

It is worth, for a moment, pausing on this point. Hundreds of thousands of businesses which are fundamentally sound, creating good jobs and with potentially transformative ideas and products close purely as a result of their cash flow challenges. It is a completely preventable disease which is ravaging the world economy.

Given the significant detrimental impacts long payment terms and slow payments have on small businesses and the economy, it is no surprise that governments have been putting increasing pressure on large buyers to speed up invoice payments. So far to little effect.

Buyers' remorse: The hidden cost of late payments

The full invoice life cycle (from the time a project is begun to the cash landing in the supplier's account) remains too long.

The siloed nature of many large organisations, accounting rules and process requirements all create barriers to addressing the problem and fail to provide sufficient incentives to hurdle those barriers. Buyers are shackled by the process burden.

In particular, as just 21% of small suppliers charge interest on slow payments⁵, for the majority of enterprise buyers, delaying payment appears to be costless.

This ignores the costs which suppliers incur trying to manage their cash flow. They may be indirect, but long payment terms, and late payments, create meaningful costs for buyers.

If a supplier is not paid instantly, it needs to find cash from somewhere in order to meet its costs. This will, most likely, come in the form of expensive financing, in one form or another, which will create further costs. While there are a variety of financing options potentially available, from the use of an overdraft to factoring/invoice finance, the vast majority of SMEs incur exorbitant costs from these approaches.

Given that typical payment terms are around 30 to 90 days, and late payment is common, suppliers have to include the anticipated cost of financing into the end price they charge customers. So, payment terms imposed by buyers result in an increase in their purchase prices.

Yet, many buyers continue to extend payment terms because these costs to the buyer are hard to measure. It is very difficult to work out how much of a premium an organisation pays for the goods and services it procures as a result of its payment practices. In a complex supply chain, many members of the chain may be incurring costs due to slow payment, some of which is passed back up the chain, resulting in a significantly higher end price for the buyer.

Supply Chain Finance 1.0

Given the negative effects of lengthy payment terms for both buyers and sellers, many buyers have looked for ways to enable their suppliers to receive payment faster.

Supply chain finance (SCF) is one such approach. An SCF lender, typically a major bank, leverages the credit rating of the buyer, rather than the supplier, to pay the invoice amount to the supplier shortly after the invoice has been approved. The bank then reclaims the money from the buyer once the invoice has been fully processed, up to 120 days later, and applies an interest charge.

SCF has found its champions over the past few years, not least in government where, in

5. Time to act: The economic impact of poor payment practice, Federation of Small Business, 2016

6. Prime Minister announces Supply Chain Finance scheme, Gov.uk, October 2012



2012, the UK Prime Minister announced government procurement departments would seek to use SCF where possible to aid its own suppliers⁶. It is a step in the right direction, certainly, but only a tiny step as SCF is not without its limitations.

Small suppliers left out in the cold

One of the most important limitations is its scalability down to smaller suppliers.

To on-board a new supplier, an SCF provider, typically a bank, has to undertake a host of checks including know-your-customer and anti-money laundering checks and is often required to set up a new bank account. For the on-boarding of the very largest suppliers, typically around 1% of suppliers by number, these costs can be justified, but for everyone else, it simply isn't economical for an SCF provider to take on their business.

This means that most of the small suppliers we have been discussing will struggle to access SCF programmes at all, representing around \$2.3 trillion in unmet demands for financing⁷.

SCF has often been used to soften the blow on suppliers from extending payment terms. For example, a buyer may have terms of 30-days, but then extends its terms to 60-days while offering SCF so that, at least in theory, its suppliers can still be paid within 30-days. Again, that works for the largest 1% of suppliers, but 99% of suppliers are left to suffer the extended terms.

Moreover, those suppliers large enough to be on-boarded by the SCF provider, should receive funds a few days after an invoice has been approved, but this still represents quite a significant delay of payment in many cases.

That is because a supplier's work doesn't start the day the invoice is issued. Often a supplier will have started spending on staff, equipment and materials well before it issues its invoice. It then takes the typical large buyer a considerable time to verify and approve an invoice. After all, they have to double check the terms and do all the checks to ensure it isn't a duplicate or fraudulent payment. That can be a cumbersome process and when a business is dealing with tens of thousands of suppliers it can be time and labour intensive as well.

Many buyers have started using electronic platforms such as e-invoicing to speed up some steps of this process. On the face of it, that is a good idea and where it can be used it has helped speed up and automate the invoice processing. For the suppliers, however, adopting any of these platforms requires a significant investment in terms of time and resources that often only makes sense if the supplier has reached a certain minimum scale. This again limits access to only the largest suppliers who have the resources to invest in such technologies.

All this combined means that a supplier might have been working on an order and incurring expenses for six months or more before an invoice is finally approved by the buyer and SCF can kick-in. Even for quite a large supplier, that is going to put a significant strain on its cash flow.

The limitations of SCF are not only of consequence to suppliers, but have meaningful negative implications for buyers.

Long payment terms can reduce the range of suppliers available to a buyer. If a buyer calls for a tender for certain goods to be delivered in nine months, very common in, for example, the fashion industry, then only those suppliers with large enough balance sheets will be able to participate. A host of smaller, and perhaps much better, suppliers

7. The future of fintech: A paradigm shift in small business finance, World Economic Forum, 2015

8. <http://treasurytoday.com/2016/05/ratings-agencies-take-aim-at-scf-ttti>



simply cannot afford to fund the nine months of working capital needed to participate in such a tender. So the buyer has a reduced choice of suppliers.

