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FX revolution

ADS Securities' Mathieu Ghanem on how blockchain technology can transform the industry

A **dynamic** approach

While research suggests that dynamic discounting is gaining traction among forward thinking finance professionals, opinion is divided on banks' approach to the concept, writes *FX-MM's* Paul Golden.

ACCORDING to a study of accounts payable and working capital published in August by PayStream Advisors, innovative CFOs are saving up to 2% of corporate annual spending by implementing dynamic discounting. However, the research also found that many companies are failing to leverage surplus cash, with just 6% of respondents using dynamic discount management to achieve discounts or rebates.

Citi is one of the banks to have teamed up with a service provider to complete its product offering rather than building its own platform, with Parvaiz Dalal, Head of Supply Chain Finance, Treasury and Trade solutions, observing that it has partnered with C2FO to offering dynamic discounting to its customers.

C2FO Senior Vice President EMEA, Colin Sharp, says dynamic discounting is having a positive impact on financial institutions.

"Banks holding customer deposits in the eurozone must have capital set aside, which costs them money to hold – using cash in dynamic discounting helps to alleviate this," he says. "Additionally, it helps the bank and the corporate address part of the supply chain which is not so suited to traditional trade finance solutions."

When assessing how dynamic discounting is impacting corporates' bank relationships, it is important to consider the former's strategy to paying suppliers and managing its working capital cycle, explains Michael Vrontamitis, Head of Supply Chain Finance at Standard Chartered. He notes that for some corporates, obtaining a discount is more important than improving working capital cycles.

He rejects any suggestion that banks are penalising corporates for using third party solutions and says large corporates in particular are always looking at ways to improve workflow and efficiency. "The only question is whether the cost of the platform on top of usual financing costs is economically viable," he says.

Collaboration benefits

Bob Stark, Vice President of Strategy at Kyriba says banks recognise the opportunity to collaborate and are actively looking to incorporate third-party technology into their overall solution. He also refers to scenarios where a corporate's supply chain finance programme requirements exceed the liquidity that a single banking partner can fund.

Tipalti's Chief Marketing Officer, Rob Israch, accepts that while the benefits of dynamic discounting are clear, corporates will be unlikely to take the initiative and be successful unless the programme is easy for them to participate in and manage, and frictionless for their suppliers.

"Every indication we have seen is that banks are not penalising corporates, but rather partnering with them and bringing in third-party fintech solutions to address their clients' needs proactively," he continues. "Banks may not be great at technology innovation, and may have difficulty being easy to work with, but the smart ones acknowledge this reality."

However, Tom Roberts, SVP Global Marketing at PrimeRevenue, suggests banks have very little involvement beyond filling the role of a technology provider. "In our experience, dynamic discounting programmes can only fill a minor role in a buyer's overall supply chain finance strategy and only applies to smaller, non-strategic suppliers," he says. "Thus, a relationship bank may have a touch point with the buyer in a broader supply chain finance programme that requires external funding."

In a truly global supply chain finance solution, an enterprise or mid-market business needs funding for thousands of suppliers, located in multiple jurisdictions and in multiple currencies.

Roberts suggests that a single bank cannot provide for every one of these needs and that banks are notorious for choosing their own bottom line over what is best for the customer, not to mention the risk of a sudden jurisdiction or services exit.

"Banks make one of two decisions – either join a third-party solution or offer their own solutions, which tend to be less beneficial for the customer," he adds.

Mixed results

According to Drew Hofler, Senior Director, Financial Solutions, SAP Ariba, if the definition of dynamic discounting is expanded to include third-party funded early payments, the impact can be mixed.

"On the positive side, supply chain financing is a service a bank can provide to customers to generate additional fees," he says. "But many companies use such services to extend payment terms with more of their suppliers than banks are willing to fund and as a result, they turn to third-parties to deliver them."

Third-party solutions need to connect the three parties involved in transactions and provide visibility and reporting along with the functionality that each needs to execute the financing event.

Banks look to third-parties to provide the platform and community where these parties can interact so that they can focus on their core competency of serving as the financing arm. But Hofler observes that they tend to view these platforms as purely transactional and not worthy of credit fees and as a result are not sharing margins, which has limited the scope for such partnerships.

Nilay Banker, Founder and CEO of Inspyrus, describes dynamic discounting as both a challenge and an opportunity for banks. "It is a challenge in that it impacts bank deposits and new loans," he says. "At the same time, dynamic discounting can be an investment opportunity by increasing demand for working capital financing. Just like corporate finance departments, it challenges conventional business-as-usual thinking in our disruptive, digital economy."

In response to demand from treasury departments, some banks are looking to partner with dynamic discount providers and are in a very good position to embrace the concept, as they can easily integrate with existing supply chain finance programmes, says David Brown, co-Founder and Chief Product Officer of Previse.

"However, there is one important distinction – dynamic discounting is a commercial instrument where suppliers pay 1-2% per invoice value, whereas supply chain finance is a financial instrument based on the client's cost of borrowing and can be as low as 100bps annually," he explains.

