it as a mode of cargo transport. However, there is a clear difference of opinion between different company sizes. More than 80% of medium-sized businesses (turnover: less than €1 bn) said they would switch to rail, compared with just 25% of larger companies (turnover: more than €1 bn). This could be interpreted as SMEs being more flexible than large corporations. >

For **58%** of those surveyed, **cost** is the most important argument for choosing means of transport.

32% put their focus on the **Lead Times**.



Less capital tied up thanks to improved timing

The faster travel time by rail not only means a faster time-to-market, which is critical for fashion companies, but it also reduces the amount of capital tied up in two ways. Firstly, the goods arrive, then are processed, and are sold faster. Secondly, stock levels can be reduced because the frequency of deliveries can be increased. These factors have a significant impact on working capital, and therefore must absolutely be taken into account when deciding on the means of transport. The ERAI index calculator, mentioned above, also helps with the pricing.

Our study found that the number of businesses fearing delivery shortages was around three times higher among companies with a turnover of less than €1 bn than in companies with a greater turnover (36% vs. 13%). 55% of SMEs are concerned about delivery delays, compared with only 25% of larger companies. This is another argument in favor of the land route, which is considered to be reliable and on schedule. Trains only have narrow time windows available to clear customs at the Chinese and Polish borders, which must be strictly adhered to.

Environmental aspects were a major consideration for at least 27% of respondents, since rail transport uses the least amount of CO₂ compared with other cargo transport methods. With pressure from consumers to improve sustainability in business practices on the rise, environmental protection will only become a higher priority in the future.

Are some goods more suitable than others?

Rail transport is not suitable for all types of goods. The route passes through different climate zones and altitudes. It is also not electrified along the entire distance, so there is no guarantee that refrigerated wagons will operate consistently. This means sensitive products such as medication or food cannot be carried, and dangerous goods are completely prohibited.

The most suitable goods for shipping by train are high-value ones that take up little space. The higher the value per kg, the more the cost of the train journey becomes comparable with sea travel. This applies even more so if the time that capital is tied up for is considered.

However, train prices are expected to increase. In recent years, the Chinese government has subsidized the rail line to make it competitive. These subsidies, which were initially 50%, are now being gradually reduced, and are set at just 30% this year.

The most suitable goods for shipping by train are high-value ones that take up little space.



In recent weeks, Covid-19 has not only disrupted the supply chains. Ships cannot be loaded and dispatched as usual. The train can be a solution due to faster reaction times and greater flexibility. Although the station in the most severely affected Chinese city of Wuhan is still uncoupled, the rail network is otherwise in operation.

Opportunities for market extension and new suppliers

The New Silk Road brings markets that have so far received little attention within easy reach, especially countries along the route such as Mongolia and Kazakhstan. Companies seeking to qualify new suppliers in these areas should define suitable product groups and carry out targeted searches. However, nothing is possible without professional risk management, since there have been no stable trade relationships with these markets to date. Equally, existing regulations could become stricter, and lead to price increases or delivery delays. It is sensible to build up supplier relationships cautiously with partners in these countries, and undoubtedly to maintain existing ties with reliable suppliers.

We expect the New Silk Road overland connection to be used even more in the future. The corona epidemic could prove to be a catalyst here. The rail line will become a middle ground between fast but expensive transport by plane and the cheap but slow way by ship. As connections are extended, and a southern route through Pakistan, Afghanistan, Iran, and Turkey becomes available in the future, there is an opportunity to connect even more markets to international trade flows. Companies in Europe should now assess the rewards they can reap, but without losing sight of the risks. //

CONCLUSION

Thanks to the significantly shorter delivery times, the train route has resulted in a faster time-to-market, increased flexibility, lower storage costs, and, in turn, less tied-up capital. The train can also provide a cheaper transport solution, especially with smaller quantities of high-value goods. Companies should look into whether the New Silk Road is a viable alternative for their needs from the Far East. As framework conditions can change, e.g. due to the planned reduction of subsidies, it is important to review transport choices at regular intervals.



