

 RESEARCH STUDY

The Murky Waters of Overseas Manufacturing

May 2023

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Introduction

The manufacturing industry is a vital part of the North American economy. In the United States, **manufacturing accounts for \$2.3 trillion in GDP**, employs 12 million people and supports hundreds of local economies. Meanwhile, **total revenue for Canadian manufacturing** reached \$787.3 billion in 2021 – an increase of \$108.9 billion compared to 2020.

But the manufacturing industry isn't immune to challenges, especially given the current economic downturn. Changes in consumer demand and supply chain bottlenecks will impact production, growth and profitability. That's why some manufacturers have already begun soliciting discounts from suppliers to proactively protect their cash flow. But you can't expect all suppliers to agree to this.

So, what's your plan of attack if your business faces cash flow problems? Are you relying on supply chain financing to shore up your operations? Supply chain financing is a great way to keep your business running in troubled economic times. But you shouldn't assume that you'll be approved for financing – it depends heavily on the data lenders see in your **business credit report**. Lenders don't just look at your business credit score and credit limit – they analyze your financials, how quickly you pay your bills, how many of your bills are past due, how much is owed and how many legal filings you have, among other information. If you don't know what's in your business credit report, you won't know if there are areas you need to improve, which could lower your chances of securing financing.

It's not just about staying on top of your own finances and cash flow. You need to be careful about how many suppliers you work with and which countries you offshore production to. When you add in geopolitical uncertainty, natural disasters and worker disputes, you're likely to face longer lead times, product shortages, higher costs and lower product quality. These problems are more than frustrating; they also slow down production schedules, which has a negative effect on customer satisfaction and revenue growth.

Spreading out your production orders to a larger number of suppliers across multiple countries will make you more resilient if your suppliers shut down their factories due to political unrest, natural disasters or worker disputes. That simple decision could have a serious impact on your ability to complete production orders, keep customers happy and increase revenue growth and profitability. Just as you need to understand your own company's credit risks for supplier financing, it's equally important to look at the business credit reports of international suppliers to see their credit scores and credit limits. If their credit scores and credit limits are low – or their DBT (days beyond terms) has increased significantly in recent months – you'll want to know as these are

telltale signs that the supplier has cash flow issues and may not be able to keep the business operating long-term.

Plus, you'll want to invest time and resources into prioritizing **supplier due diligence** and ethical sourcing given how consumers are less willing to buy from brands that engage in unethical, corrupt practices. At the same time, U.S. and Canada have introduced regulations in the last few years, requiring companies to prove their goods aren't produced using forced or child labor. The behaviors and practices of your suppliers reflect on your brand and could either increase or decrease your profitability.

SURVEY METHODOLOGY & OBJECTIVES

We surveyed over 480 finance and supply chain professionals in the United States and Canada who use international suppliers to manufacture their goods. Our goal was to understand their key challenges and priorities with supplier due diligence and financing. We also wanted to understand their approach to ethical sourcing and compliance – and how this would impact their decision to work with international suppliers. The survey was fielded in March 2023 and included companies across the following industries: retail and wholesale, healthcare and pharmaceutical, manufacturing, aerospace, automotive, technology/electronics and transportation.



Key Trends & Insights

Winning the Work: North American Companies Lean Towards China, UK and Europe for Overseas Manufacturing

As our study reveals, 64% of North American manufacturing companies use suppliers in Asia to produce their goods. To understand why Asia is such a popular market for North American manufacturers, let's look at some market statistics.

Investment in Asia has tripled over the past 10 years, with the region accounting for **more than \$1 of every \$2 of new net investment** in the past decade. The region is on track to account for 40% of the world's consumption and **more than 50% of global GDP by 2040**. Asia is also home to the largest and most important players in multiple industries, from semiconductors and renewable energy technology to consumer electronics. Plus, a large portion of raw materials for North American companies are sourced from China, Vietnam and other countries in Asia.

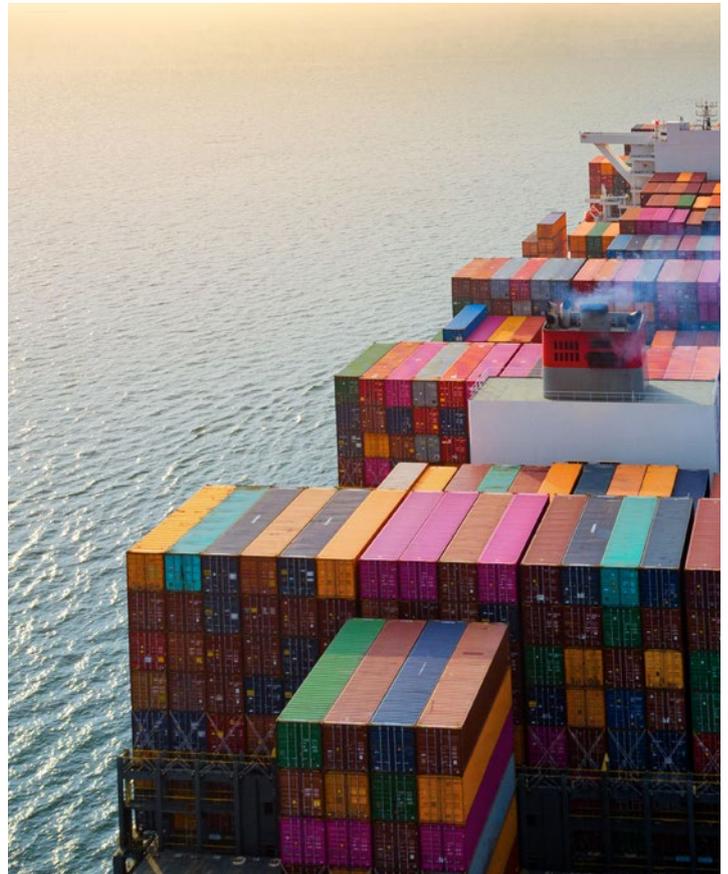
Our study reveals that China holds the most export prowess with almost half (43%) of the respondents offshoring production of their goods in the country. This makes sense given China's low labor costs, large labor pool, strong business ecosystem, low taxes and duties, lack of regulatory compliance and competitive currency. But it doesn't mean China is immune to supply chain challenges.

China's 'Zero Covid' policy, which is meant to control all COVID-19 outbreaks with minimal social and economic disruption, has put a strain on the country's manufacturing capabilities. As a result, **China has lost manufacturing and export market share** in key consumer categories, including clothing and accessories, footwear, furniture and travel goods. Meanwhile, import rates soared in 2021, with container shipping rates from China to the United States **reaching record highs in 2021** – above \$20,000 per 40-foot box.

What we found especially interesting is that offshoring production to the United Kingdom and Europe is more common than using suppliers in India and Mexico.

For instance, 25% of the respondents said most of their international manufacturing is done in the United Kingdom or Europe, while just 10% would source factories in Mexico and only 8% would use suppliers in India.

One reason for this could be that freight rates from India to the U.S. increased considerably in 2022. For example, **the average price of a 40-foot container from Chennai was \$5,100**, while the average price from Mundra and Mumbai were \$4,900 and \$4,850, respectively. On the other hand, a rise in diesel rates has affected cross-border trade between the U.S. and Mexico. This has driven some of the larger trucking companies based in Mexico to increase their rates by between 3-5%.





