How multi-enterprise networks are changing the supplier finance game

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Multi-enterprise platforms provide a way for a wide variety of industry sectors – from consumer goods, to retail, to auto parts, to manufacturers – to enable buyer-supplier ecosystems to digitise commerce.

These platforms provide different functionality along the source–to-pay (S2P) spectrum, with some offering specific functionality (e.g. an e-invoicing suite for suppliers with a portal or an A/P automation suite) or a much broader functionality, such as supply chain collaboration.

Many companies are entering new levels of maturity with their source-to-pay and supply chain applications and this connected commerce world is bringing new opportunities around supplier finance. With advances in data access, algorithms, and predictive technologies, new lending solutions can be made available to all suppliers. Funders can now leverage network data, other third-party data, and buyers' ERP data to provide finance options to a platform's supplier ecosystem.

Beyond today's early pay options

Up until about 2010, companies had few options to pay suppliers early. In fact, if you were not a large, investment grade corporate that could offer bank-funded supply chain finance (SCF) to your top-tier suppliers, your options were limited to p-cards and prompt-payment discounts.

Now, early pay options such as dynamic discounting and supply chain finance have become more common for large buyers to offer to their suppliers as a way to extinguish their receivables early. These solutions have flourished as many buyers are still pushing hard on working capital. The Hackett Group's recent study across more than 50 industries covered in their scorecard, found DPO reached its highest level in 10 years – 57.4 days, up from 53.3 days in 2016. This compares to a decade ago, where DPO clocked in at 40 days.

But the early pay solutions offered by buyers to their suppliers are focused on a very specific subset of suppliers. The figure below shows the supplier focus of early pay programmes and some of the key questions impacting the traditional early pay methods today.

While there are many explanations for why these methods only reach a small subset of suppliers, our analysis has shown it comes down to a few key reasons:

- Supply chain finance (aka buyer-centric reverse factoring) may not be offered to all suppliers, this is due to:
  - The buyer consumes bank credit lines in arranging this type of financing.
  - Buyers, if they sign a guarantee, run the risk that this type of financing can be construed by their accountants as bank debt versus trade debt, impacting their loan covenants.
  - Costly and time-consuming KYC supplier onboarding requirements may limit the size of the supplier the bank is willing to actively onboard. Often, supply chain finance programmes offered via banks or non-bank providers are solicited to only the top 50 or 100 suppliers.
- Sliding scale dynamic discounting programmes – that use technology to enable companies to pay their suppliers early using their own cash – are

often limited in size and priced at a high hurdle rate of 12%, 18% or even 36% per annum. Corporate treasuries do not want to commit sizable company cash to these programmes and look to them for yield management, not necessarily to help suppliers. In addition, these programmes shorten DPO (days payable outstanding). Another limiting factor is that dynamic discounting programmes are typically offered to vendors that sell only indirect goods, as opposed to direct materials.

- Commercial card solutions have become a convenient buying tool for low-dollar purchases and as a payment/finance vehicle (source of rebates as well). However, it has been poorly adopted in part because of the perceived shortcomings related to fees, lack of detailed/flexible spend reporting, and poor integration into the broader procurement/AP process (P2P). Cards also have inflexible fixed interchange rates (typically 2% to 3% flat), limiting the number of suppliers who would accept the pricing.

The hidden ingredient – connecting platforms with fast & intelligent underwriting

B2B lending is particularly indistinct, given how difficult it is to assess risk for all the counterparties to a trade. This is where platforms, networks, and digitisation come into play. Networks contain valuable data on the performance history of buyers and their suppliers.

Connected networks can address risk assessment through the power of rich, real-time information that has been cross-validated by multiple parties in the transaction. For example, a typical S2P network could have supplier information on:

- Annual volume
- Transaction history (i.e. length of doing business)
- On-time performance
- Completeness of shipment (partials or full)
- Business by commodity
- Payment (tying back Bank payment details)
- History of credit note adjustments

This incredible avalanche of collected data about supply chain transactions provides the raw materials that algorithms need to assess risk.