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About the Study

INVERTO surveyed around 40 decision-makers in SCM and Logistics for the Lead Times Study. The vast majority of respondents come from retail and manufacturing industry, especially the automotive and chemical sectors. You can find out further information about the survey results here: inverto.com/leadtimes-study

Economic slump on the horizon

Clear skies becoming overcast



Our tenth edition of the Raw Materials Study is marked by the uncertainty experienced in 2019. The gloomy economic situation and ongoing trade disputes are creating anxiety among the companies that responded to the survey. This is a massive contrast to the previous year, when economic growth called for all hands on deck.

Last year, almost 60% of respondents said they feared not being able to procure the raw materials they needed, compared with just under 30% this year. While that figure has halved, the number of those expecting sales to fall has doubled.

Trade disputes on everybody's mind

Raw material availability and price fluctuations have had a considerable influence on performance for well over 70% of companies that responded. It comes as no surprise that companies are concerned about trade disputes, since raw materials are generally traded at a global level. More than 80% expect trade barriers and customs barriers designed to safeguard political interests to increase, or at least remain at the same level. Just 17% believe that free trade will reign again after the Brexit process has been completed and the Trump presidency has come to an end.

Understandably, many have prepared themselves to encounter customs barriers in global trade. This is resulting in measures such as qualifying new suppliers in other

procurement markets or shifting volumes between existing suppliers. What is more, a quarter of respondents are planning to implement at least one such measure. It is interesting to note that over 50% of companies surveyed are looking to shop closer to home, with Europe being mentioned as a region that is increasing in importance for raw material procurement, followed by China at 40% and Russia at 28%.

Long-term contracts for planning security

Managers do not expect prices to continue rising or resources to remain scarce, in view of the economic downturn. On the contrary, most suspect that prices of raw materials will see a moderate fall. One exception, however, is energy prices. Half of respondents believe electricity prices will increase, while a third envisage the same happening for oil and gas. Very few fear an actual shortage of raw materials.

To counteract the effect of price fluctuations, 70% of survey respondents are attempting to conclude long-term contracts where possible, and a further 20% aspire to do the same. Despite that, the past twelve months have shown that not very many suppliers are willing to sign contracts for the long

term. 40% of respondents have been forced to procure the raw materials they need at the daily rate – almost three times higher than what they had originally planned. If the current economic downturn is here to stay, these figures are expected to change, and more suppliers will be open to concluding longer-term contracts.

Another popular measure to secure production is to build up, increase or reserve stock. Shortages can of course be better tackled with a larger warehouse, but a measure like this requires long-term capital. So, decision-makers should carefully consider how much of a buffer they actually need to ensure security of supply. >

Understandably, many have prepared themselves to encounter customs barriers in global trade.

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Business Intelligence Tools are there, as is the desire to use them, but companies are struggling to find the right solution and deploy it.

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Seeking innovative solutions

The most commonly used strategies are certainly effective in securing a supply of raw materials. But there are other, far less commonly used options that could come in handy. Admittedly, these do take more time, and are usually associated with initial investments and closer cooperation with production. They also call for the support of executive management and the specialist departments, and cannot be implemented by procurement without consulting the powers that be.

They include using alternative materials, something which 40% of respondents reported that they already do. The benefits are clear: if you can replace a raw material that is affected by a dispute or in short supply, then you eliminate the procurement risk. Using recycled materials and reducing raw materials usage are further ways to minimize the risks to raw material procurement. Both strategies are seen as sensible solutions by respondents, but they are hardly ever implemented.

When it comes to digitization, there is a clear gap between what companies are thinking and what they are actually doing. Almost half of survey respondents think it makes sense to use business intelligence tools in raw materials procurement, yet only one

fifth actually use them. This figure is in line with the general findings on digitization. The tools are there, as is the desire to use them, but companies are struggling to find the right solution and deploy it.

Despite the current uncertainties, only few companies plan to secure their raw material supply through direct access, i.e. vertical integration. Our study revealed that just 5% have opted for this measure. The vast majority of respondents, on the other hand, expect politics to create the framework conditions that ensure raw material supply for the economy. Given that the current uncertainty has mainly been caused by political circumstances, this expectation is understandable, and governments have recognized this. The German Parliament, for example, is currently working on a new version of its raw materials strategy to help support businesses.

