

UPS Capital
Global Supply Chain
Finance
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Overview

With the supply chain lengthening as a result of globalization and offshore production, many U.S. companies have experienced a reduction of capital availability. In addition, the pressure faced by U.S. companies to improve cash flow has resulted in increased pressure on their overseas suppliers. Specifically, non-U.S. suppliers receive pressure in the form of extended payment terms or increased working capital imposed on them by large U.S. buyers. The general trend toward open account from letters of credit has further contributed to the problem.

As a result, there is a need for global supply chain finance (GSCF) solutions. UPS Capital, the financial services arm of UPS, has developed a suite of GSCF solutions, which leverages UPS Capital's funding capabilities with UPS's goods and information capabilities.

The market opportunity for a GSCF solution is significant. The total worldwide market for receivables management is US\$1.3 trillion. Payables discounting and asset-based lending add an additional US\$100 billion and US\$340 billion, respectively¹. According to a September 2006 Aberdeen Group study that surveyed 110 firms on supply chain finance, only 13 percent of respondents are currently using supply chain finance techniques, but 56 percent have plans or are investigating options to improve supply chain finance techniques.

The role of GSCF is to optimize both the availability and cost of capital within a given buyer-supplier supply chain. It does this by aggregating, packaging, and utilizing various information generated during supply chain activities and marrying this information with the physical control of goods. The coupling of information and physical control enables lenders to mitigate financial risk within the supply chain. The mitigation of risk allows more capital to be raised, capital to be accessed sooner or capital to be raised at lower rates.

The need to increase capital or inject capital into the supply chain more quickly is being caused by several factors:

- Market trends with respect to the global supply chain have caused companies to demand an integrated approach/solution to physical and financial supply chain challenges.
 - Buyers are looking to optimize their balance sheet by delaying inventory ownership.

¹ Sources: FCI, WTO, UPS Product Research and Evaluation (6/05) and Celtsoft



- Suppliers are looking to obtain funds earlier in the supply chain at favorable rates, given buyers' desire to delay inventory ownership.
- Middle market companies are looking to monetize non-US domiciled inventory to increase liquidity.
- There is wide interest in integrated supply chain finance solutions.
- Globalization of the United States and Western Europe's manufacturing bases has resulted in fewer domestic assets that can be leveraged to generate working capital.
- Most small and medium suppliers to U.S. and European businesses are located in countries that lack well-developed capital markets. Without access to efficient and cost-effective capital, production costs increase significantly or the suppliers go out of business.
- Letters of credit, a long-standing method of obtaining capital for suppliers in less developed countries, are on the decline as large buyers are forcing suppliers to move to open account.
- There is a desire to ensure stability of capital as supply chains elongate. Another Asian financial crisis (such as the one in 1997) would severely disrupt U.S. buyers' supply chains by making capital unavailable to their suppliers.

The Role of the GSCF "Translator"

Physical and informational control are the keys to a GSCF solution. There is a need for logistics providers and financial services firms to join together to develop precise visibility tools that provide CFOs and global supply chain managers with the data they need and lenders with the collateral security required to provide capital. In fact, according to a November 2006 study conducted by the Aberdeen Group, large companies are four times more likely to be planning to spend over US\$500,000 in supply chain finance technology over the next 18 months. Once a robust information-based system is established, trading partners, logistics companies, and banks need to be able to access the information quickly and efficiently.

The starting point for information about goods being transported must be the entity that is transporting the goods – the supply chain services provider, transportation company, and/or logistics partner. These are the entities that have the physical control of the goods while in the supply chain. Access to this information is a must from a demand planning perspective. Knowing where the goods are in transit, the financial services provider can more confidently extend financing at various milestones within the supply chain.



We believe there is a critical role missing in this equation, however, and that is the supply chain finance “translator” – the entity that is experienced in both logistics/transportation and financial services. The translator is the subject matter expert, if you will, that can bring all entities to the table – transportation and logistics; banks; buyers; and sellers and speak the various languages and understand the needs of each party. In addition to participating in the financial transaction, the translator can help bridge the information divide between the physical and financial worlds, providing critical analysis about the information being collected from the supply chain.

