

Managing Cashflow Guides



6. Factoring and financing options



Cashflow is critical to business survival but all too often the day-to-day challenge of running a business, particularly a smaller business, can mean losing sight of some of the skills for successful cashflow management. This series of guides, developed in partnership with the Institute of Credit Management, is part of a series of initiatives providing practical support to help businesses help themselves through these difficult times. They are designed to provide straightforward and speedy advice with simple checklists and top tips. I hope you find them useful.

Peter Mandelson
Secretary of State for Business

Most businesses extend credit to their customers and extending credit requires finance. Unless a business has the cashflow to support the difference in timing between the cash it collects and the cash it has to pay out, it can be in trouble. Managing cashflow effectively means staying on top of finance and ensuring funds are available when they are needed.

Can you answer yes to all these questions?

- Do you have sufficient cash reserves to meet commitments and pay suppliers on time?
- Are you getting longer payment terms from your suppliers than you're giving to your customers?
- Do you have finance facilities in place that will grow with your business (Factoring and Invoice Discounting are designed to do just this)
- Is the product or service you supply so vital that you can dictate payment terms?
- Is the level of your bank overdraft or short-term finance sufficient?
- Do you monitor the creditworthiness of your customers?
- Do you have access to adequate credit management systems and skills?

Six Top Tips

If you can't answer yes to all the questions opposite, you might need to consider these alternatives in financing your business.

- 1.** Don't wait until things become critical. You need time to put arrangements in place and it's easier when you're not under too much pressure.
- 2. Factoring** – the factor agrees to pay an agreed percentage of approved debts as soon as they receive a copy of the invoice; 80-85% is common. The balance, less charges, is paid when the customer pays and the factor will undertake all credit management and collections activity following an agreed credit policy. The advance is likely to be 'with recourse' (meaning that the factor will be able to reclaim its money from you if your customer does not pay) so the option of bad debt protection should be strongly considered.
- 3. Invoice Discounting** – immediate cash for up to 80-85% of the approved invoice value is available. However, responsibility for the sales ledger operation and credit management activity remains with the organisation and the service is normally undisclosed to its customers. Payments received are paid into a bank account administered by the invoice discounter, after which the company is credited with the balance, less charges. Again, this advance is likely to be 'with recourse' (meaning that the discounter will be able to reclaim its money from you if the customer does not pay) so the option of bad debt protection should be strongly considered.
- 4. Supplier Finance** – sometimes called 'Reverse Factoring', is an option if you are a regular supplier to a large organisation that has an appropriate arrangement in place. Invoices are paid immediately (and ahead of terms) when the buyer confirms it has approved the invoice for settlement. The buyer then repays the financier according to the original contract payment terms. This allows you to receive an immediate cash payment, less a discount that is based on the buyer's credit rating and is without recourse (meaning that money will not be reclaimed from you if your customer fails to pay).
- 5. Project Bank Accounts** – ensure that the contractor and their supply chain receive promptly monies rightfully due through certified interim payments. The Project Bank Account is set up in trust for the whole supply chain and is the medium through which payments are made. The Project Bank Account makes payment on receipt of an instruction signed by both the project client and contractor, and the supply chain is notified of the day they will receive payment from the Project Bank Account. Project Bank Accounts have Trust Status which prevents a receiver seizing the proceeds of the account in the event that the contractor goes into receivership.
- 6. Asset Based Lending** – where funding is provided, secured against the property, plant, machinery, stock, or sometimes even the brand name, of a business.

The Guides in this series:

1. Knowing your customer
2. Payment terms
3. Invoicing
4. Treating suppliers fairly
5. Credit insurance
6. Factoring and financing options
7. Chasing payment
8. When cash runs short
9. When all else fails
10. When your customer goes bust



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For tips on getting paid and advice on best practice in credit management, call the Institute of Credit Management on **01780 722 911** email **tech@icm.org.uk** or visit **www.creditmanagement.org.uk**

For further information and advice on starting up, running and growing a business, call Business Link on **0845 600 9006** or visit **www.businesslink.gov.uk**



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