# Dynamic discounting

Provide your supply chain with the working capital it needs

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# Why supplier financing is in demand

The last few years have exposed global supply chains' strategic value and fragility. This has caused finance executives to more closely consider the strategic weak points in their supply chain, the nature of their procurement policies and the damage that late payments are causing to their respective supply chain networks. Historically loose monetary policy, and risk aversion from geopolitical uncertainty, have also pushed cash balances for many large corporations to record levels recently.[1] This has left firms struggling to find an investment risk versus return balance that makes sense.

These considerations have led to an openness to complementary ways of supporting supplier health and providing early payment in an easy, flexible, and balanced way.

## The growth of dynamic discounting

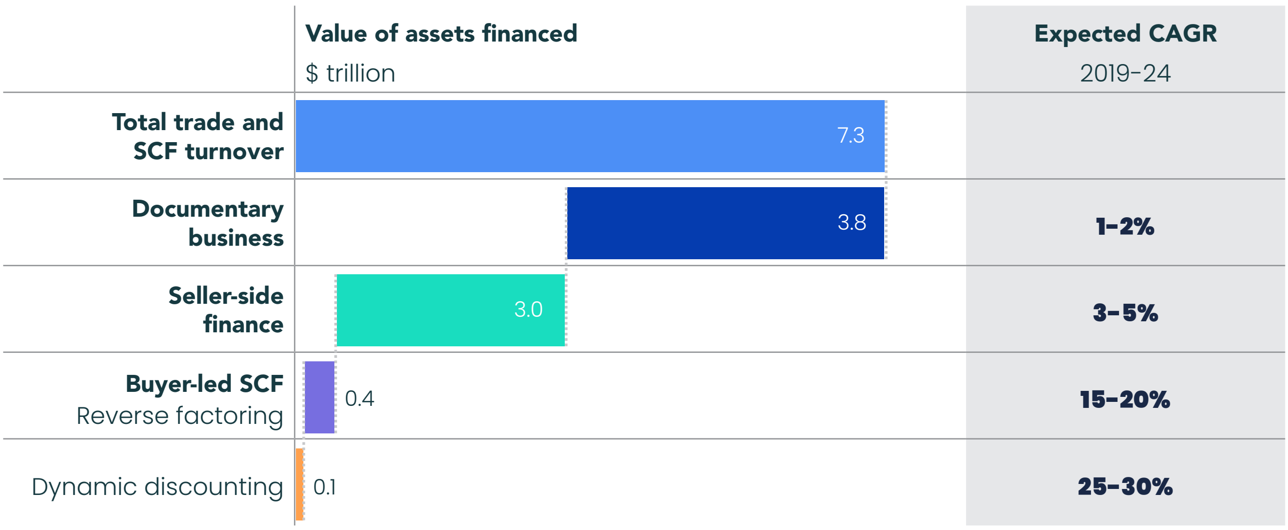
While dynamic discounting currently makes up a relatively small percentage of global supplier finance, recent McKinsey research forecasts the growth of dynamic discounting to far outstrip other forms of supplier finance over the coming years.[2]

One driver for this is the strategic ability to quickly and confidently inject cash into the supply chain when needed, often precisely for smaller vulnerable suppliers. Larger firms are increasingly implementing a range of overlapping and complementary programs, such as supply chain finance and dynamic discounting, to ensure different supply chain segments have the working capital they need to meet production targets.

With the risk of inflation and further raw material shortages in the years ahead, the ability to support suppliers in this way and build strong supplier relationships will likely mean the difference between meeting customer demand or costly stock outages.

As technology continues to digitize and integrate supply chains, the hurdles and bottlenecks that have previously limited dynamic collaboration between buyers and suppliers on a large scale are falling away. With supporting technology reaching a tipping point, the time is ripe for dynamic discounting that balances the working capital needs of suppliers with excess cash from buyers looking for practical yield. The following points highlight some of a dynamic discounting program's key benefits and critical success factors.