UPS Capital is in a unique position to serve as this translator. Because it is a unit of the world’s largest package delivery company and a GSCF services provider, UPS has insight into the physical and financial supply chain. In fact, banks have stated that UPS Capital brings to the market the ability to act as a translator between logistics and finance, an ability that no other provider has.

The following chart explains this translator role:

Activity	Logistics/Transportation Provider (UPS)	GSCF Translator (UPS Capital)	Financial Services Provider
Goods	Deliver transportation, logistics, and supply chain services – i.e., move the goods.	N/A	N/A
Information	Collect and provide information about goods disposition to customer, translator, and financial services provider.	Verify data transfer; aggregate, analyze, manipulate, and provide data; authorize financial transactions.	Receive data from translator in order to authorize financial transactions.
Funds	N/A	Participate in funding for transaction and assume a proportionate share of the risk.	Participate in funding for transaction and assume a proportionate share of the risk.
Sales & Marketing	Identify prospects, participate in sales calls, stem commoditization.	Identify prospects, market GSCF, participate in sales calls, identify financial risks, assist in structuring credit solutions.	Identify prospects, participate in sales calls, assist in structuring credit solutions.
Financial Benefits	Transportation revenue, deeper relationship with customer and translator.	Interest income, fee income, deeper relationship with customer, financial services providers, and logistics/transportation provider.	Interest income, deeper relationship with customer, translator, and logistics/transportation provider.



Global Supply Chain Finance Solution Set

With UPS Capital and UPS in place, we envision a product set that could include:

- Global Asset Based Lending (GABL)
Enables middle market companies to monetize off-shore or in-transit inventory. This results in increased liquidity to this class of borrower.
- Inventory Finance
Enables companies that supply to large buyers to secure financing on inventory that they are required by buyers to hold. This results in an improvement in the net cash conversion cycle for the buyer while providing the supplier with capital at a reduced rate.
- Receivables Management Services
Provides third-party outsourcing of receivables management and collections process. It also provides financing of those receivables and guarantees on the payment of those receivables.
- Payables Discounting
Provides third-party outsourcing of the payables process and leverages a buyer's credit quality to obtain favorable financing rates for suppliers. This results in lower cost of capital for the supplier, a portion of which can be passed on to the buyer.
- Insurance
Further mitigates trade risk through cargo, credit, and transaction dispute insurance.

Selling these solutions will require the cooperation of all parties – transportation/logistics providers; the translator; and financial services firms. And due to the complex nature of GSCF, solutions must be sold using a consultative approach to C-level executives. The point of contact is typically the CFO. While financial services firms have relationships with CFOs, they cannot execute the sales process alone because lending occurs in silos, based exclusively on the supplier's and buyer's individual credit capacity, as well as silos within banks themselves. By partnering with large banks, UPS Capital will have better access to C-level executives, while gaining potential new customers and capitalizing on the banks' global presence to sell and promote GSCF.



Summary

Independent research from the Aberdeen Group confirms the need for GSCF.

In its *Supply Chain Finance Benchmark Report* (September 2006), the Aberdeen Group found a disconnect in supply chain finance practices. While buyers are extending payment terms to their suppliers, the suppliers often have limited access to short-term financing and, therefore, a higher cost of money. This cost-shifting to suppliers results in a financially unstable and higher-risk supply base. Overall, the benchmark report showed that companies should be pursuing three key areas of improvement: GSCF financing; GSCF technology; and GSCF visibility.

Expanding on the benchmark report findings, the Aberdeen Group, in *New Strategies for Financial Supply Chain Optimization* (November 2006), found that best-in-class companies are more likely than their peers to have a cross-functional team of purchasing, supply chain, and finance professionals managing their GSCF programs. Best-in-class companies also are achieving better performance, such as a 10-day advantage in their cash conversion cycles. In other words, these companies are unlocking the trapped value in the financial supply chain by implementing new GSCF techniques and taking advantage of third-party GSCF experts.