However, it seems implausible that governments in Europe would intervene in the markets as much as the United States under Trump or even China are doing. After all, this runs contrary to the principle of a free global market economy. //

CONCLUSION

Instead of waiting around for political solutions, the onus is on companies to expand their raw materials expertise on their own initiative. Procurement needs to work with executive management and production to find innovative solutions and secure their own supply effectively. By calling for cooperation and creativity from everyone involved, it is even possible to substitute critical raw materials in some cases.



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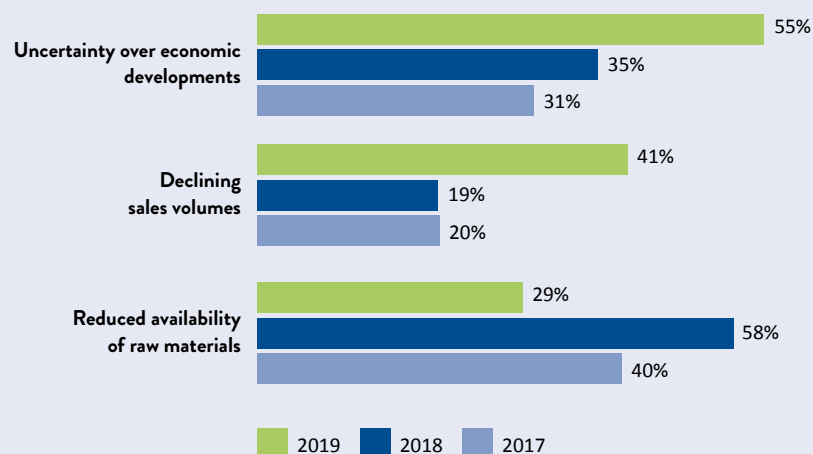
About the Study

For this year's **Raw Materials Study**, INVERTO questioned 87 managing directors, board members and procurement decision-makers.

