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Focusing the financial flow of supply chains: An empirical investigation of financial supply chain management

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ABSTRACT

The objective of this paper is to establish a theoretical foundation for financial supply chain management (FSCM) in order to strengthen managerial decisions concerning financial flows in supply chains. Although such decisions are made frequently and partial aspects of FSCM are already understood in business practice, empirical knowledge about FSCM is in its early stages. The study provides fundamental information derived from eight case studies based on 40 interviews. The analysis extends previous studies of the interface between operations management and finance by (i) contributing to a mid-range theory of FSCM by exploring two distinct but not exclusive FSCM categories, their antecedents, and performance effects, (ii) empirically deriving a testable framework for FSCM, (iii) relating FSCM to established theories in the field of SCM, and (iv) basing the analysis on transaction cost economics. Managerial insights reveal that weak working capital causes firms to focus on FSCM. More specifically, the study identifies two FSCM categories: pre-shipment FSCM (before invoice release) and post-shipment FSCM (after invoice release). Managers can improve upstream supply chain working capital with pre-shipment FSCM, whereas post-shipment FSCM strengthens the buying firm's working capital position. Based on transaction cost economics, we analyze how these improvements stem from risk reductions, which are more effective if firms are integrated internally and externally.

1. Introduction

The field of supply chain management concerns itself with the collaboration and coordination of several stakeholders to optimize the flow of goods, information, and finance along the entire supply chain (Mentzer et al., 2001). While firms often collaboratively manage flows of goods and information with their supply chain partners, they do not do so when it comes to cash flows. Prominent examples have been documented, such as in the automotive industry, e.g. Ford Motor Company (Zhao et al., 2008). Systematic payment term extensions are also practiced in other industries and can lead to supply chain disruptions (Boissay and Gropp, 2007). From a different point of view, Bates et al. (2009) provided further motivation to better manage financial flows. Across industries, median inventories averaged 18.3% of all assets in the 1980s but decreased to 7.4% in the 2000s. Consequently, management tools need to be explored to provide additional opportunities for supply chain improvements.

As a response to these developments, more than 15% of firms already engage in advanced methods of managing financial flows along their supply chains (Aberdeen Group, 2007). In this paper, these methods are considered to be financial supply chain management, which we define as *optimized planning, managing, and controlling of supply chain cash flows to facilitate efficient supply chain material flows*. FSCM thus requires the interaction of financial managers and supply chain managers within the company, as well as collaboration beyond the borders of the firm with service providers (e.g. banks), suppliers, and customers. As opposed to traditional financial flow management, which typically follows the rationale of optimizing the cash flow of a single firm, FSCM extends the scope to the entire supply chain of the firm. Typical methods of FSCM are summarized in Table 1. While this list is comprehensive and, in our opinion, involves many diverse practices fundamental to FSCM, this paper focuses on those aspects that are closely related to short-term credit and the OM finance link. In this way, we address the supply chain and production economics perspective rather than the purely financial perspective.

To illustrate our FSCM definition, we consider the example of Rolls–Royce plc in supplier financing (AirFinance Journal, 2010). The company's approach enables suppliers to obtain a loan from Citi Bank almost immediately after delivery to Rolls–Royce. Instead

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