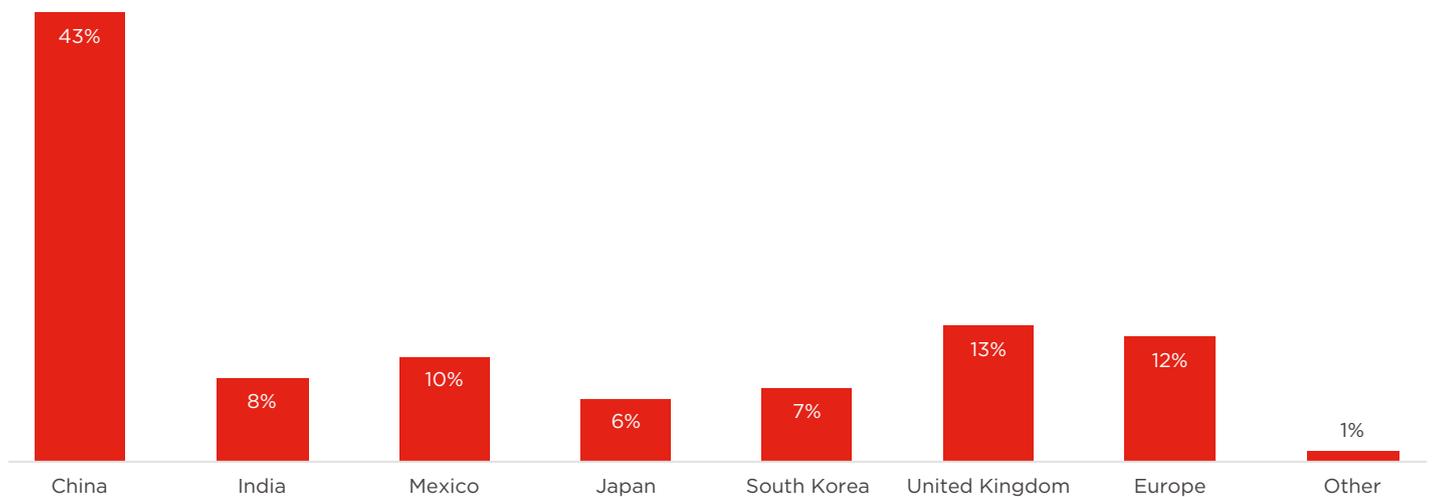
But we're still surprised to see that Mexico isn't as popular for North American manufacturing, especially since exports of non-petroleum goods from Mexico to the United States grew almost 27% in February 2022 compared with the previous year. To that end, Mattel, the maker of Barbie dolls and Hot Wheels toy cars, recently **announced plans to make Mexico the site of its biggest plant in the world** – a \$47 million consolidation and expansion project that includes a 200,000-square-foot facility with about 3,500 workers.

Meanwhile, **data from Bain and Company** shows that exports from India have seen tremendous growth over the last two years, with a compound annual growth rate of 15%. India has reached \$418 billion of manufacturing exports in fiscal year 2022. However, India-U.S. trade relations have been

strained for some time. But this is something the U.S. wants to change, as Secretary of State Janet Yellen explained at a speech in New Delhi in November 2022.

The key takeaway here is that you shouldn't rely on suppliers in a single country to complete most or all your production orders. Doing so could cause serious problems if unexpected problems arise from political unrest, pandemics and other socio-economic issues. The last thing you want is to be unable to meet your customer demand when 75% of the factories that produce your goods have shut down temporarily or don't have enough money to keep the business running. And you don't want to outsource most or all your production to countries with high import rates and shipping costs, as that could drain your cash flow.

Where is most of your international manufacturing done?



Struggling with Product Shortages? Supplier Over-Reliance Is Likely the Reason

Is it better to partner with less suppliers and only use suppliers in a single country? Or is it better to diversify and distribute production to a larger number of suppliers across multiple countries? If you ask us, it's better to work with more suppliers and diversify the countries where you work with suppliers to reduce your risk considerably.

Relying on too few suppliers and limiting your production to a single country could cause all sorts of problems. Imagine if over 50% of your international suppliers are based in one country and that country is facing political unrest. That political unrest could result in worker protests and a factory shutdown, which will bring your production to a screeching halt. As our study reveals, this concern is weighing heavily on the minds of North American manufacturers with 75% admitting they're severely to moderately worried that political instability and labor disputes in foreign countries could disrupt their supply chain.

So, we were surprised to see that 35% of the surveyed companies use less than 500 international suppliers to produce their goods. Meanwhile, just 7% distribute their production across 10,000 to 15,000 suppliers and only 3% use more than 15,000 suppliers.

Unfortunately, political unrest and worker disputes have become an all-too-common occurrence in countries like China, India and Vietnam. In December 2021, over 2,000 female workers staged a protest over working conditions at a manufacturing facility for Apple iPhones in Tamil Nadu, India. What started as a small-scale protest on December 15 quickly spiraled out of control and grew into mass protests due to a lack of communication from the company, contractors and health and labor department officials.

Things were only made worse by rumors of the death of two workers. As a result, the manufacturing facility

suspended operations just three days later on December 18, promising improvements after Apple put the plant 'on probation' and placed a hold on all orders.

Over the last few years, many factories in Asia were shut down for months due to the COVID-19 pandemic and lockdowns enforced around the world. Based on [data from Liberty Street Economics](#) for the first four months of 2020, U.S. imports from China declined sharply in February and March before bouncing back in April. The decline was partially offset by growing imports from other countries in Asia, like Vietnam, India and Bangladesh.

In recent years, Vietnam has grown its export prowess to become the second-biggest supplier of apparel and footwear to the United States after China. And while Vietnam fared relatively well during the first part of the pandemic in 2020, a rise in infections from the Delta variant of the coronavirus took its toll on Vietnam due in large part to the uneven distribution of vaccines. This surge in COVID-19 infections forced Vietnamese factories to either close or operate at severely reduced capacity.

In a [September 2021 interview with The New York Times](#), Calvin McDonald, Lululemon's chief executive, admitted that its over-reliance on factories in Vietnam wasn't the best strategy and had caused production issues. He explained, "A third of our global sourcing does come from Vietnam so we are definitely in the market. We are encouraged with the recent news of a phased opening in South Vietnam but we continue to work with our partners, shift and, if necessary, leverage airfreight and other ways to get our fall and winter goods in."



Lululemon isn't the only American apparel manufacturer that was hit hard by factory shutdowns in Vietnam. Apparel company Everlane faced delays of four to eight weeks in 2021, depending on when factories it worked with in Vietnam had closed. Meanwhile, footwear manufacturer Nike cut its sales forecast in November 2021, citing the loss of 10 weeks of production in Vietnam since mid-July 2021 (with factories set to reopen in phases as of October 2021).

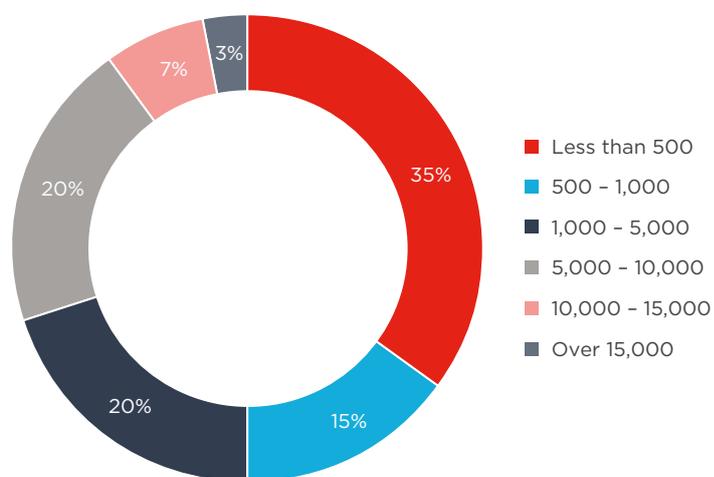
While the effects of COVID-19 are hard to ignore, things have resumed back to normal in most countries around the world. But other factors, like climate change, are putting a strain on international supply chains. Think about semiconductors – also known as chips. They power just about everything in the world – from mobile phones to laptops to cars. And Taiwan produces over 60% of the world's semiconductors and over 90% of the most advanced ones.

But chipmaking requires a massive amount of water. To put this into context, Taiwan Semiconductor Manufacturing Company, the world's biggest chipmaker, consumes 99,000 tons of water per day at its chip facilities in Southern Taiwan Science Park alone. The more advanced chipmaking techniques become, the more water is needed. But climate change and fewer typhoons in the region have reduced the amount of water available to produce these chips. According to [Taiwan's Water Resources Agency](#), the accumulated rainfall in southern Taiwanese cities like Tainan and Pingtung has been about 40% of the rainfall in an average year recently – the lowest level in three decades.