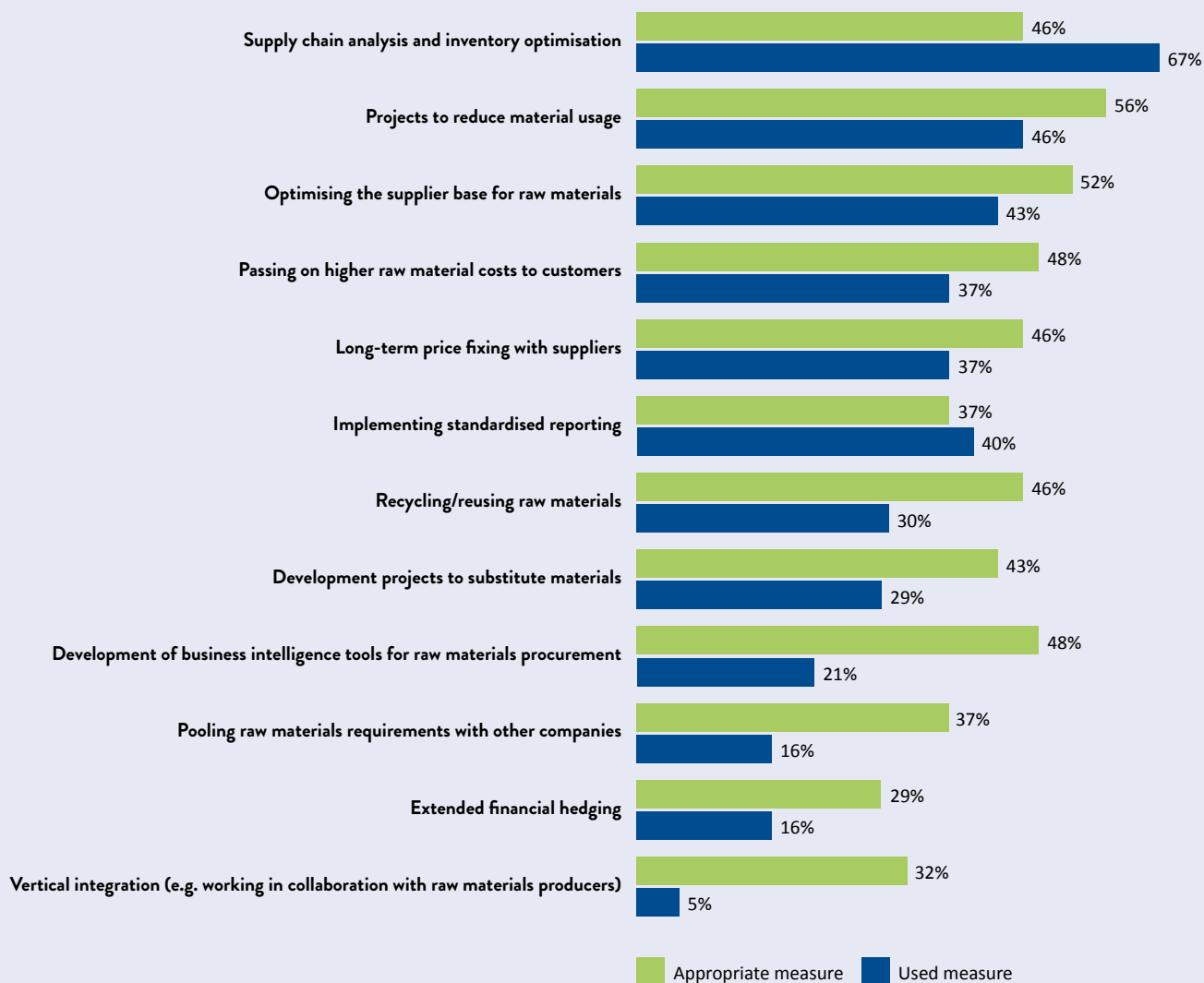
The respondents are in the retail, mechanical and plant engineering, and chemical and process industries. A white paper containing the study's findings and recommended actions can be found on our website:

inverto.com/raw_materials_study

/ Greater Fears Over Economic Uncertainty Than In Previous Years



/ What measures do you consider appropriate to developing the management of raw materials? And what measures do you use? (Tick all answers that apply)





Creating new and sustainable products with suppliers

The power of cooperation

Attractive new products are the best way to stay a step ahead of the competition, and to achieve your own growth objectives. This is becoming a priority for managing directors and procurement managers across Europe, as our latest study on procurement transformation reveals, in which 185 companies took part.



The study results show that traditional tools such as sourcing and product group management, processes and policies, and supplier management currently remain at the forefront as action areas in procurement. These instruments ensure the fundamental priorities in procurement are fulfilled: ensuring a reliable supply to satisfy all the company's needs, achieving savings, and establishing efficient processes. However, the top executives surveyed said that, in future, they will focus on further skill areas: systematic innovation management, conscious design of procurement strategy and team culture, employee development, sustainability, and social responsibility.

As well as assuming the role of cost manager, modern buyers are increasingly taking on cross-sectional tasks for further development. The decisive factor for success is how employees understand and fulfill their own role in day-to-day business and when communicating with suppliers.

Role of procurement under transformation

Procurement's ability to create and implement innovation, something which is essential for the future, is the most striking change. Yet respondents cited this as one of the lower current priorities.

