INNOVATION SOURCING - HOW BANKS CAN LEVEL THE PLAYING FIELD FOR TRUE INNOVATION

As procurement moves centre-stage for corporates looking for product innovation and value creation, banks can play a vital role in facilitation, writes Dr Sebastian Hölker, head of innovative trade products at UniCredit

Here's a question for supply-chain finance (SCF) specialists the world over: what do corporate leaders in the pharmaceuticals, consumer goods, IT, telecommunications and automotive sectors have in common?

They have all adopted 'innovation sourcing' – the next step up the evolutionary ladder with respect to procurement. Innovation sourcing moves procurement on from its traditional role of purchasing- and spend-optimisation by recognising procurement as a critical, strategic, cross-functional, business process that has the potential to become a key facilitator and guarantor of value creation.

In practice, this means that the leading and most innovative companies in some of the most advanced industrial sectors have started engaging in product innovation from a unique perspective: that of their suppliers.

Enterprises that make use of innovation sourcing expect their suppliers to be vastly more than the mere providers of goods or services. Instead of viewing them as cost components (to be squeezed) they have adopted and adapted the modern zeitgeist that real innovation – the blue-sky thinking that generates seismic shifts within industries – is more readily nurtured in small, less formal organisations that allow creative minds to innovate without the barriers or organisational burdens of major corporations.

They have learnt the lessons of the digital revolution: that much of the most disruptive product innovation takes place well away from the R&D laboratories of major corporations.

Yet this is a two-way street. More and more midcap suppliers are realising the additional value they can bring to their customers by identifying and pursuing technical and business innovations jointly with their major industrial clients.

Cooperative innovation

Being born of the digital age, such cooperative innovation has been developed under the guise of some catchy titles: including 'science hub' and 'connect and develop' as well as 'innovation sourcing'. Indeed, if looking beyond the B2B space towards consumer product innovation, the concept of 'crowdsourcing' becomes relevant.

As different as they are, all these environments generate a dialogue with the suppliers that uses relationship, business value and innovation to drive revenue growth on both sides. Enterprises that use innovation sourcing share the conviction that those that make the best of both internal and external ideas will win.

Of course, while still new, such innovation has been under discussion within procurement circles for some time, as the following thoughts from procurement leaders attests:

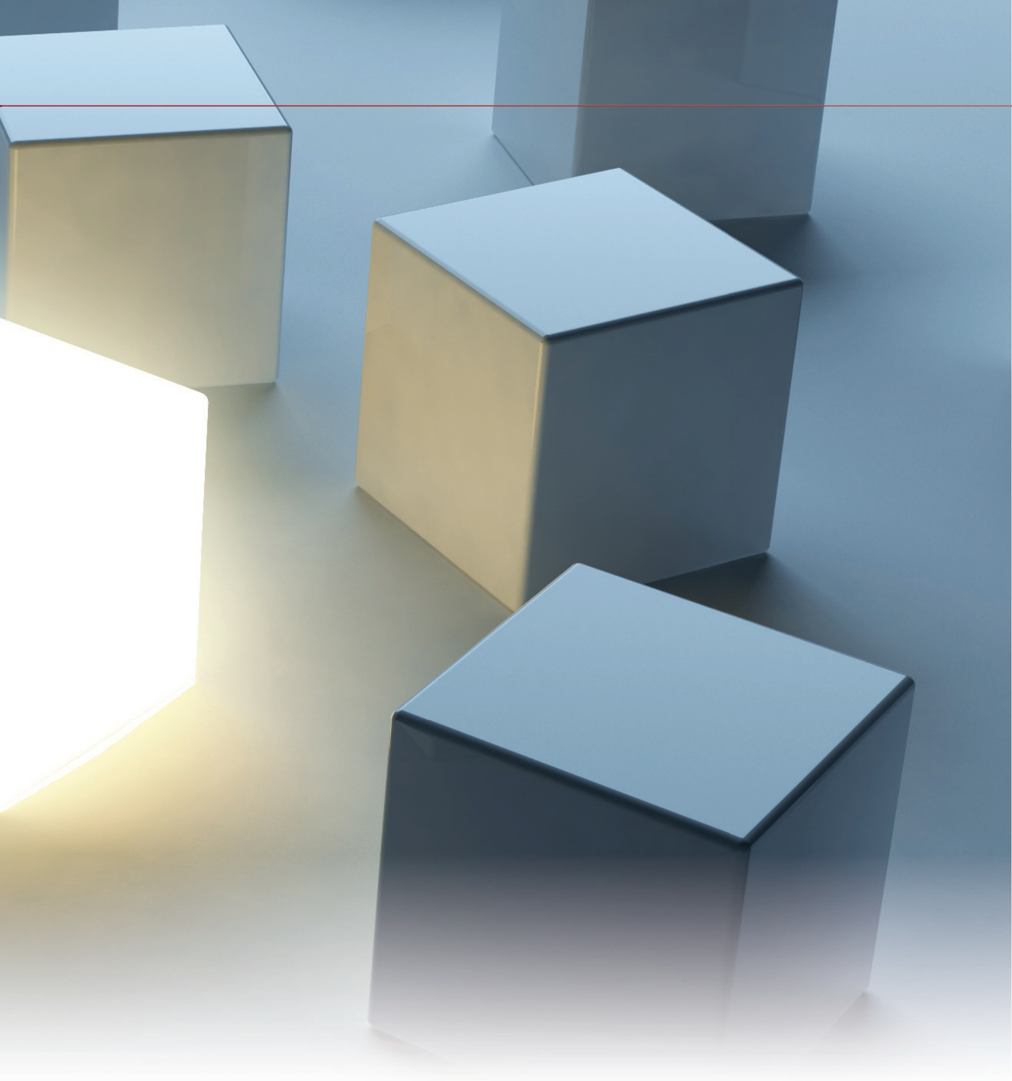
"Traditional cost metrics drive most supply management organisations, not innovation measures. But cost alone will not create a winning business proposition in a world where competition quickly copies leading products and customer expectations continuously change…"