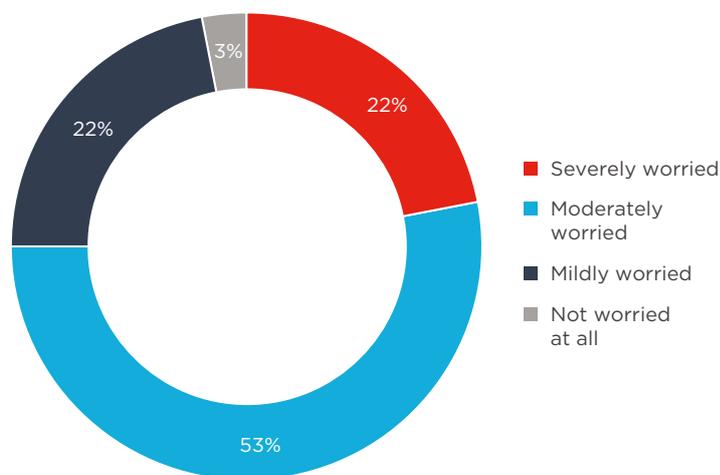
It's clear just how dangerous it can be to rely on too few suppliers and not have a plan in place to offload production to other suppliers if production is shut down. It can increase your supply chain risk and lead to product shortages. And if you have high customer demand for those products but can't deliver them, you could lose loyal customers and the repeat sales that come from them.

While the total number of suppliers a manufacturing company uses depends on various factors – from the size of the company to order volume to customer demand – larger companies shouldn't be relying on a small group of suppliers to produce their goods. Diversification is key to de-risking your supply chain and reducing the chances of product shortages.

How many international suppliers do you use for manufacturing your goods?



How worried are you that political instability and labor disputes in foreign countries could disrupt your supply chain?



Want to Restore Brand Confidence in the Age of Cancel Culture? Prioritize Ethical Sourcing and Supplier Due Diligence

Gone are the days when consumers shopped purely based on what they needed or wanted. As the world has battled disease, wars, social injustice and economic downturns, shoppers expect brands to do more than just deliver high-quality products and provide exceptional service. They expect brands to be socially responsible and ethical – and are making their buying decisions based on that criteria.

For example, **25% of consumers cite a 'zero tolerance' policy** towards companies that embrace unethical practices. Plus, **research carried out by OpenText** found that nearly nine in 10 (88%) global consumers would choose to buy from companies with ethical sourcing structures in place over ones that did not. The research also found that 83% of global consumers are willing to spend more on a product if they can be certain that it's ethically sourced.

But it's not just that consumers expect brands to act ethically and responsibly. If your brand fails to do so, consumers will call you out for it publicly on social media. This has certainly played out over the last decade, with more brands and high-profile figures being cancelled for unethical behaviors, cultural appropriation and corruption.

Not prioritizing ethical sourcing and due diligence, both within your own business and with the international suppliers you work with, could have serious consequences. Not only could you lose the loyalty and repeat sales of customers, but your brand reputation could take a huge hit with negative publicity and plummeting stock prices. To add fuel to the fire, you could also find your business on the receiving end of **lawsuits, compliance violations and regulatory fines**. In the U.S., for example, the Uyghur Forced Labor Prevention Act was passed unanimously by the U.S. Senate in December 2021. The act bans imports from China's Xinjiang region unless companies can prove their goods were not produced using forced labor or child labor.



Meanwhile, U.S. senators introduced the Slave-Free Business Certification bill in 2022. The bill requires certain large companies to carry out audits on their supply chains to ensure they are free of slave labor. If the bill passes, eligible companies could be fined up to \$1 million if forced labor is identified in their supply chains. Canada has a similar type of legislation awaiting adoption. The bill, known as S-211, would require that companies report on their efforts to stop goods made with forced labor from entering their supply chains. If you've been working with suppliers that employ forced labor, then you're opening your business up to compliance violations and regulatory fines. On top of that, you could lose loyal customers, which would deplete your cash flow significantly.

The growing regulatory pressure has led to some brands taking ethical sourcing and supplier due diligence very seriously. Take Patagonia, for example. Touted as the world's most responsible company, Patagonia monitors all its processes, including every step of the manufacturing process with the goal of minimizing its environmental and social impact. The clothing brand is also a certified B Corporation, having met or exceeded stringent criteria consistently and earning an 'outstanding' score in each of the last five years.



For manufacturers, Patagonia is a prime example of how being a purpose-driven, sustainable company can drive revenue growth and profitability. According to Yvon Chouard, the founder of Patagonia, “the brand has an estimated value of \$3 billion. It sells more than \$1 billion in outdoor clothing and gear and brings in \$100 million in revenue a year.”

We expected the respondents in our study to show a similar commitment to ethical sourcing. But what we uncovered was a contradiction between the CSR beliefs and actions of North American companies. On the one hand, 83% of the respondents run compliance checks on international suppliers at least once a quarter. We suspect this is being driven by the growing consumer demand for ethical sourcing. But then nearly half (42%) of the respondents admitted they would still work with an international supplier that has been found to be on a [sanctions list](#) or involved in corruption, bribery, fraud or slave labor.

Matthew Debbage, CEO of the Americas and Asia for Creditsafe, believes this contradiction highlights a bigger problem in global supply chain management. “Many companies are simply running compliance checks to tick a box and show that they did the necessary due diligence. But they’re not using the results to protect the integrity of their global supply chains. It’s more of a tick-box exercise than anything else. And this needs to change if brands want to restore customer confidence and position themselves for long-term revenue growth. That’s the purpose of compliance checks – to give you the information you need to avoid working with unethical, corrupt suppliers and, ultimately, prevent your company from incurring financial and reputational damage as a result.”

You don’t want to fall into the same situation as many clothing and footwear manufacturers are in. H&M and Nike, for example, have faced backlash and consumer boycotts recently for working with international suppliers who employ forced labor. Canadian companies have also had their fair share of challenges with compliance. In 2018, [Canadian company Kinross Gold was fined \\$950,000](#). The fines resulted from the company’s failure to implement anti-corruption compliance programs and controls when it purchased two African subsidiaries.

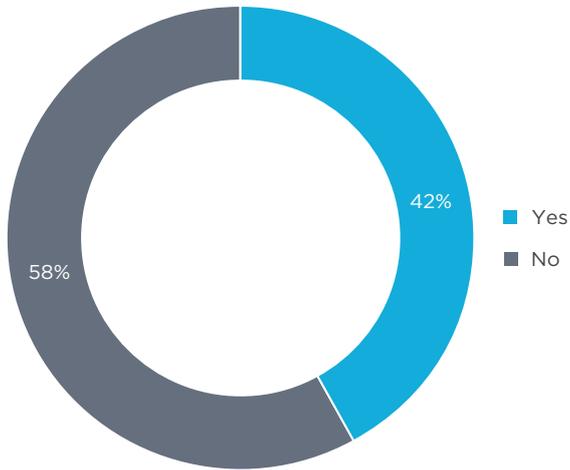
These examples aren’t meant to terrify you. The U.S. and Canadian governments are cracking down on forced labor and child labor in global supply chains. And cancel culture is only going to intensify. You need to understand how your corporate actions (and those of your international suppliers) influence your brand reputation and customer loyalty.

The good news is that a considerable portion of companies realize this, with 28% of the respondents saying reputational damage is the worst consequence of working with a supplier that has been sanctioned or involved in corruption, bribery, fraud, money laundering or slave labor. After that, manufacturers believe government fines (26%) and compliance violations (24%) would cause the greatest damage to their businesses.