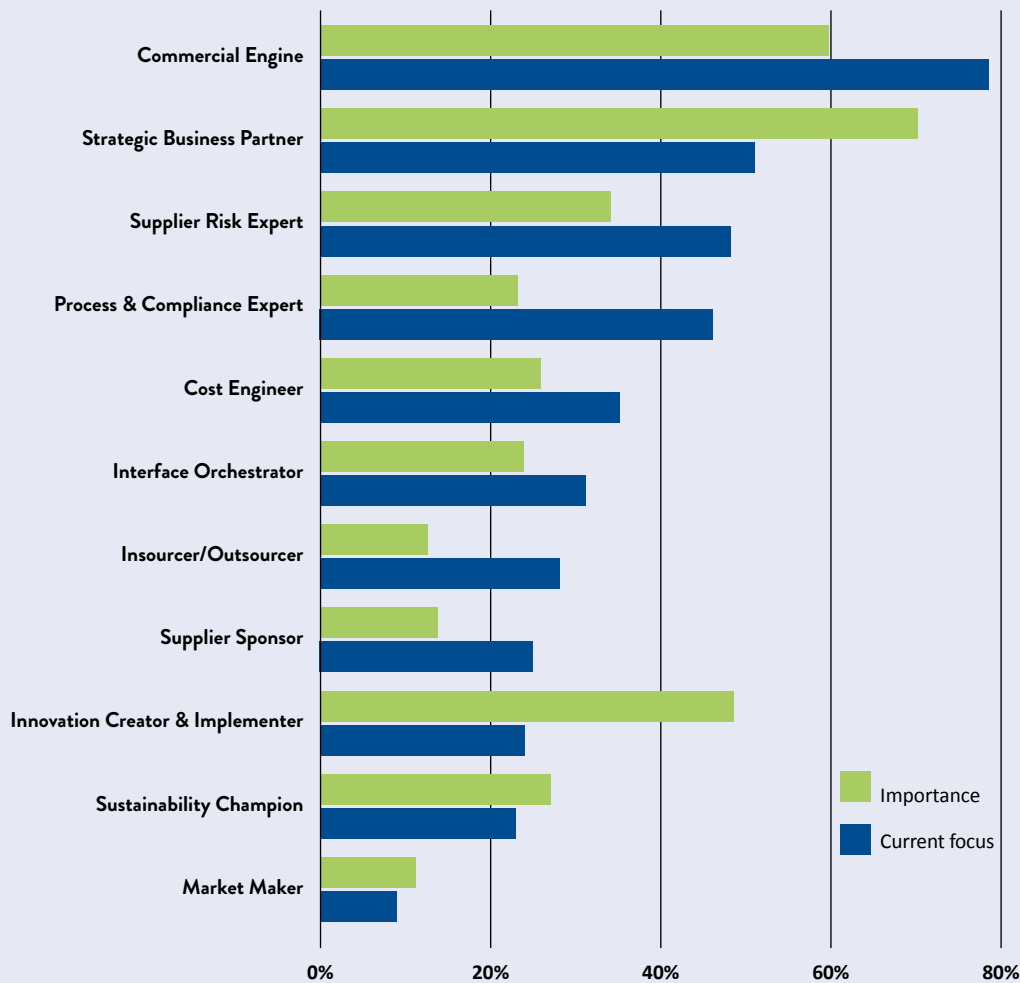
This development reflects these changes, as well as the perception of external innovation, and is therefore a response to the challenges that companies face in terms of growth, competitiveness, and sustainability. These issues, which respondents find themselves concerned with, call for changes to procurement. Procurement should be looking to expand its contribution to the overall organization beyond its traditional field of competence, which focuses on cost reduction, risk and a reliable supply.

As an intermediary between the internal and external supply chain, procurement is in a unique position to shape this new structure, together with the company's specialist departments and suppliers.

Supplier as an innovation partner

Suppliers are often more innovative and more ambitious in their fields than the customers who buy their products. They know best about which products are competitive, what the underlying technologies are, and what development opportunities exist. Their customers, in turn, are in contact with end customers, and therefore know about their needs and behavior. Close cooperation on innovation is very much worth it, for both sides. But how can this work? >

/ Role of Procurement: Current focus and importance



Close cooperation with specialist departments within the company and communication with suppliers can help procurement to create new alliances.



When seeking to involve external development partners, procurement forms a vital link to various functional areas. Close cooperation with specialist departments within the company and communication with suppliers can help procurement to create new alliances. Of course, this only works if procurement understands the needs of the specialist departments better than ever before and can also grasp the challenges for which suppliers need to develop innovative solutions.

