

A Guide to Invoice Discounting



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The biggest issue most businesses face today is not being able to get cash in quick enough to pay the bills.

There are two main options – **Invoice Discounting or Invoice Factoring.**

Invoice discounting and factoring both provide finance against unpaid invoices. Factoring provides the additional advantage of a full sales ledger and collections service under which the “factor” takes on the responsibility of collection of your ledger.

Under an invoice discounting service you continue to administer the sales ledger and the service is usually provided in a confidential manner.

In this guide we will concentrate on looking at the benefits of invoice discounting.

Invoice discounting provides an immediate injection of cash to your business by allowing you to raise funding against 90% of your unpaid and future invoices. Unlike restrictive bank overdrafts invoice discounting provides a working capital facility that grows with your business.

An invoice discounting facility provided by the most appropriate finance company will leave you free to unlock the true potential of your business rather than spend your time juggling bills and chasing customers for outstanding invoices.

However choose the wrong finance company and it could have disastrous consequences on your business!

How Invoice Discounting Works

Invoice discounting is very straight forward:-

- You deliver goods or services to your client.
- You notify the invoice discounting company of the work performed and your invoice is raised
- The invoice discounting company advances you the pre-agreed percentage value (typically 70-90%) of the invoice the same or the next day.
- Invoice discounting can be provided on a confidential basis.
- A trust account is set up and as your customers payments are paid into this account.



- The finance company deducts its charges and then pays you the balance of the invoice value.
- Invoice discounting is usually provided up to a maximum period of 90 days
- Invoice discounting does not provide credit control.

How Much Will it Cost?

There are two headline charges associated with invoice discounting facilities and a number of secondary costs which should be studied in the small print.

Firstly, the interest element for the actual amount of money borrowed.

This is calculated as a percentage over Bank Base Rate or LIBOR typically at 2-4%.

Beware certain finance companies will charge a minimum base rate several percentage points higher than actual Base or LIBOR. LIBOR and Bank Base Rate are not always the same. Bank owned invoice discounting companies tend to link their funding to Bank Base Rate whereas an independent invoice discounting company will link to FHBR.

The second element is the cost of providing and administering the facility.

This charge is usually a percentage of the annual turnover and can be anything from 0.1% to 2% depending on your circumstances and whether you require credit insurance. Because invoice discounting does not provide credit control the service fee is usually much cheaper than with a factoring facility.

A refinancing charge is also applied by many invoice discounting companies. After an initial period of say 60 days the value of any unpaid invoices are rediscounted for a further period of 30 days at a percentage of the amount outstanding. This could be as much as 1 or 2 %

Disbursement costs are the amount invoice discounting company's charge for doing one off tasks such as sending payment of direct transfer or sending you a letter. This should again be checked in the small print



Am I Eligible for an Invoice Discounting Facility?

Any business providing goods or services to other businesses on credit may be eligible to apply for an invoice discounting facility.

You can be a limited company, sole trader or partnership, and from a cost effectiveness point of view, turnover should be more than £250,000 however there is no upper maximum

Invoice discounting is not normally available for new start businesses.

It is now possible to discount foreign invoices.

Businesses that have previously been declined by a high street bank may be eligible for funding via a more flexible independent invoice discounting company.

Specialist invoice discounting packages are available for businesses involved in the construction industry or undertake work via contracts.

Whilst invoice discounting is traditionally available only to profitable well established businesses the most important aspect from a finance company's point of view is the company's credit control procedures and their invoicing trail. Any business that can demonstrate that they have adequate systems and procedures in place may be eligible.

How Do I Choose an Invoice Discounting Company?

There are 3 types of invoice discounting companies:-

High street bank based invoice discounting companies controlled by their parent bank

Independently owned invoice discounting companies that do not obtain their funding from the banks.

Bank owned invoice discounting companies whilst owned by a bank have their own autonomy and trade independently of their parent bank.

NB. The most important aspect of an invoice discounting company is the ability of the finance company to provide the right level of funding against your unpaid invoices. Because invoice discounting does not provide credit control a high street bank may prove to be a cheaper option and should not be overlooked. However as with factoring, independent based invoice discounting companies tend to be more flexible and easier to deal with.



We would recommend obtaining quotes from two or three companies.

The invoice discounting company which will best suit your business depends on a number of differing factors: -

Geographic location as independents can be regionalised rather than nationalised

Turnover. Different invoice discounting companies are better than others in a certain turnover level. There are also a number of independent invoice discounting companies specialising in funding to the smaller business

Length of time trading.

Credit rating. Banks will only fund businesses with reasonable credit

Number and quality of invoices

Concentration levels. If you have only one or two customers this may exclude you from certain funders but not others.

Any foreign invoices? Certain invoice discounting companies have an international presence and these are not necessarily the bank owned invoice discounting companies.

Is part of your business contractual? There are only two invoice discounting companies that can provide a facility

Do you need credit insurance? Banks and independents provide very different types of credit insurance

Do you need an overpayment? Certain invoice discounting companies can provide a top up via an EFG loan

Do you have any other borrowing facilities with your bank? There is an argument for and against using a bank in this instance. Too many eggs in one basket or does having one funder provide economies of scale and more flexibility.



Summary

A good independent invoice discounting broker will be able to discuss your own unique requirements and put you in touch with the most suitable invoice discounting providers.

Always see two and a maximum of three, any more and the finance companies won't take you seriously.

Make sure you understand the charging structure and remember the headline rates do not always show the full picture.

Make sure you are comfortable with the individuals involved in the business.

Make sure you know the credit limits of your top ten customers.

Don't be afraid to ask questions and arrange a visit to their premises.