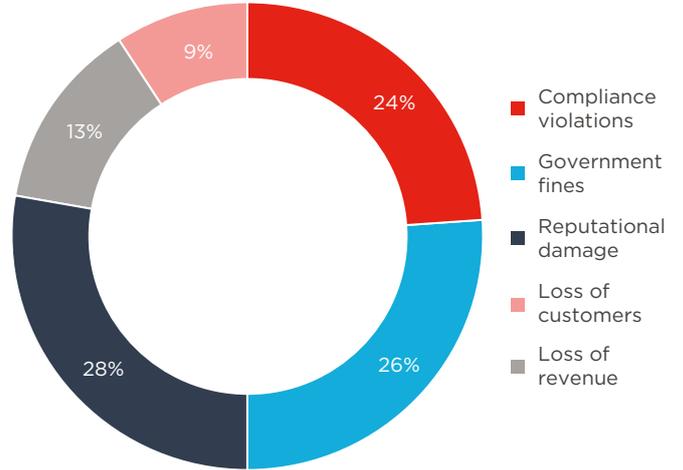




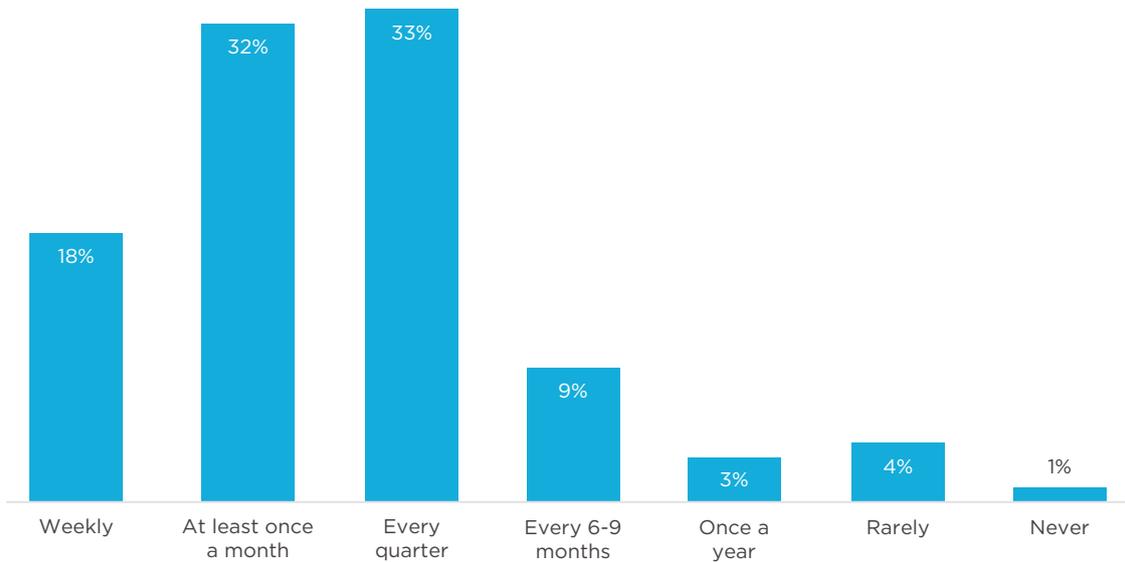
If you found out a supplier has been sanctioned or involved in corruption, bribery, fraud, money laundering or slave labor, would you still work with them?



If a supplier was found to be sanctioned or involved in corruption, bribery, fraud, money laundering or slave labor, what would cause the greatest damage to your company?



How often do you run a compliance check on your international suppliers to determine if they have been sanctioned or involved in corruption, bribery, fraud, money laundering or slave labor?





Tips to Carry Out Due Diligence on International Suppliers

- **Run international credit checks on your suppliers:** Make sure your suppliers have sufficient cash flow and income to complete your production orders. You don't want to hand over a large percentage of your orders only to find out a supplier falls short of cash and will shut down.
- **Screen your international suppliers (and the directors in the company) against real-time sanctions databases, global enforcement lists, adverse media, state-owned enterprises and Politically Exposed Persons profiles:** Don't assume all suppliers have the same mindset and approach to corporate social responsibility (CSR) as you do. And don't just take their word for it. Do your research and let the data tell you for certain. Remember, it's not just about how responsible and ethical you are. What your suppliers do, how they treat their workers and what activities they engage in all have repercussions for your own business – from damaging your reputation to reducing customer trust and loyalty to negatively impacting sales and revenue growth.
- **Build compliance workflows into your decision process with suppliers:** If you work with a large number of international suppliers, then you'll want to automate the decision process. Vetting every single supplier will take a lot of time and could lead to things falling through the cracks. For example, you might have missed that an international supplier has engaged in bribery or slave labor. Both are inexcusable practices. And even though your business isn't the one engaged in those activities, your business can still suffer as a result. That's why it's important to build compliance rules and decision models to make the right decision quickly. Plus, you can standardize the criteria you use for every supplier. That way, you use the same rules and criteria for every supplier – making your business more transparent and less likely to be accused of playing favorites with certain suppliers over others.
- **Make sure you have a digital audit trail to prove compliance with federal and state laws:** There are several federal and state laws that outline the requirements for supplier due diligence. For example, the United States-Mexico-Canada Agreement (USMCA) has provisions that require companies to take measures to prohibit the importation of goods produced by forced labor, including forced child labor, to address violence, sex-based discrimination and immigration protections in the workplace. And there are newly proposed legislative initiatives too. For instance, the Slave-Free Business Certification Act of 2022 was recently introduced in the U.S. Senate. The Act would require any publicly traded mining or manufacturing entity with annual worldwide gross receipts that exceed USD \$500 million to conduct an audit of its supply chain to investigate the presence or use of forced labor by the company or its suppliers. Companies would be required to submit and publish a report containing the results of the audit and the company's efforts to eradicate forced labor from the supply chain.





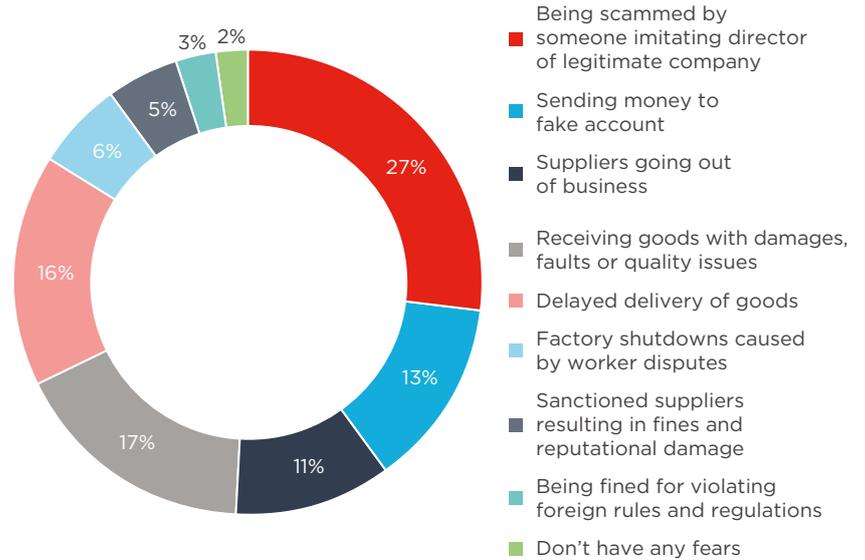
Eradicating Supply Chain Fraud Is More Pressing Than Fixing Production and Shipping Problems

Working with international suppliers can be stressful and induce fears about the risks and dangers that lie ahead. As our study reveals, four in 10 manufacturing companies are concerned about being scammed by someone imitating a director of a legitimate company or sending money to a fake bank account. These are legitimate fears and may have been triggered by past experiences with international suppliers.

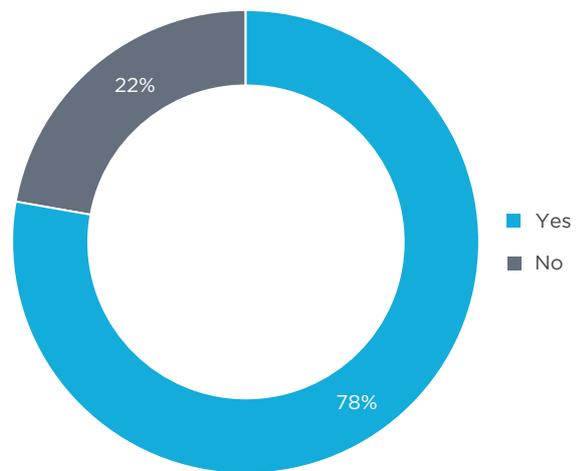
But shipping delays, factory shutdowns and suppliers going out of business are all common occurrences in the world of manufacturing. So, we were surprised to see that manufacturers aren't as stressed about how these issues could affect their sales and revenue growth. For instance, only 17% are worried about receiving damaged or faulty goods and just 16% are concerned about shipment delays. On top of that, only 11% are worried about supplier factories being shut down and just 6% are concerned about factory shutdowns due to worker disputes.