To engage suppliers in the development process, procurement must develop cooperation even further within a performance-oriented partnership. The focus here shifts from pure negotiation, which focuses on quantities and prices, toward give and take, in which further factors such as cooperation, open exchange, and exploring shared perspectives come to the fore. The aim is to increase performance to a level previously thought impossible, based on specifically defined expectations. That way, both sides can benefit from the new-found cooperation.

Cornerstones for new-and-improved procurement

Future supplier relationships will be structured around different, pre-determined type groups. After all, not every provider is a suitable innovation partner, and not every procurement need requires such close cooperation. The strategy of tomorrow's buyer towards their suppliers will depend much more than ever before on how important the supplier is to the company. The aim is a close development partnership with suppliers who can drive innovation forward. By contrast,

procurement can implement a cost reduction strategy with suppliers of standardized components.

But if this transformation is to be successful, buyers will need to possess different skills than they do today, their managers believe. It is no surprise that the CPO study respondents said that leadership strength (50%), a willingness to work together (47%), and agility (42%) are the most important skills and ways of working. The transformation of procurement involves making the development process dynamic and agile. And equally, employees must be promoted and trained accordingly for them to keep up.

Improving transparency and sustainability

While originally a niche issue, an increasing number of customer groups are now looking to produce goods more sustainably. Fridays for Future is perhaps one of the most recognized public movements, and more and more consumers are basing their purchases on sustainability and social responsibility factors. The number of investors whose investment strategies prominently incorporate these aspects has exceeded a critical mass. Equally, it is becoming more important to take the cost of transporting resources into consideration, typically in the form of a CO₂ certificate, the cost of which is already expected to rise.

Customers' sustainability demands have changed, and many companies have realized this. Nearly 72% of those who responded to our Procurement Transformation Study said that they considered it important to include sustainability goals in their business operations. However, this is not so much the case for global supply chains, with only a handful of companies being able to trace all their primary products back to their origin.

CONCLUSION

Companies that proactively get their strategically important suppliers involved in putting innovation and sustainability into practice together can unlock competitive advantages. The key to getting to grips with this new supplier relationship is ensuring an open dialogue and freer exchange of information, forming the foundations for an effective collaboration. By developing a common definition of cooperation and innovation, you as a company and your strategic partner create value in a new product range that will meet the needs of your customers and the expectations of your stakeholders.

Most important employee skills:



A strategy for sustainability

As with other development strategies, making production more sustainable involves analyzing which sustainability criteria apply in your own supply chain. What is absolutely essential is achieving transparency throughout the chain. The United Nations' Sustainable Development Goals can be taken as a starting point, in addition to certifications and standards that are specific to your sector.

However you approach it, involving suppliers in the process is vital. Ultimately, innovation and sustainability go hand in hand, as sustainable products require new materials and methods. That is why there is so much pressure on procurement, as the department responsible for finding and evaluating new preliminary products. It is also procurement that needs to ensure that new criteria are also met. To achieve this, procurement needs to set new evaluation standards, which the team must derive from the new specifications. It also needs to investigate new procurement markets and harness the potential of new instruments, such as certificates or monitoring tools. //



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Tony Yu has been General Manager for INVERTO in China since April 2019. The experienced consultant and purchasing expert has transformed our location in Shanghai – from a pure sourcing office to a comprehensive consulting offering for European clients in China. Close cooperation between companies and suppliers plays a key role in developing competitive advantages.



INVERTO Shanghai Office

“Communication is the most critical success factor”

As a procurement and supply chain specialist, you have already been able to gather extensive experience in your career – both on the consulting and corporate side. How did you become a part of INVERTO?

After starting my career in consulting, I worked as a procurement manager for a leading American electronics group, where I was responsible for the procurement of indirect materials from the Asia-Pacific region. Before joining INVERTO I was Director for China at a world-renowned consulting firm. As I am enthusiastic about consulting, the step to INVERTO was the logical consequence to combine my experience in consulting and purchasing in an optimal way.

You manage our Chinese office in Shanghai and your team mainly serves European customers – how does that work in practice?

