

Invoice Finance

All businesses rely on receiving money for goods and services that they provide and if everyone paid their bills on time wouldn't life be much simpler! Invoice Finance is the means by which financial institutions will advance you part of your invoiced sales value prior to your customers paying their bill. The two principal types of Invoice Finance are normally known as 'Factoring' and 'Invoice Discounting'.

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Since Redarch was established in 1995 our team of seasoned business professionals have offered their experience and knowledge in all aspects of business.

We work as advisors within your operations with demands on our services being dictated by the growth and development of the business and the individuals therein.

Our Service is there to guide and support not to dictate or take control, it is your business and we never forget this.

If you are ready to start investing in the future of your business and optimising the returns then call us on 01376 57 37 67.

Factoring and Invoice Discounting

Factoring allows you to obtain finance based on the value of your outstanding invoices, which is particularly advantageous to businesses that are growing quickly as it is often a more flexible source of working capital than bank overdrafts or loans.

An added benefit of factoring is that it allows you to outsource sales ledger and credit control with more sophisticated procedures and credit rating systems than most small and medium sized business could afford.

How Factoring and Invoice Discounting Works

Although there are many differences between the different factoring companies and you need to shop around to get the best deal for your business they all basically follow the same procedures before offering facilities:

- The factor audits your books and accounts to establish that your sales ledger meets its criteria.
- You should generally have a reasonable number of customers with no one customer accounting for too large a proportion of your business. Although some factors will take a view where there are only a few customers and where one customer has a particularly strong credit rating.
- Factors only provide finance to businesses dealing on trade credit terms, preferably working to industry standards.
- You should be collecting your debts within a reasonable time frame.
- Businesses such as builders and advertising agencies which are paid in stages, may need to look to specialist factoring companies
- Too many small invoices may make factoring uneconomical.
- Businesses whose sales are diminishing are unlikely to find factoring cost effective
- Where credit limits are required by the factor, you and the factor must agree how they will be handled.
- For non-recourse factoring (where the factor protects you against bad debts), the factor will usually set credit limits for each customer based on the credit rating they achieve
- Once you make a sale, you invoice your customer and send a copy of the invoice to the factor.
- Most factoring arrangements require you to factor all your sales.
- The factor pays you a set proportion of the invoice value within a pre-arranged time.
- Typically, most factors offer you 80–85 per cent of an invoice's value within 24 hours.
- The factor issues statements on your behalf and collects payments.
- The factor contacts late payers by phone and pursues outstanding invoices
- You remain responsible for reimbursing the factor for bad debts, unless you have arranged a 'non-recourse' facility

- You receive the balance of the invoice (less charges) once the factor receives payment.
- The factor provides regular reports on the status of your sales ledger, with many factors offering online account information.

The Advantages

Factoring

- Cashflow is maximised
- Factoring enables you to raise up to 85 per cent or more on your outstanding invoices, whereas an overdraft secured against invoices would normally only raise up to 50 per cent.
- You negotiate an initial credit line which can continually grow in line with your sales without further negotiations whereas bank finance, such as overdrafts and loans secured against existing assets, has to be continually renegotiated and additional set up fees paid.
- Factoring tends to reduce the time and money you spend on debt collection, as much of the work in maintaining a sales ledger is done by the factor for you.
- You retain your own sales ledger operations if you opt for invoice discounting
- You can use the factor's credit control system to help assess the creditworthiness of new and existing customers reducing the risk of bad debts.
- You can purchase 'non-recourse' factoring to protect yourself against bad debts.

Invoice Discounting

Invoice discounting enables you to retain the control and confidentiality of your own sales ledger operations and:

- You collect your own debts.
- 'Confidential invoice discounting' ensures that your customers do not know you are using invoice discounting.
- You send out invoices and statements as usual.
- The invoice discounter makes a proportion of the invoice available to you once it receives a copy of an invoice you have sent.
- Once you receive payment, you must deposit the funds in a bank account controlled by the invoice discounter.
- The invoice discounter will then pay you the remainder of the invoice, less any charges.

If you want to use Invoice Discounting as opposed to factoring:

- The requirements are more stringent.
- Different invoice discounters will impose different requirements; although a general rule is that your annual turnover must be over £500,000 and in some cases exceed £1 million, and

the invoice discounter will regularly audit your books (usually every three months) to check that your credit control procedures are adequate.

- You must have a minimum net worth of around £30,000.
- Your business must be profitable.
- The requirements for 'disclosed' (ie non-confidential) invoice discounting are generally less demanding.