To understand why manufacturers are more stressed about supply chain fraud than production errors and shipping delays, let's examine the different types of supply chain fraud.

What's your biggest fear about working with international suppliers?



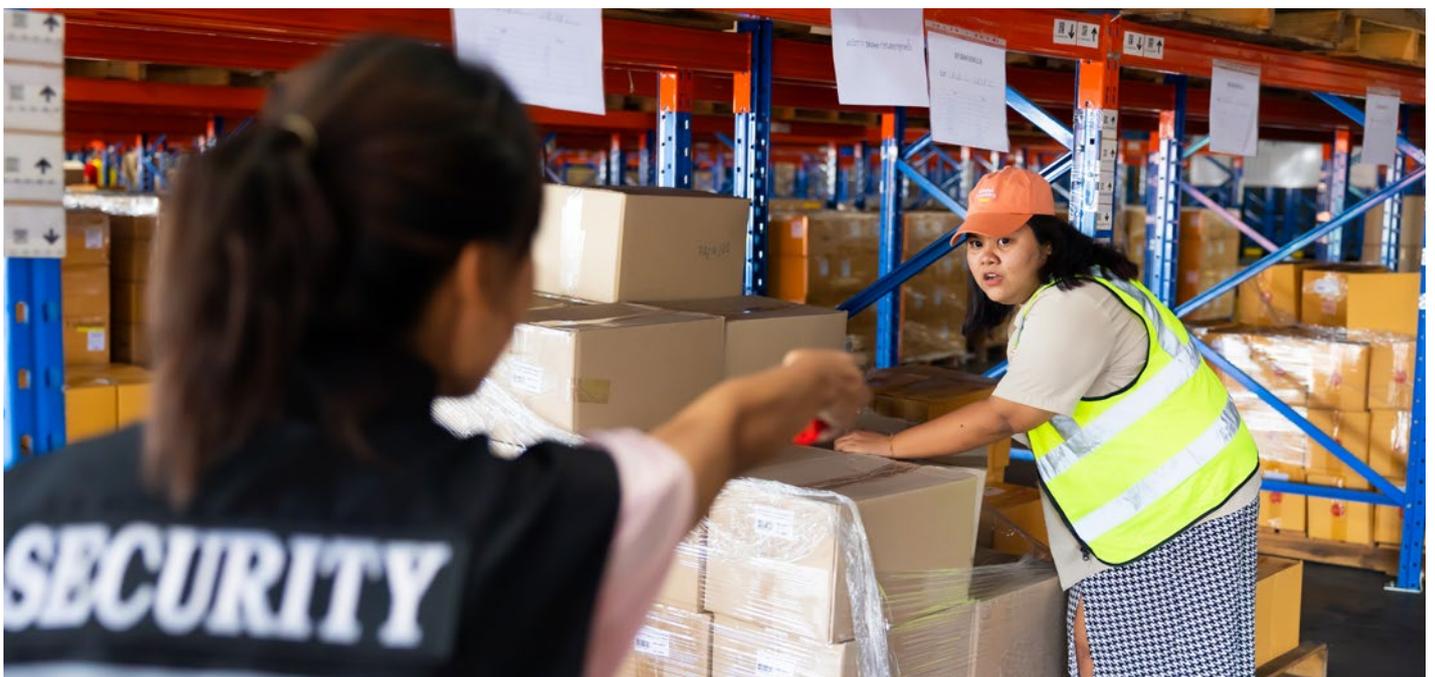
Do you currently have any compliance due diligence policies and procedures in place to protect the integrity of your international supply chain?





Types of Supply Chain Fraud

- **Theft:** You often see supply chain theft played out in TV shows and films with a character jokingly saying the items ‘fell off the back of a truck.’ But this isn’t a joke for manufacturers. This type of theft tends to be more common with high-value consumables like electronics and high-end fashion that can either be used by the fraudsters themselves or sold for cash. Unfortunately, theft is often done by employees of factories themselves or through collusion with an outside partner. One study found that 90% of all significant theft losses came from employees, while 60% of employees would steal if they knew they wouldn’t get caught.
- **Lookalike Company/Director Scam:** The duplicate name scam is a trick to snag victims, especially if you’re in a hurry or not looking closely. Scammers are often quite smart and do their research to pick a name very close to actual suppliers who are popular and in demand with manufacturers.
- **Payment Fraud:** With so many payments and paperwork (digital or physical) flying through the supply chain, it’s no surprise that people will try to manipulate the system. Billing schemes, authorized push payment fraud, Automated Clearing House (ACH) fraud, check payment fraud, expense fraud are all common tactics used by payment scammers.
- **Bribery and Kickbacks:** Bribery and kickbacks tend to be carried out by more senior-level executives in the supply chain. For instance, the owner or managing director of a factory in China could attempt to bribe a North American manufacturer to choose them over another supplier. It can also include kickback schemes that involve creating fake invoices, having an employee make sure those invoices are paid and then paying a kickback fee to that employee for doing so.



We can't help but wonder if this overwhelming fear of fraud has anything to do with manufacturers' lack of confidence in the due diligence procedures and tools they have in place. Our study found this is likely to be the case, with 22% of the respondents admitting they don't have any compliance due diligence policies or procedures in place to protect the integrity of their international supply chain.

As a manufacturing company, you rely on international suppliers to produce the goods that you sell to your customers. Those suppliers are a critical piece of your supply chain. You wouldn't be able to generate sales and revenue without them. But the more you rely on those suppliers, the more vulnerable your business is to risks.

That's why you need to take supplier due diligence very seriously. Run the necessary **international credit checks** to make sure your suppliers' finances are in good shape so they can afford to produce the orders you bring to them. You also want to make sure they aren't **flagged on sanctions lists and don't have any compliance violations** for bribery, corruption, fraud, slave labor or other unethical practices. All these issues can have a direct impact on your brand reputation and cause your once-loyal customers to walk away and buy from your competitors instead.

Tips to Protect Your Business Against Supply Chain Fraud

- **Be vigilant and don't rush into decisions:** There will certainly be times when you're up against the clock and need to find a supplier quickly. But you shouldn't let that cloud your judgment and stop you from properly vetting any supplier you're considering doing business with.
- **Verify the identity and legitimacy of suppliers:** Scams are opportunistic in nature. Fraudsters know this and capitalize on it. Don't ever take someone's word that they are who they say they are. As we explained earlier, it's quite common and easy for fraudsters to pretend to be a well-known supplier (or director in the company). **Check that the company is legitimate** and make sure that the person you're speaking to is, in fact, a director of the company.
- **Conduct regular and 'surprise' audits of your supply chain partners and processes:** Make sure you understand where the risks of fraud lie. For instance, if a supplier doesn't have theft prevention and detection policies and systems in place, your goods are more likely to 'fall off the back of a truck' into the wrong hands. And don't always schedule your audit appointments – surprise your partners so you can see how things truly operate on a day-to-day basis.
- **Train your employees to be aware of potential scams:** Scammers are often sophisticated and will target people who they believe to be vulnerable or likely to 'fall for it.' Make sure all your employees in the supply chain and finance teams know what scenarios or red flags to look out for. Run mock sessions so they can get a real sense of what kinds of scams to expect. The more they know and expect, the more likely they are to identify and prevent fraud quickly. You may even want to offer incentives or rewards to encourage employees to be vigilant against supply chain fraud.



