HOW “DYNAMIC” IS DYNAMIC DISCOUNTING?

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Businesses of all sizes are looking for ways to improve cash flow and working capital. In addition to improving processes, leveraging the right technology and getting more products to more customers, expediting payment is one of the ways an organization can positively impact their bottom line almost immediately. We recently published an informative eBook on early payment, *The Definitive Guide: Early Invoice Payment – The supplier’s guide to understanding early payment options and how to leverage it for improved cash flow*. One option highlighted in the guide is Dynamic Discounting, but let’s take a close look and see just how dynamic this early payment option is.

Dynamic Discounting is a method of invoice payment that allows for a supplier to receive that payment early and a buyer to receive a discount for making that payment earlier than term. The amount of the discount is relative to the date the early payment is made.

Key to Dynamic Discounting is a sliding scale where the earlier a payment is made the higher the discount will be for the buyer and, conversely, the lower the net amount paid to the supplier. In addition, Dynamic Discount is typically structured around an online interface, where the customer offers to pay approved invoices with a discount tied to the timeframe a supplier would accept it. Furthermore, a supplier has the option of accepting the offer (or, taking the payment) or simply waiting to be paid at term where there is no discount.

Dynamic Discounting has been applauded for eliminating the challenge supplier organizations face when incorporating static terms. It was not uncommon for customers to pay at term (i.e. 30 days or more) while still taking a discount intended to be used only if paid early.

Another key element of Dynamic Discounting is that the system puts the buyer in control of making the offer. A supplier cannot request that a customer make an early payment, but instead only accepts or declines the offer from the buyer.

It’s Not Supply Chain Financing

It is important to note that in the case of Dynamic Discounting, a buyer will typically pay the invoice from its funding rather than use a third-party to finance it. Whereas in the case of Supply Chain Financing, a buyer would look to a third-party, such as a bank, to cover the early payment. In both Supply Chain Financing and Dynamic Discounting, the buyer benefits by saving on the cost of the purchase. The supplier also benefits from both methods by receiving payment early, which contributes to the company’s working capital and can significantly lower DSO.

Factoring the Difference

With another form of early payment, Factoring, the supplier is the one that turns to a third party to finalize the transaction. The supplier sells the receivable to the lender or factor and receives an advance on the value of that receivable. Sometimes it’s done in a single transaction, other times it can be done in two transactions where an initial amount is advanced followed by another amount once the customer pays the outstanding invoice to the factor. The factor is responsible for obtaining payment from the buyer and, depending on the structure of the agreement with the supplier, will be liable for the outstanding payment or will make the supplier responsible if the customer does not pay.

Dynamic Discounting Considerations

The buyer has flexibility when using a Dynamic Discounting mechanism. They can offer it to all suppliers or only a select few. They can offer one supplier, or group of suppliers, one APR while offering other suppliers something different. Once an invoice is approved a message is sent out to the supplier offering an early payment. The supplier can then opt in, select the date they wish to be paid and the system will work out the discount to be applied. This automates the process, which makes it easier to use and more efficient for both parties.

It’s worth noting that not all customer-approved invoices may be available for Dynamic Discounting. Those invoices that appear on the platform ready for payment can be selected by the customer while other approved invoices may not be. In addition, the discount rate may change based on a number of factors, such as how much capital the customer has assigned to pay invoices early, the current APR offered by alternative institutions or the nature of the relationship between the customer and the supplier.

Is Dynamic Discounting Right for Your Organization?

Dynamic Discounting can be a valuable tool for getting paid early, but it's good to know the differences between it and other early payment solutions. Dynamic Discounting can be used in any industry and for any company. It has been particularly favored by smaller businesses that benefit the most from increased cash flow and the flexibility that comes with improved working capital. Rather than ask whether Dynamic Discounting is right for your organization, perhaps the better question is whether your customer thinks it's right for you.

Ernie Martin is Founder and Managing Director of Receivable Savvy. He brings over 25 years of experience in financial supply chain management, marketing and communications and draws upon his extensive experience to share knowledge and best practices with AR professionals. His resume also boasts time at several well-known brands and companies such as Tungsten Network, Delta Airlines, CIGNA Healthcare and Georgia Pacific as well as a number of years as an independent consultant.