Despite what many players in the third-party early payments space might believe, underwriting is not just necessary, it is critical. For example, just because a buyer approves an invoice does not fully guarantee that the payment will be made 100% on the invoice value. Up until a buyer remits funds via ACH, cheque, card, or wire, that buyer reserves the right to dilute the invoice value. The technical term is post-confirmation dilution – invoices that have been approved and scheduled for payment but are nonetheless not paid in full. There are many reasons for post-confirmation dilution: credit memo for another invoice on same payment date; buyer disapproves already approved invoices; counterclaims or chargebacks; taxes; disputes; other items.

> **"Sell-side techniques have limits too. Factors finance 75% to 90% of the invoice value to manage dilution risk, not the full invoice value. Unsecured or secured lending facilities may only advance 60% of the invoice value, requiring a supplier to obtain additional equity capital to scale the facility in line with increasing sales."**

However, post dilution confirmation risk can be predicted and managed

A fully digital underwriting engine can continuously and intelligently interact with the network or platform to manage the risk profile of each of the suppliers on the platform. An automated decision engine can assign a cumulative score to a supplier based on factors such as liens, taxes, credit, judgments, fraud-threat, and compliance.

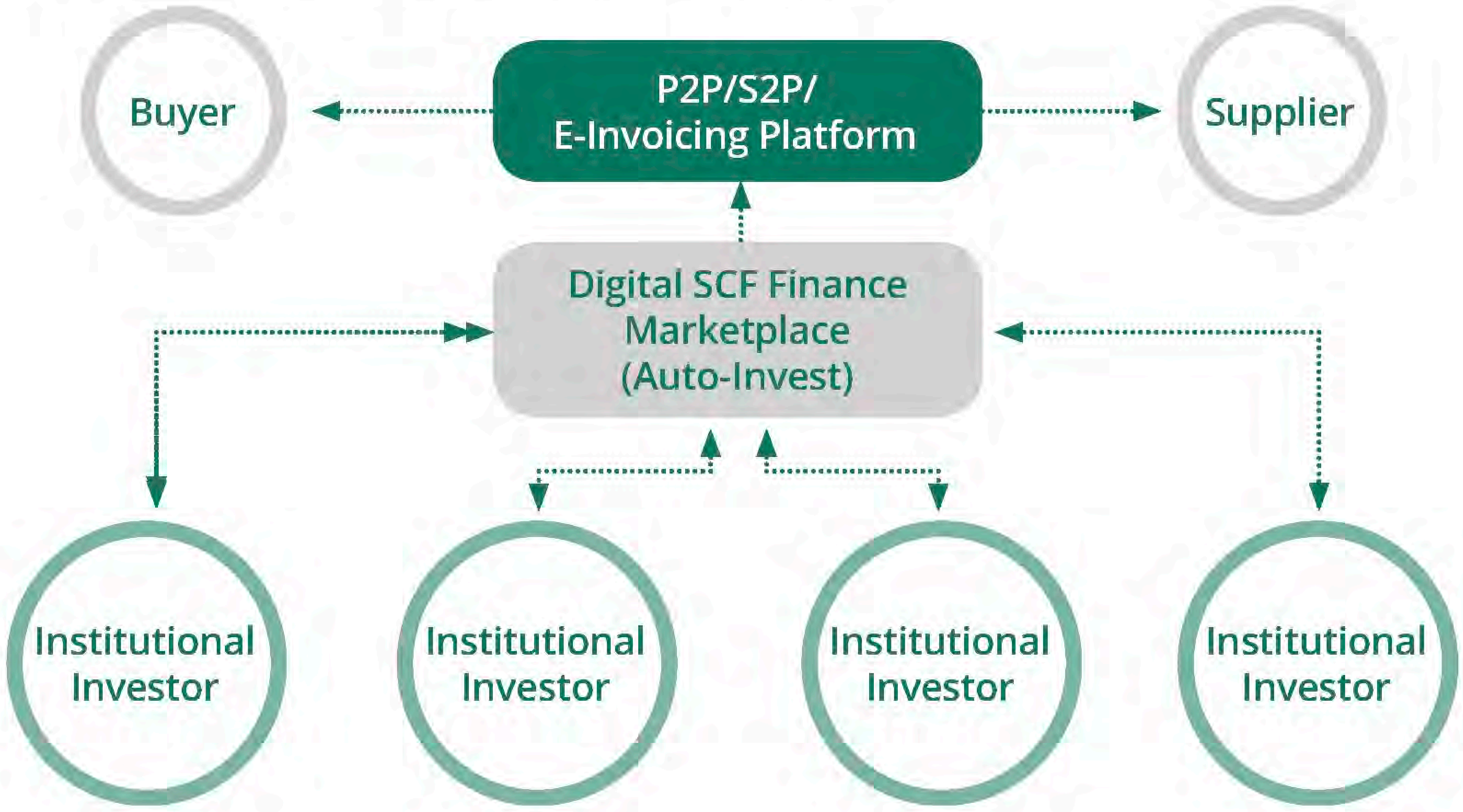
The larger P2P/S2P platforms host hundreds of buyers and millions of suppliers. This enables digital supply chain finance providers to step in seamlessly and instantly offer funding for any eligible early payment request that may arise. This can be executed with no change to the suppliers' customer experience.