Suppliers Should Expect More Price Haggling from Manufacturers in Next 12 Months



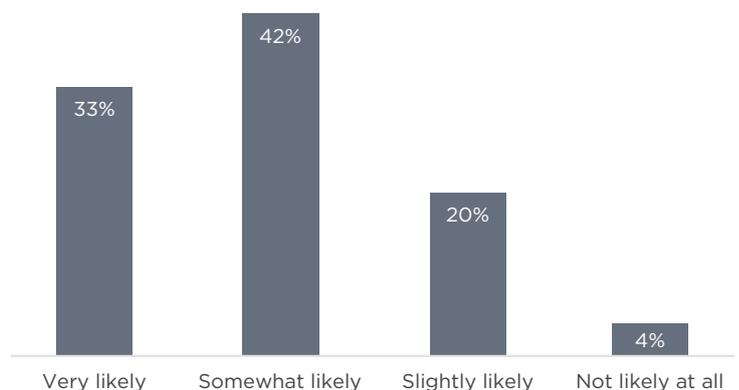
Price haggling is part of the process when working with international suppliers. Both sides want to get the best deal. And both sides are likely to use certain negotiation tactics to get their desired outcome. But as we've seen this year, many manufacturers are asking for discounts from suppliers. And the data from our study indicates this will continue to be a trend, with 95% of the surveyed manufacturers saying they plan to ask suppliers for a discount in the next 6 to 12 months to proactively protect their cash flow.

Supplier discounts are usually requested for one of two reasons. On the one hand, your company **may not have enough incoming revenue** to offset the payments you need to make. So, it's a matter of necessity. On the other hand, you could have a healthy cash flow and simply want to proactively cut back on spending, so you don't get caught off guard if there's a decline in customer demand due to the economic downturn. If it's the latter reason, that's a very smart and strategic move.

Whole Foods Inc. is a prime example of this, as it recently asked its suppliers to reduce their prices. With 513 Whole Foods Market locations across the United States, the grocery chain certainly fits into the category of a large business. As their payment data reveals, Whole Foods Inc. hasn't made this request because it's in financial trouble. Rather, it's in good financial shape with a credit score of 80 (putting it into the 'very low risk' category) and a credit limit of \$10 million. Not only did the grocery chain have an impressively low DBT (days beyond terms) of 3 in 2022, but it also had an excellent track record of paying its suppliers on time with just 8% of suppliers' invoices paid late.

Clothing manufacturers Levi's and GAP have also requested supplier discounts – in the range of 10% to 20%. While we can certainly understand where these discount requests are coming from, it's certainly not the best news for suppliers. For suppliers, this should be a wake-up call to be proactive in how they manage their cash flow. They need to be prepared for customers to ask for discounts this year and should make sure they can sustain the business after those discounts take effect.

How likely are you to ask your suppliers for a discount to proactively protect your cash flow in the next 6 to 12 months?



Note: Figures may not add to 100 due to rounding.

Is Supply Chain Financing Making Manufacturers More or Less Resilient?

We can see why supply chain financing is appealing. It offers a cushion to your cash flow and allows you to keep your business running so you can pay your employees, suppliers and vendors. It also makes your business more resilient and competitive during economic downturns.

Our study indicates that supply chain financing is popular and seen as a go-to solution for maintaining operations when cash is tight. In fact, 69% of manufacturing companies have used supply chain financing in the last 12 months and another 66% expect to use it in the next 6 to 12 months. These findings signal that manufacturing companies are using multiple lines of credit to stay afloat through the year. So, it's not just nice to have; it's a necessity that manufacturing businesses likely can't survive without.

The more financing you secure, the more your debt burden grows. So, if customer orders and revenue decline, you won't have as much cash available in your accounts to pay back all that financing you've taken out. And if that happens, you could fall into default on those loans, which will have a negative impact on your creditworthiness. Imagine how this could affect your chances of selling the business to a large brand or investment firm – often a solution for struggling, near-bankrupt companies. The deal could fall through if the buyer checks your business credit report and sees that your debt to cash ratio is too high and you take too long to pay your invoices.

Despite a heavy reliance on supply chain financing, 86% of manufacturers are confident that they'll have enough cash flow

to pay all their suppliers in the next 6 to 12 months. Perhaps this confidence comes from the fact that they have already secured supply chain financing and aren't worried about securing more financing. Or perhaps they feel confident in their customer relationships and order volumes.

Some might say supply chain financing is making manufacturers more resilient. But we'd argue the other side of this. It may be more of a crutch for some manufacturers and enabling bad financial practices. Yes, supply chain financing can be tremendously helpful in maintaining operations and cash flow. We don't deny that. But if you want to continue to secure supply chain financing, then it's important that you understand what **credit risk data financing companies will be looking at** to decide whether to approve or reject your application. Supply chain financing can be as delicate as a house of cards – it can come tumbling down if your finances aren't in order.

Mike Bevilaqua, SVP of Research and Education at **Credit Research Foundation**, has some points for manufacturers to consider. "The impact of supply chain financing on a manufacturer's resilience will depend on how it is used and implemented. When used judiciously, it can be a valuable tool for managing cash flow and improving resilience. However, manufacturers should be careful to avoid over-reliance on supply chain financing and ensure that their relationships with suppliers remain strong and productive. Additionally, supply chain financing can be a source of tension between manufacturers and their suppliers. Suppliers may feel pressure to accept extended payment terms or may be charged high fees by the financial institution providing the financing."

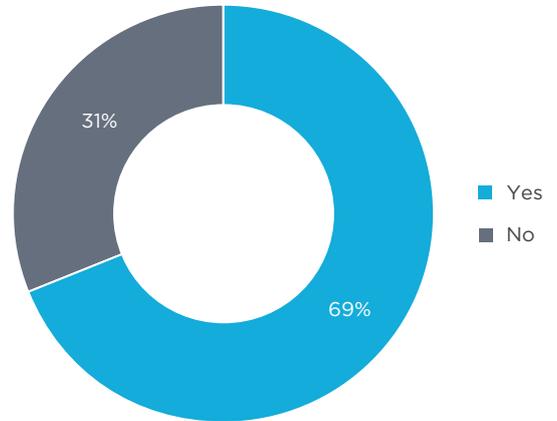




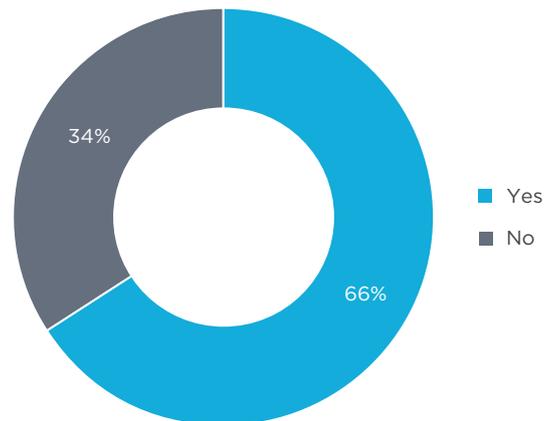
Key Data in Business Credit Reports That Influence Financing Approval

- **Average DBT:** This refers to how many days past the agreed payment terms a company pays its invoices. So, the higher the DBT figure is, the less likely a company is to pay on time.
- **Monthly DBT variation:** This paints a picture of how steady your cash flow is and how reliable you are with paying your invoices on time each month. If your DBT fluctuates often and increases drastically over certain months, this could indicate cash flow problems.
- **Past due payments:** This shows financing companies how much debt you have and how large your debt burden is. For example, if your business credit report shows that 70% of your payments are past due, that will be a red flag and could influence their decision to approve your financing. At the same time, financing companies will be looking at the total amount owed/past due. In some cases, a company may have a large amount of past due payments on its record, but that doesn't always amount to a large amount of money owed. It's when you have a high percentage of past due payments coupled with owing a large sum of money (over \$1 million) that financing companies will be concerned.
- **Legal filings:** This refers to lawsuits, court judgments, tax liens and UCC filings that appear on your business credit report. As our [State of Credit Risk: 2022 report](#) found, U.S. manufacturers had a total of 102,164 legal filings in 2022, which cost over \$1.2 billion. So, if your business credit report shows that you have dozens of legal filings, that could be a warning sign of potential cash flow issues down the road as you'll have to account for legal fees, court judgments and fines coming out of your accounts.