The Costs

Finance charges should be comparable to an overdraft, with typical charges on the amount financed range from 1.5% to 3% over base rate, with interest calculated daily.

Credit management and administration charges, including the maintenance of your sales ledger, depend on your turnover, the volume of your invoices and the number of customers that you have. For invoice discounting, where finance alone is provided, administration fees range from 0.2% to 0.5% of annual turnover. (i.e. between £2 and £5 per £1,000 of annual turnover)

Credit protection charges (for non-recourse factoring) largely depend on the degree of risk the factor associates with your business, particularly the credit worthiness of your customers.

The Disadvantages

- Unless carefully implemented, factoring can have a negative impact on the way your business operates.
- The factor usually takes over the maintenance of your sales ledger, which may alienate some customers who may prefer to deal with you rather than a factor.
- Factoring may impose constraints on the way you do business.
- For non-recourse factoring, most factors will want to pre-approve your customers, which may cause delays.
- The factor will apply credit limits to individual customers (though these should be no lower than prudent credit control would suggest).
- You may only want the finance arrangements, but unless your scale of operations is big enough to justify invoice discounting, you may feel you are paying for credit controls and collection services that you do not need
- Ending a factoring arrangement can be difficult.
- Your only exit route is to repurchase your sales ledger or to switch factors.
- On a practical level, you need to be able to provide an alternative form of financing

Export Factoring

Export factoring enables you to minimise the risk of doing business overseas by relying upon a factor to collect payments.

- You can use export factoring to bypass the complexities of export finance and offer your customers 'open account' trading.
- The turnover requirements are higher than with UK factoring.
- You can choose to invoice in one currency and be paid in another.
- Many customers will prefer being quoted in their own currency.
- You can protect yourself against currency fluctuations.
- The cost of export factoring compares favourably with the cost of export finance.
- The cost of export factoring is typical marginally higher than the cost of domestic factoring.
- You can minimise the risk of non-payment by purchasing credit protection.
- Using an export factor's credit protection systems can be cheaper than using specialised export finance.
- Most factors will insist that you purchase credit protection.

Picking a Factor

You will probably want to talk to several factors and get quotes from more than one before you make a decision. (Be careful, particularly if using internet sites that you are getting quotes for the same service)

- There are many independent factoring and invoice discounting companies, as well as subsidiaries of the major banks, you do not have to factor with your current Bankers and indeed may find it beneficial not to in many circumstances.
- Confirm that all the factors you are considering offer the services you require, at the right price.
- Ask how each factor's credit-control system works, including questions like: Will the factor want to pre-approve future customers? What credit limits will the factor want to set? How quickly will the factor make decisions?
- Confirm each factor's proposed finance, credit management and credit protection charges, and how they will reduce as turnover grows.
- Some factors may want to charge you for a survey of your debtor book before they will offer you an arrangement

Before you Sign an Agreement!

Once you have chosen a factor, make a detailed check before you commit yourself. Extricating your business from such an intimate working relationship can be complicated and expensive.

- Check, as far as you can, that the factor's performance is likely to be satisfactory.
- Does the factor (and the individual who will be responsible for your account) have experience of your industry?
- How will you communicate with the factor?
- What reports will you receive?
- What information will you have to provide?
- How often will you and the factor meet?
- How quickly does the factor collect debts?
- How does this compare with your own debt collection performance?
- How flexible will the factor's methods be?
- What is the factor's idea of 'quick response', in an emergency?
- What will happen if customers accidentally breach their credit limits?
- What will happen if you want a customer's credit limit increased?
- What will happen if the factor's performance is unsatisfactory?
- Ask for references and telephone some of the factor's existing customers.
- Ask how well the factor has performed and whether there have been any problems.
- Discuss how the factor will handle debt collection, including details of when statements will be sent and how disputes will be handled
- How will the factor pursue overdue debts?
- What will happen when a customer's payments are seriously overdue?
- What form will the final reminder letter take and when will it be sent?
- What further action will the factor take to collect overdue debts?
- Will a collection agency be used?
- Will legal action be taken?
- As with all legal documents, read the factoring agreement carefully, confirm the terms and conditions for ending the factoring arrangement and make sure they are clear. If in doubt, take legal advice.
- What would happen if you wanted to change factors?
- There may be a notice period (typically three months) and a fee.
- What would happen if you wanted to alter the services provided by the factor?

N.B. Redarch always use 'Plain English' developing Real Growth and Optimising Potential, keeping things simple, knowing that your success is ours also.