That can create a situation where a buyer is paying a large supplier's invoice early at a 0.16% discount through a supply chain finance programme but an SME at 2%, because they don't qualify for supply chain finance.

COLIN SHARP is C2FO Senior Vice President EMEA

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"What the market really needs is solutions which can scale to suppliers of any size at the same cost"

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That can be difficult to justify, adds Brown. "What he market really needs is solutions which can scale to suppliers of any size at the same cost. That means looking at models based on the buyer's risk rather than the supplier."

An alternative model

Henning Holter, Head of Corporate Business Development at Tungsten Network Finance, refers to two emerging models for supply chain finance programmes – the traditional model driven by a few large banks who capitalise on their relationships with large corporates to extend the client's credit rating to a small number of their strategic suppliers; and the alternative, which capitalises on an existing or auxiliary network and technical infrastructure – such as electronic invoicing – to offer the buyer the same benefits, but extend the supply chain finance programme deeper into their supply chain.

Holter believes a few banks will continue to offer their own programmes directly, but that even these institutions will see the value in third-party partnerships. "For other banks, these partnerships open a new distribution channel to an attractive asset class previously unavailable due to high cost," he adds.

As long as we remain in a low interest environment, dynamic discounting will be very appealing to corporates, says Dalal. "Building the data and applying artificial intelligence is very relevant, not just for dynamic discounting but across all supply chain financing solutions," he adds. "The key is to convince the risk, compliance and credit chain in an organisation to lower their threshold based on the historical data points."

Most financial technology platforms (including dynamic discounting) already leverage artificial intelligence – the real value comes from being able to do something meaningful with it. According to Sharp, this comes down to striking the right balance between high-tech and high-touch.

"Artificial intelligence together with smart data can 'learn' how to address high volume, repetitive customer support tasks, pricing recommendations and unique product features by customer segment," he says. "But when it comes to making final B2B finance and procurement decisions, customers require support backed by actual insights created from data, human intelligence and financial experience."

The next level

Hofler expresses confidence that artificial intelligence can take dynamic discounting to the next level by detecting patterns in trading, cash flows and partner behaviours that can be connected to historical trading data to create new opportunities for cash flow financing.

"Key parties can be proactively notified of these opportunities so that they can capitalise on them, and technologies such as business networks will continue to evolve and create an ecosystem where all the parties involved in financing events can easily get the information they need to make better decisions, and collaborate in real time to execute them," he says.

Holter adds that sophisticated data analytics, predictive behaviour and automated support features are important tools to create more efficient supplier onboarding and better risk management.

These tools help create effective supplier segmentation to help optimise the pricing and onboarding strategies, as well as better reporting, reconciliations and financing requirement predictions, which drives lower cost and better rates.

The real impact will come from coupling dynamic discounting with invoice automation to ensure companies capture every possible discount available, delivering the force multiplier necessary to turn finance departments into profit centres, suggests Banker.

"Dynamic discounting also utilises advanced algorithms to help rapidly segment suppliers into optimal discount tiers and automatically recognise and apply pre-existing discount terms to expedite invoice processing," he says. "Enabling technologies such as artificial intelligence and adaptive learning will enhance these benefits even further and can help suppliers automatically select the best invoices to request early pay discounts, based on payment terms and other factors."

The value of integration

Israch refers to the value of integration, observing that if a finance team can barely even pay its suppliers on time, it will never be able to have a successful early payments programme.

This means that before the finance team can embark on such a programme, it needs to have its accounts payable and supplier payments process streamlined and optimised, he says. "Once we automate and speed up this workflow significantly, integrating early payments directly into that process is a home run. Corporates ultimately will want the early payments offer built directly into that new modern speedy workflow, to ensure efficiency for the finance team and optimal offer acceptance rates by their suppliers. That is where fintechs really deliver value."

Stark also expects to see distributed ledgers play a role within financing platforms to enable more immediate and structured information sharing. "The next generation of technology will stimulate even greater automation within finance and treasury, creating new opportunities (and jobs) that focus more on analysis and optimisation," he says.

Game changer

Most dynamic discounters have e-invoicing systems to streamline the process, but these require significant upfront investments in terms of implementation for both the buyer and seller. Most small suppliers simply are not equipped and resourced to implement these systems, so are often omitted from dynamic discount schemes. According to Brown, this is where artificial intelligence technology can be a real game changer.

"By looking at patterns in past invoices and payment data, machine learning and advanced data analytics enable you to get a highly accurate view of the likelihood a buyer is going to pay its invoice," he explains. "Because the analytics can determine that risk right from the point an invoice is issued, a bank (or any funder) can use that information to fund invoices on day one, without the need to wait for invoice approval from the buyer."

That means that there is no need to force change to the multinationals' processes and it also means that smaller businesses can be included.

Vrontamitis expects clients to deploy technologies to optimise working capital – including big data and analytical models – and potentially use artificial intelligence bots to make decisions around when to pay early using bank funds or their own funds and when to pay late. FX

MICHAEL VRONTAMITIS is Head of Supply Chain Finance at Standard Chartered

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