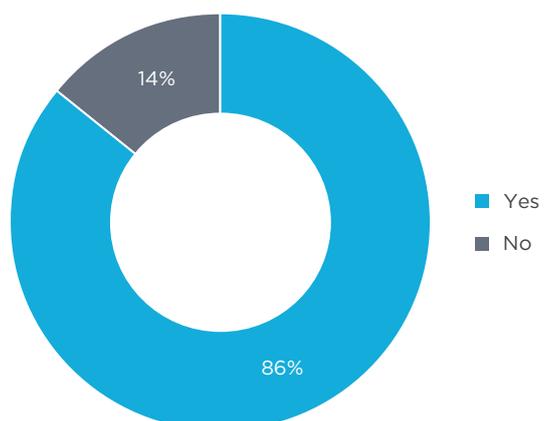
Have you used supply chain financing in the last 12 months?



Do you expect that you'll need supply chain financing over the next 6 to 12 months?



Do you feel confident that your company's cash flow is stable and healthy enough to pay all your suppliers over the next 6 to 12 months?



Relationships Trump Money: Both Sides Flexible with Payment Terms

Negotiating payment terms can be a sticking point when sourcing international suppliers. Suppliers are likely to ask for either a partial deposit or a minimum of Net 30 payment terms. So, it's not that big of a surprise that 31% of the respondents said their international suppliers prefer to be paid with a partial deposit of 30-60% and then paid the remaining balance upon completion of orders.

Given that 95% of the respondents said they plan to ask for supplier discounts in the next year, you'd think manufacturers would be less willing to pay a partial deposit or full payment upfront. But our study reveals manufacturers are more flexible when it comes to payment terms – with 33% willing to pay a partial deposit of 30-60% and then pay the remaining balance upon completion of the order. Interestingly, only 24% of the surveyed manufacturers would ask for Net 60 payment terms and just 17% would try to negotiate Net 90 payment terms. This is likely a negotiation tactic – agreeing to pay less overall but paying a larger percentage of the total order value as a partial deposit.

These findings indicate that the manufacturer-supplier relationship is built on mutual trust and respect and that the relationship carries significant weight in the decision to work with each other. So, even with the economic downturn and increasing requests for supplier discounts, manufacturers are inclined to stick with suppliers they trust and are more open to paying partial deposits.

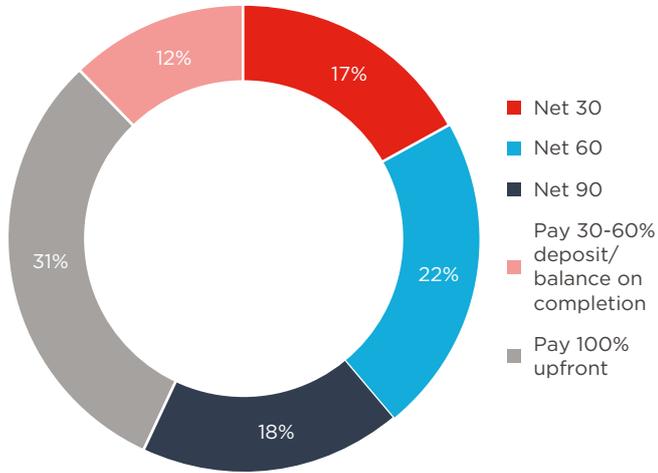
To see how far this trust would go, we asked North American manufacturers what they would do if an international supplier asked for full payment upfront. Surprisingly, few manufacturers are turned off by this request with just 9% saying they'd walk away and work with a different supplier. Meanwhile, almost half (44%) would try to negotiate the option to pay a partial deposit. Far fewer (25%) would push for Net 30 or Net 60 payment terms, indicating manufacturers are more flexible and understanding about the financial pressures and burdens that suppliers face.

But not all manufacturers are as flexible and open-minded when it comes to payment terms. For some, a request like this could ring alarm bells, signaling bigger financial issues. As a result, 22% of the respondents said a request for full payment upfront would trigger them to run an international credit check on the supplier to see how strong or weak their finances are.

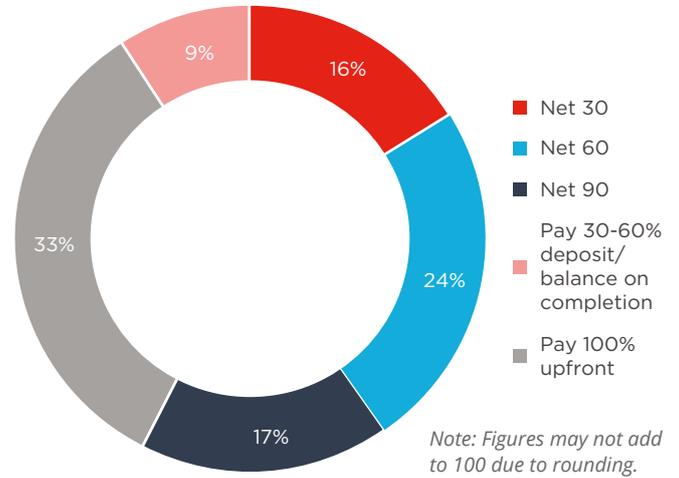




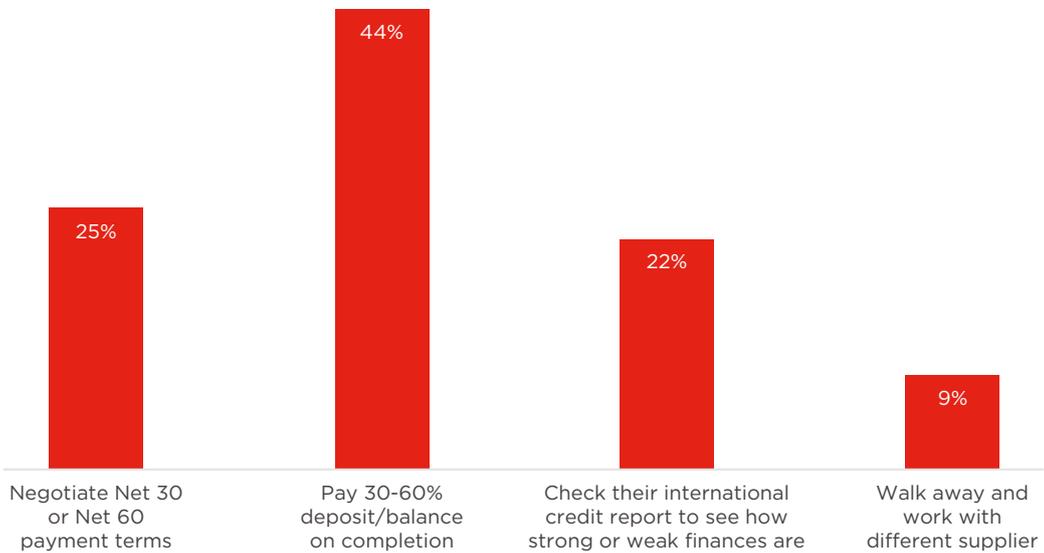
What payment terms do your international suppliers typically request?



What's your preferred payment terms for international suppliers?



How do you respond if an international supplier asks for 100% payment upfront?



Income and Cash Flow Play Integral Role in Supplier Selection Process

Partnering with an international supplier is not a decision to be taken lightly. There are several risks and threats your business can be exposed to if you get into bed with the wrong supplier. For instance, if a supplier shuts down and can't complete work orders you've already given to them and paid partial deposits on, that's both money and inventory that you need to recoup.