## The trade and supply chain finance landscape




Source: McKinsey Global Transaction Banking service line

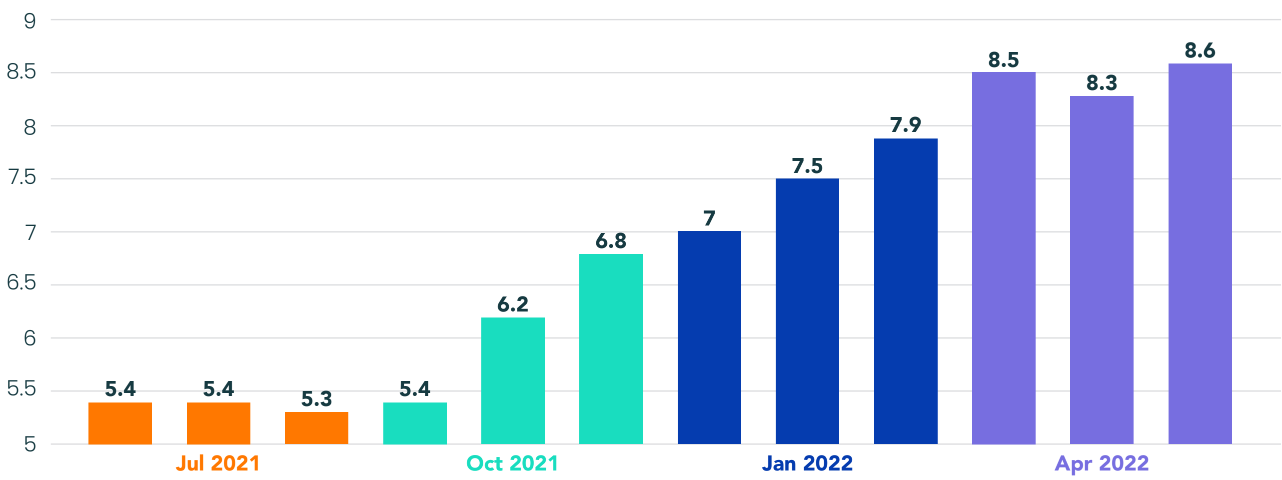
# Driving operating costs down

Inflation expectations for the years ahead are also front of mind for many firms. In the US, inflation reached 9% in 2022, the highest rate was seen in over 40 years, and is outstripping gross domestic product (GDP) growth rates by a stretch.[3] This gap between inflation and economic growth continues to challenge several markets, including the United Kingdom and the European Union.[4]

The covid-19 pandemic increased the volatility and rapid acceleration in the prices of many commodities and raw materials from the agriculture and mining sectors. For CEOs, finance, procurement, and treasury departments, this is already translating into a focus on cost reduction, exacerbated by war on the European continent.

Dynamic discounting can support this cost reduction objective in two ways. Firstly, through the broad, automated discount program at the heart of the system, which is accounted for as a reduction in procurement costs, directly reducing cost of goods sold and improves gross margins. Secondly, time and costs in accounts payable, invoicing, and the supply chain are reduced through less manual work, improved processes, and fewer supplier inquiries.

### The United States inflation rate




Source: U.S. Bureau of Labor Statistics

# Putting suppliers and supply chain technology first

With new economies, like the gig economy, growing out of digital innovation, many industries are learning that to thrive, they need to view and engage with suppliers in the same way as customers. This means investing in digital tools and simplified user journeys that facilitate connecting with suppliers and reduce manual workloads in the supply chain.

This has long been the case in implementing supplier finance and dynamic discounting programs. Older systems often limited smaller suppliers' ability to access and benefit from the program with complicated joining and manual invoice processes. Limited engagement with suppliers, in turn, reduced the scale and effectiveness of these programs for buyers.

## The importance of uptake

A critical factor in the uptake of supplier finance, and recent growth in dynamic discounting, is an investment in systems that put suppliers' needs first, such as a free-to-use portal that gives transparency across the broader supply chain, integrating the workflows of buyers and suppliers.

The challenges of onboarding high volumes of suppliers on a global basis mean that certain providers rely on archaic processes that lead to lengthy onboarding periods, while others charge the supplier for onboarding. An effective outreach methodology requires the resources and experience to support at scale.

Recognizing that each supplier has unique financial needs, driven by their interest rates and payment terms, means a comprehensive view of all supplier data is a vital feature. This gives suppliers the analytics and insights to improve their processes and more effectively and dynamically take control of their cash flow.

> We saw at least a 2.5x ROI over and above making investment decisions on our cash, borrowing in the market, including spending money on the program itself.

**Francois Coetzee**
**Project, Bank and Cash Manager** | Sasol

# Buy-in from the right teams at the right level

Successful dynamic discounting programs don't just require cooperation with suppliers. Another critical success factor is cross-functional engagement within the buyer's firm and buy-in from the right executive level.

Given that inventory management, supply chains, and working capital impact so many systems and functions across a business, process improvements and technology investment are often required to benefit fully from solutions like dynamic discounting. Manual approval and invoice processes in accounts payable can delay the acceleration of cash flow for suppliers, so digitization of the invoice process and supply chain are highly supportive foundations for any supplier finance. Ensuring an effective framework for dynamic discounting requires clear and common communication and collaboration between procurement, IT, accounts payable, finance, and treasury departments.

## Competing KPIs

Another challenge that requires engagement and collaboration is that supply chain solutions often require a trade-off in competing key performance indicators (KPIs) based on each firm's financial position and objectives. In some cases, finance, treasury, or various executives may struggle with the concept of releasing cash flow early to gain discounts. This requires the early engagement of all stakeholders to understand the metrics and bottom line profit-and-loss benefits that make the trade-off value-adding. The most successful programs ensure an early business champion at the executive level from either procurement or finance to support this process. This critical role is about communication and momentum that builds alignment between divisions, driving understanding of the business case and different objectives and KPIs.