Connecting platforms with a marketplace model for supplier finance

The effects of the financial crisis that unfolded between 2008 and 2009 uncovered systemic weaknesses in the global financial and banking system, including excessive lending and risk-taking without the support of adequate capital and liquidity buffers. Regulators quickly moved in and enacted regulations to address these flaws, while also enforcing compliance rules that were in effect. The aim was to make banks more resilient and to reduce the impact of bank failure on the economy and taxpayers. However, these changes had a number

Figure 1 provides a solution model that serves both investors with early pay receivables and a technology/ underwriting model offered to P2P platforms, marketplaces, etc. to offer flexible funding options for supplier – buyer ecosystem.

Figure 1: Service Model for Digital Supply Chain Finance



of unforeseen consequences that have permanently impacted the lending landscape, particularly for non-investment grade companies and SME's.

Because alternative lenders are not subject to the same restrictions as banks, there is a massive opportunity for non-bank originators and funders to supplement the traditional bank-driven business model as demand for supply chain financing grows amongst customers.

Figure 1: Service Model for Digital Supply Chain Finance

This solution operates a marketplace lending platform where institutional investors syndicate in providing early payment funding in multiple jurisdictions. International institutional investors with multi-currency and multi-country capabilities can use auto-invest systems that are built into this type of platform to manage investments, transactions, accounting and reporting.

The solution combines the funding from its marketplace platform with its proprietary technology to offer platforms and networks the following:

- Free access to technology (providing modules like dynamic discounting and e-invoicing at no cost to enable transaction flow).
- Flexible funding options for buyers, enabling them to use their own cash or third-party funding for early payments.
- An underwriting decision engine that uses fast data to create a dynamic credit limit for each supplier. Suppliers can take early payment on invoices up to the dynamic credit limit without buyers providing any guarantees such as a promissory note or irrevocable payment undertaking.
- Funding of early payments to the long tail of suppliers – not just the largest.
- Off-platform funding for suppliers' receivables issued to non-platform buyers, in order to facilitate better management of supplier receivables portfolio and reduce instability risk for buyers even further.

Final Thoughts

Companies can now leverage their ERP data, network data, and other third-party data to enable fast data credit decisions. This means funders can provide finance options to their total supply base and not leave small suppliers out in the cold. With the advent of advances in access to data, algorithms and predictive technologies, new lending solutions can scale to all long-tail suppliers.

We are still in the early days of such initiatives, but as commerce increasingly digitises and multi-enterprise supply chain collaboration platforms become the norm, we believe new digital supply chain finance opportunities will flourish.