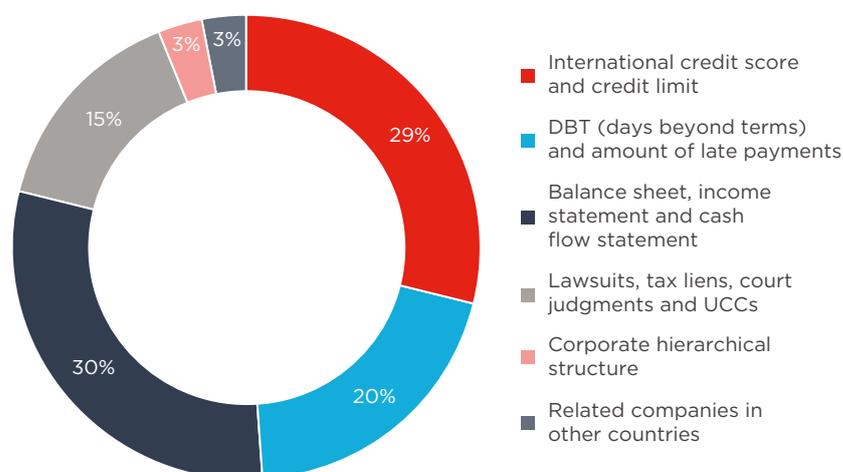
At the same time, you don't want to partner with international suppliers that are embroiled in legal trouble – be it lawsuits, tax liens or court judgments. That's not only going to blow back on your own company's reputation, but it could also result in your company being fined for working with the supplier. And your company is likely to lose business contracts from longstanding customers once they find out you're associated with unethical and irresponsible suppliers.

But our study found that most manufacturers don't consider lawsuits, tax liens and court judgments to be all that important when running credit checks on international suppliers. In fact, just 15% of the respondents said legal filings influenced their decision to work with suppliers. What manufacturers care about most with suppliers are balance sheets, income and cash flow statements (30%), followed by international credit scores and credit limits (29%) and DBT and late payments (20%).

But as our [State of Credit Risk: 2022 report](#) revealed, there were over 2.7 million total legal filings against American businesses in 2022. While that figure is high and alarming on many fronts, it's even more worrying when you consider that those legal filings cost American businesses over \$54 billion in 2022. And the manufacturing industry had 102,164 legal filings, which cost over \$1.2 billion. So, not paying attention to this type of data in a supplier's credit report could hide clear truths about a supplier's financial stability and cash flow problems.

As SVP of Research and Education at [Credit Research Foundation](#), Mike Bevilaqua understands how important the supplier selection process is. He explains, "Ultimately, the decision to work with a supplier should be based on a holistic assessment of all relevant factors, including the supplier's credit report, payment history as well as their product quality, pricing and customer service. It's important to perform due diligence and conduct thorough research to minimize risks and ensure a successful business relationship, including understanding the magnitude of ongoing litigation or legal filings and potential impact to ongoing operations."

When checking international credit reports of suppliers, what data has the greatest influence over your decision to work with them?





Production Quality Isn't Just a QC Problem; It's a Finance Concern Too

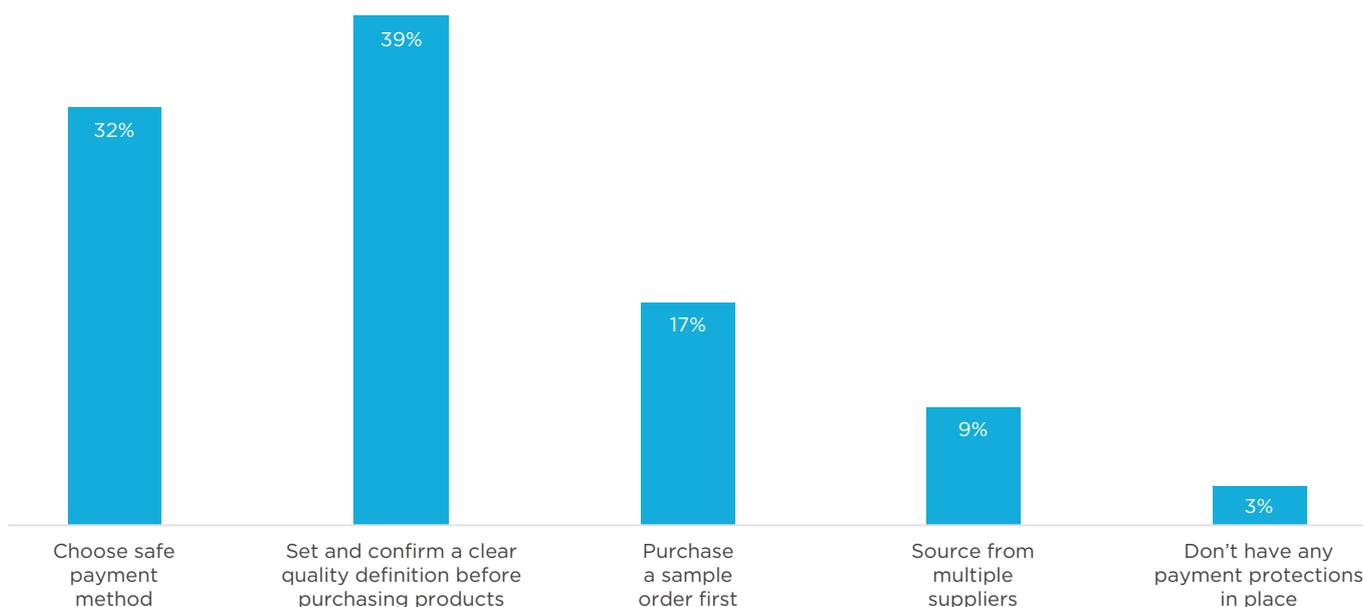
Quality can often be subjective. What qualifies as superior quality to one manufacturing company could be seen as sub-standard by another. It's up to you to define the quality standards for your product and make sure those meet your customers' expectations. But just knowing your product quality definition in your head isn't good enough. You need to document it and make sure that every supplier you work with gets a copy of it and understands thoroughly what factors make up a high-quality product. That way, you're reducing the chances of spending money on poor quality products.

Our study indicates that manufacturing companies may have been burned in the past with international suppliers sending them faulty or damaged goods. So, rather than take the loss, we're seeing many companies take action to protect their payments if they receive faulty goods. For example, 39% of the

respondents set and confirm a clear quality definition before purchasing products from an international supplier. Meanwhile, 17% ask for a sample order first so they can get a sneak peek of what to expect before they commit to a full order (and pay the full price).

It's important to understand that the quality of your goods isn't just something your quality control team should be focused on. Your finance team needs to stay on top of this too. If over 50% of your orders come back with damages or faults, then you'll end up spending more money to get those orders produced and shipped again. That's now money coming out of your accounts for both the production and shipment, which wasn't initially planned for and will eat into your cash flow. So, your finance team needs to set some payment protections in place and write these protections into your supplier contracts.

How do you protect your payments if there are damages, faults or quality issues with orders from your international suppliers?



CONCLUSION

Offshoring your production to international markets can bring many benefits – from reduced costs to increased production capacity to greater access to talent and innovation. But it can also bring many challenges and risks.

As our study has shown, you shouldn't take the decision to work with overseas suppliers lightly. Even something as simple as deciding how many international suppliers to partner with and which countries to source your production can affect how resilient or weak your global supply chain is.

One of the most important lessons is that you should do your due diligence before partnering with international suppliers. What they do has a direct effect on your brand reputation and bottom line. So, if one of your suppliers is found to be engaged in corrupt activities like money laundering or bribery, you'll want to know that information before you make a decision. And you'll certainly want to know if any of your suppliers use slave labor or child labor, as these aren't just unethical practices but will also open your business up to reputational damage, loss of customers and revenue, compliance violations, government fines and more.

The good news is that manufacturers and suppliers equally value their relationships and are willing to negotiate payment terms that work for both sides. This will prove invaluable over the next few years as both sides face economic pressures and mounting debt. But you need to be careful about being too dependent on supply chain financing. While it certainly can prop up your business in hard times, taking out too many loans and piling on too much debt could make it hard to keep your cash flowing if you experience any declines in customer demand and sales.

Finally, it's clear that we live in a culture where consumers prefer to shop with ethical and socially responsible brands. And when brands fall short of this expectation – or partner with suppliers that engage in unethical, corrupt practices – consumers are quick to react and call brands out publicly. While the threat of public exposure shouldn't be the primary reason you prioritize ethical sourcing, it should serve as a reminder that what you do as a business matters. The best way to protect your brand and position it for long-term growth is to prioritize and invest in supplier due diligence.





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