## What is dynamic discounting?

Dynamic discounting allows suppliers to receive early payment on an individual invoice basis in exchange for a discount on the invoice.

While there are many similarities to a supply chain finance program, like onboarding suppliers onto a digital system that facilitates transfer, approval, and selection of invoices for discounting, a key difference is that in most dynamic discounting programs, the cash for payment of the invoice is not financed by a bank, but is paid out of the buyer's cash surplus.

A few key benefits are:

- The supplier has control of which invoices to discount and the flexibility of when to accelerate their payment at any time through the invoice term at a rate that is suitable
- Suppliers have access to cash at a lower effective rate than would normally be available with bank lending
- The buyer gets a risk-free yield on surplus cash, strengthens their supply chain, and automates a wholistic discounting process for accounts payable

# A self-funding business case

The importance of communicating and clearly understanding the business case for dynamic discounting cannot be understated given the opportunity for self-funding and broader supply chain technology investment.

One of the essential benefits of dynamic discounting is its ability to strengthen supplier relationships by supporting the health of all suppliers during market turmoil or shock events where bank or government financing is limited. On this basis alone, quantifying the value of avoiding stock outages, many firms have looked to add dynamic discounting to a toolbox of supply chain support systems. On a day-to-day basis, dynamic discounting also offers a cost-effective and flexible means of supporting the cash flow of smaller suppliers who can obtain accelerated working capital, as they would normally through their own discount programs, in a more automated way and at lower costs than traditional finance.

## The advantages of dynamic discounting

For buyers, dynamic discounting is particularly attractive to those with excess cash as it offers the opportunity to attract a higher effective yield than most traditional low-risk investments. Importantly, given the cash is simply an acceleration of an existing obligation, this yield is risk-free.

The most advanced systems are driven by artificial intelligence, which finds the right balance between supplier and buyer cash flow objectives and yield certainty. For buyers, the stability and predictability of returns from their system can be a crucial difference between the uncertain and volatile yields of many auction-based discounting or supplier finance programs.

With a predictable, higher return on excess cash and a system that can engage the full spectrum of suppliers, the business case for dynamic discounting programs can often generate a self-funding cash flow. This cash can be used to fund the initial investment in technology that can integrate supply chain analytics, inventory management, and a range of finance tools. More broadly, the cash flow from a longer-term dynamic discounting program offers the potential to fund ongoing investment in new and broader supply chain, logistics, and finance technology.

# A long-term focus on supply chain data and finance automation

With digitization and advanced data applications rapidly transforming supply chain management, ongoing technology adoption and integration are increasingly necessary for companies to manage working capital, eliminate errors, and improve processes that directly impact profitability. Older systems and electronic data interchange (EDI) processes cannot achieve the efficiency needed in modern supply chain management. This requires electronic invoicing systems or supplier portals that incorporate more efficient data exchange, with automated workflows and compliance validation of purchase orders and invoices.

One example of this type of finance and procurement integration is the ability of systems, such as that offered by Taulia, to manage the accounting treatment of supplier finance and dynamic discounting that has come under more focus recently. Taulia's system automates the offsetting of credit notes from suppliers that apply the discount to purchase orders, along with the value-added tax adjustments required from various tax regimes, to ensure the reduction in cost of goods sold.

Implementing dynamic discounting or supply chain finance with a fintech platform like Taulia's is broader than the initial benefit of integrated systems that make such a program simple and automated rather than a manual burden. It is fundamentally about partnering with a supply chain technology provider that automates information exchange between supplier and buyer, improving invoice approval processes and times, ensuring prompt payment of invoices, and meeting supplier needs through data insights.

## What is needed for success?

As the health and flexibility of the entire supply chain become a strategic strength in many industries, it is not surprising that more firms are adding dynamic discounting to their supply chain and working capital management toolbox. However, success requires a system partner with access to a large network of suppliers and the technology to balance supplier and buyer needs and ensure a seamless implementation that can scale across the entire supply chain to reach even the smallest suppliers.

Whether supplier health, timely payments, the yield on excess cash, or cost reduction are the priority today, the pandemic has taught us that more than ever, our systems and processes need to be ready for tomorrow's challenges. With this in mind, having a technology provider focused on streamlining, automating, and integrating the entire supply chain will continue to be a strategic advantage.

Get in touch today to further understand how dynamic discounting or Taulia's supply chain tools can support your objectives and KPIs in the coming year.


1. https://edition.cnn.com/2021/08/17/investing/cash-companies-balance-sheet/index.html

2. https://www.mckinsey.com/~/media/mckinsey/industries/financial%20services/our%20insights/accelerating%20winds%20of%20change%20in%20global%20payments/2020-mckinsey-global-payments-report-vf.pdf

3. https://tradingeconomics.com/united-states/inflation-cpi

4. https://www.forbes.com/sites/alejandrochafuen/2021/12/31/the-united-states-economy-in-2022-all-eyes-on-inflation/?sh=1c1966715dc8