Invoice Finance: is it right for your business?

Despite the talk of “green shoots” of recovery, many business owners are still having difficult conversations with their bank managers as they try to renew facilities. Even fundamentally sound companies can suffer from debilitating cash shortages which can eventually lead to the breakdown of profitable trading.

What is Invoice Finance?

It involves a company selling its sales invoices to a third party funder, who will then allow the company to draw loans against the money owed on those invoices. This can improve the flow of working capital and, if a Confidential Invoice Discounting Agreement is used, the company’s debtors won’t know that the Invoice Finance provider is involved. Funds can be advanced against new invoices quickly, giving a company greater power to negotiate discounts with suppliers and invest in the business for the future.

How does it work?

1.) The finance provider will carry out some checks on the business finances and profiling of its debtors.
2.) A credit limit is allotted to each customer.
3.) After the company has provided a debtor with goods or services, they are sent an invoice and the Invoice Finance provider is notified too, usually in an electronic format.
4.) If it meets the finance provider’s requirements and is approved, an agreed percentage of the invoice value is made available.
5.) Payment is made by the customer and the company updates the sales ledger.
6.) Finally, the finance provider credits the company with the remainder of the invoice value, less any charges.

There is no doubt that Invoice Financing can provide businesses with a solution offering a flexible funding option that can provide increasing facilities as the business grows. When the customer settles the invoice the cash is repaid, interest (or a discount) is charged on the balance of cash drawn down and a service fee is usually charged for providing the facility. With the exception of the service fees, this makes an Invoice Finance facility similar to an overdraft, except that the borrowing limit is set by turnover and the value of invoices outstanding.

What Types of Invoice Finance are available?

1.) Invoice Discounting

For established businesses, Invoice Discounting is ideal. The business continues to receive customer's payments, manage its own sales ledger and credit control activities. A drawdown facility on sales invoices of up to 80% is provided, with the balance when a customer pays. There are two options available:

a.) Confidential

Confidential Invoice Discounting is provided for established profitable companies with a strong balance sheet and the arrangement is not disclosed to customers.

b.) Disclosed

This service is provided for those companies whose balance sheets are not so strong, and the finance company's involvement is disclosed to customers. For many companies, this facility develops into a Confidential Arrangement, as the benefits of consistent cashflow take effect and profitable expansion gets underway.

2.) Full Service Factoring

The main difference from Invoice Discounting is that the funder takes over responsibility for running the sales ledger and handles debtor collection. There are two options available:

a.) Recourse Factoring

Provides the same drawdown facility as with Invoice Discounting, without the burden of running the sales ledger, but with the knowledge that cashflow will be safeguarded through effective but sensitive supervision and collection. Considerable savings can be made in administration costs, such as sales accounting, stationery, postage, telephone charges, computer systems, staff time and other associated costs, by the finance company looking after customer accounts through state of the art computerised accounting systems.

b.) Non-Recourse Factoring with Bad Debt Protection

Provides all the benefits of Factoring and Invoice Discounting such as immediate advance of up to 80% of the face value of the invoice, with the balance when the customer pays, with the added advantage of 100% Bad Debt Protection.

Will it work for your business?

It's ideal if you trade with other businesses and invoice them in arrears. It's particularly suited to industries and sectors with high values of outstanding invoices.

For Invoice Finance to work, you should have a good spread of debtors and need to be selling goods or services on normal credit terms, with no stage payments or contractual sales. Invoicing can be made and advanced in sterling, euros and dollars. Your accounting package should be computerised. Before entering into an Invoice Financing agreement, companies should first consider the following:

- Why do they need additional funds and what is the most appropriate form of finance?
- Carefully review their terms and conditions, lock-in periods, service charges and interest rates.
- Consider what the impact will be on their accounts team? Can they cope with the additional workload?
- Review their systems and procedures as these will be audited by the finance provider.

What are the benefits

- Immediate finance is provided which is automatically geared to turnover and is not normally dependent upon whether the business is willing or able to provide collateral security.
- If a business has limited physical assets but has sizeable invoice debts, it may find it hard to secure funding against the assets through traditional funding methods. Invoice Finance specialises in this area, helping to support the business ambitions and growth plans.

- Restrictive overdrafts may no longer be required.
- Improvements to Return On Capital Employed (ROCE) can be made by using the cash generated.
- Accounts administration costs can be reduced and expert sales ledger and credit control skills can be utilised.

What are the drawbacks

- Any Invoice Finance provider will want to audit a company before any agreement is put in place. If the financial performance has not been good, the ageing of the debtors is too old, or the credit control procedures are inadequate, the charges made for the agreement may be higher, or the application for finance turned down.
- As any finance is linked directly to turnover, if the quantity or value of sales invoices drops, so does the amount of cash available from the facility.
- The credit worthiness of customers, in relation to the value of the goods supplied to them, may cause problems. The finance provider may not allow the full value of sales invoices if they exceed the agreed credit limit for that customer.
- Many Invoice Finance arrangements offer insurance against bad debts which can be an added benefit of using a facility, but the premium also becomes an extra cost. The purchase of a trade indemnity policy can be optional, but sometimes it is a mandatory condition of the offer from the lender and, therefore, another cost.

REMEMBER!!!

Through its network of strategic partners, Remedy has access to specialist Invoice Finance providers, who are not banks, and are able to offer higher drawdown levels of up to 90% of invoice value, due to the expert knowledge they have of specific markets. To see how you can access this network of expertise and improve your cashflow please call Remedy For Business Ltd.