Overall, our business strategy for Shanghai comprises of two aspects: 'local for local' and 'local for global'. This means that we support European clients both in their local offices and support the European offices in their activities in China. While in the second case we work closely with the INVERTO consultants at the European locations and customer support is generally their responsibility, we want to further strengthen our position in the 'local for local' area, where we offer the full range of services ourselves. All in all, the expertise of our employees is very important to us – in addition to a great deal of know-how regarding the Chinese supplier markets, they must also understand European customers and be able to implement a uniform global purchasing program to meet their needs.

What do you see as the biggest challenges facing European companies in China today?

With economic and technological progress, the competitive situation has become extremely tough and suppliers' order books are full. Today, the biggest challenge for European companies is to create competitive advantages for their products in order to compete against Chinese companies and to be preferred by suppliers.

Close cooperation with local suppliers could also be an important competitive factor. What should buyers pay particular attention to when working with Chinese suppliers?

That's right, communication is the most critical success factor, especially at the beginning of the relationship – I personally call it the 'warming up'. Chinese suppliers will only enter a serious business relationship if they recognize a genuine interest in working together. During negotiations it is very useful to present clear facts and figures and to point out advantages for both sides. In the end, both sides should work towards a long-term cooperation instead of only placing short-term orders. For long contract periods, suppliers are usually willing to accommodate the client on the cost side. Another critical factor is the customer support during the cooperation, but especially in the implementation phase. Chinese suppliers often still have gaps when it comes to providing qualified personnel who also have a feeling for differences in culture, practice, language etc.



However, competition does not only extend to supplier markets: Chinese companies are now operating at a similar level to Europeans and are trying to open up new sales markets. What hurdles do they have to overcome?

The biggest challenge for Chinese companies in Europe is to gain a comprehensive understanding of the economic, legal and political structures and their influence on their own business.

One topic that European companies are intensively involved with is the New Silk Road – what influence do you think this will have?

In recent decades, the rapid growth of Chinese production in China has created an imbalance between domestic supply and demand. The Chinese government sees the new Silk Road as an opportunity to solve this dilemma and facilitate access to overseas markets for Chinese manufacturers. At present, the project still faces many challenges, particularly due to the lack of qualified staff, trade protectionism and the financing bottleneck. In the long term, once the learning period is over and Chinese manufacturers have established the appropriate infrastructure, this strategy will play an important role in modernizing China's manufacturing industry and boosting the Chinese economy.

If you work in this dynamic environment every day, how do you spend your free time?

As a balance to the challenging everyday life as a consultant, I like to go jogging, which always refreshes me and gives me the best ideas. Otherwise I like to spend my free time with my family or gardening. I find it very relaxing to drink a cup of tea while enjoying the blooming flowers around me.

On a trip to Shanghai, what should definitely be on our "bucket list"?

BUND, Shanghai's harbor boulevard, is always the first place I show my guests from other countries. It mixes the beauty of the past in the form of the historic buildings with the future – the skyscrapers of Pudong. The most beautiful time is in the evening, especially when you go on a boat trip and enjoy the flashing neon lights that are emitted from all the towers.

XiantianDi, also called "new heaven on earth" is an area with an upscale shopping and dining complex. It is very relaxing to sit out here on a warm and sunny day in a café, chatting with friends or watching the people.

And finally, you should visit the Yu Garden. This is one of the few old sights of Shanghai and once belonged to an official of the Ming Dynasty. There are many small shops around the garden where you can buy souvenirs. //

20 years of INVERTO:

Procurement in transition

What distinguishes us and our employees and what topics do we cover within different projects and industries? On the occasion of our 20th company anniversary we would like to offer you a very personal insight. The history of INVERTO is closely linked to the development of procurement – so we will give you an overview of the changes in procurement and how they will develop in the future.



**Cover story in
the next issue!**

Results Risk Management Study

Risk management protects in crises

Download Whitepaper

inverto.com/riskmanagement

Our current risk management study shows that systematic risk management is neglected in the vast majority of medium-sized companies. This takes its toll when short-term crises such as the current coronavirus outbreak occur. In the white paper we show how you can take precautions with a differentiated risk management.



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