"Out of 100 companies, there are probably 15 or 20 where the purchasing organisation is involved in innovation. The rest are fighting for it…"

"Focus means balance. We can't say as procurement that we just want to be innovative and forget the rest; neither can we do the rest and forget innovation…"

Banks in innovation sourcing

With the point made – that procurement can be a value driver in far deeper and more imaginative ways than pure purchasing –



where do the financiers fit in? In particular, what is the role of the banks?

A good banking relationship is more than a mere 'one-on-one' interface between customer and bank. The entire value chain of a bank's customer should be of importance. Indeed, major corporates are part of an eco-system within which banks need to immerse themselves. The entire global value chain and supply networks are crucial to a company's health – making the health of such an eco-system also crucial to the company's banking partners.

Based on this holistic viewpoint, financial institutions should provide a range of products and services that facilitate this deeper, broader and more complex procurement environment as a source of value and innovation, both for suppliers and buyers. The core of those solutions puts emphasis both on flexible working capital management and the mitigation of supply chain risks.

Managing working capital, and supply chain risk

In the area of working capital management, SCF can act as a catalyst for innovation sourcing - enabling both buying firms and their suppliers improve working capital and reduce costs.

What's more, SCF technology helps automate the process of exchanging invoices and payments (and related documents), as well as information between buyers, sellers, financial institutions and other involved parties - making it accessible in real time.

That said, the central feature of SCF adoption is the fact it allows suppliers to gain access to liquidity by leveraging the stronger credit rating and financial standing of their buyers. And while this is good news for the suppliers, by allowing suppliers to fully concentrate on innovation and value creation it's good news for the buyers as well.

Risk management

Such symbiotic gains explain why the most innovative industries are adopting SCF as a key deliverable in this partnership. In the context of innovation sourcing, it's also why many are adopting SCF as an integral part of their comprehensive risk management strategies. They understand that for the supply chain, it simply makes no difference if the disaster that strikes the supplier has a natural or a financial cause. Whether it's an eruption of the

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Icelandic volcano Eyjafjallajökull, or a Wall Street earthquake – such as the collapse of Lehmann Brothers – the result is a disrupted supply chain. Thus, the financial health of a corporate's supplier base belongs to the core supply chain risks. And these deserve to be managed in the best possible way.

As any study of the techniques applied in supply chain risk management and supply chain finance makes obvious, very similar mechanisms and techniques apply to both. Supply chain risk management begins with data – and so does financial risk management in modern supply chain finance. Today, there is an abundance of data available in real-time from end-to-end of the supply chain. This data allows us to move away from a pure balance sheet risk analysis – that reflects mainly past economic health – to a transaction-based, real-time risk assessment.

This serves both the corporates and the bank. It provides real-time visibility and a never-before-seen transparency of many important supply chain activities that have an impact on its overall financial stability.

And by connecting buyers with their suppliers, innovative banks provide the financial playing field in which innovation sourcing can flourish – leaving suppliers to concentrate on innovation rather than on credit, and relieving buyers of the worry they may lose a valuable source of innovation due to supplier insolvencies.

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