Buyers should also be aware that many SCF programmes have met considerable scrutiny by auditors recently, and in some cases payables under the programme have been reclassified as debt⁸. The fact that SCF programmes rely on approved invoices does not help here, since a binding irrevocable commitment to pay may be viewed as a characteristic of debt rather than payables. The accounting concerns can usually be resolved, but require a lot of attention and are often considered a meaningful risk

SCF 1.1 – dynamic discounting

In the last five years, the next iteration on SCF, dynamic discounting, has started to gain some traction. The essence of dynamic discounting is that the buyer has an option to receive a discount on the goods and services purchased based on paying earlier - the earlier the payment is made, the greater the discount. The buyer typically (though not always) funds the early payment with their own balance sheet, rather than using a third-party funder such as a bank.

With many buyers holding huge amounts of cash on their balance sheets, and interest rates very low, many firms are attracted to dynamic discounting as an effective use of cash. The profit and loss benefit from the early payment discount outweighs the cost of capital from reducing payment terms.

While dynamic discounting is an interesting new model, it suffers from the same challenges as SCF 1.0 - namely that it is only appropriate for the largest suppliers, and it still requires an approved invoice as well as significant process change to reduce approval times. Dynamic discounting is a good tool to give large corporates a better yield on their cash but is complex and uncertain for suppliers.

Again, in order to speed up the process, most dynamic discounters have e-invoicing systems, but these require significant upfront investment in terms of implementation for both the buyer and supplier. Most small suppliers simply are not equipped to implement these systems and so, once again, are left out altogether.

In addition, it is worth noting that dynamic discounting, being a commercial instrument, is significantly more expensive for the suppliers than SCF. Suppliers typically pay 1-2% per invoice value, whereas SCF is a financial instrument based on the client's cost of borrowing, making dynamic discounting significantly less financially attractive to suppliers.

SCF 2.0 – an intelligent approach

To really get to grips with the slow payment problem, buyers require a solution which they can roll out across their entire supply chain, reaching down to even the smallest suppliers and the tiniest invoices, and in a frictionless way. After all, it is the SMEs that have the greatest challenges with cashflow and are most in need of financing.

As we have already described, the moment that a buyer approves an invoice is not the start of the project, so a truly effective payment solution must be able to be deployed well before invoice approval, from the time a project is agreed and an invoice or purchasing order received.

Achieving such a system is possible with the aid of machine learning and predictive technologies, but, we must fundamentally rethink supply chain finance. We need SCF 2.0.



The true risk in the payments chain is the small number of problematic invoices which won't get paid. If those risky invoices can be identified with precision, they can be excluded at an early stage, leaving the remainder bulk of 'good' invoices which are highly likely to be settled eventually by the buyer. These can therefore be paid immediately by a funder in confidence, at very attractive financing rates.

Previsе's smart technology does this by analysing hundreds of millions of data points from the buyer's invoice data to predict the very few invoices which are unlikely to be paid so that the rest can be paid instantly.

Funding can therefore be extended to the suppliers instantly, without having to wait for the buyer's approval of the invoice.

Given that this approach does not require any assessment of the creditworthiness or strength of the SME supplier, but looks purely at the probability an invoice is likely to be settled, it is a completely scalable solution which can be applied to even the smallest supplier.

The program is funded by a small fee, 1% per month of invoice terms, paid by suppliers. This fee is split between the buyer, the funder and Previsе. This approach means that buyers earn meaningful new profits from implementing instant payments. While the supplier receives instant cash far easier and cheaper than it could otherwise access.

Let's take a simple illustrative example. An SME made to wait 2 months to be paid a \$100 invoice, given the costs of financing, is only receiving \$96 in today's money. Through SCF 2.0 they could be paid instantly \$98 (an extra \$2!), with the other \$2 shared between the buyer, for access to its data, and Previsе for the small costs of running the programme.

Buyers make money. Suppliers save money.

Instant payment brings benefits for all

SCF 2.0 will eliminate the problem of slow payment all together. It would allow suppliers of any size to be reliably paid on the day of receipt for every valid invoice they issue. It would make instant payment the expected standard in business to business transactions, much as it is in the consumer sphere.

This system will be a revolution, not just for struggling entrepreneurs, but for the entire economy.

Right across the world, sluggish investment and a lack of productivity improvements are keeping wage and GDP growth depressed, with a knock on for average living standards⁹. Implementing instant payment world-wide would unlock more than \$650 billion annually for SMEs¹⁰, a complete transformation of commerce, the world economy and the lives of billions of people across the globe.

To find out more about how to implement 'SCF 2.0' in your business, get in touch with the Previsе team at info@previ.se for more information or to schedule a no commitment demo of our instant payment decision making technology.

9. Continued slowdown in productivity growth weighs down on living standards, OECD, May 2017

10. Previsе research found that 29% of SMEs take loans to cover cash flow. We calculated this as a percentage of total SME funding according to UK Finance's lending figures for Q42017 (£108.7 billion)

