Debtor Finance

YOUR GUIDE TO DEBTOR FINANCE FOR AUSTRALIAN BUSINESSES

Learn about:

- invoice factoring
- invoice discounting
- modern invoice finance
- how to set up debtor finance

waddle

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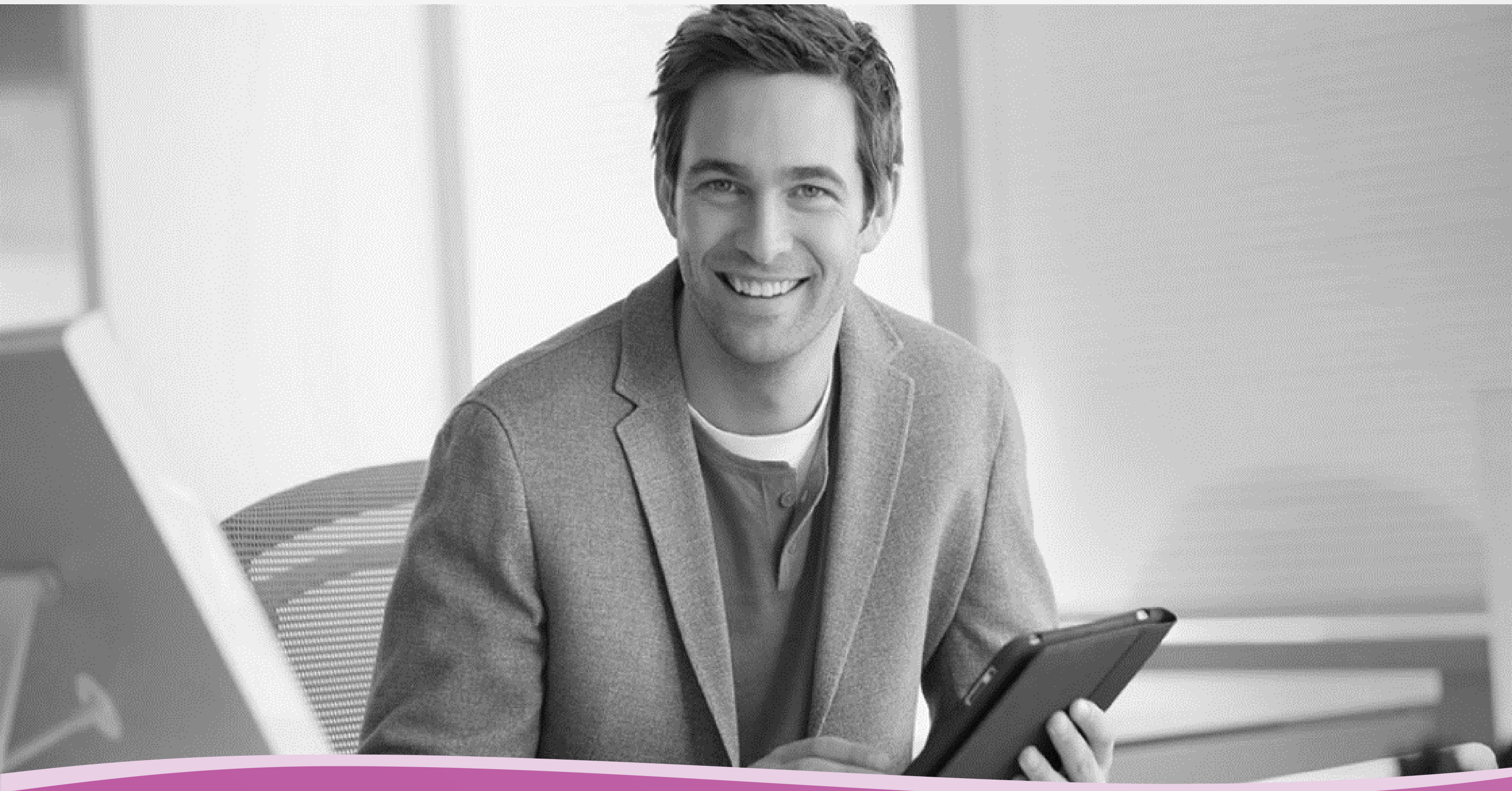
Introduction

This is a big topic, so let's start by defining exactly what we mean when we talk about debtor finance.

Debtor finance refers to a group of working capital products where the underlying loan collateral is the accounts receivable assets of a business. Colloquially this product type is also known as Invoice Finance. Before we get into the detail, however, a little bit of history.



The history of Debtor Finance

Debtor finance is one of the oldest forms of commercial finance.

in fact, debtor finance dates back to the Roman Empire where invoice financiers of the time would assist Roman merchants to finance their trade transactions. Just like modern businesses, these early merchants had to overcome cash flow issues. Consider that for a merchant to complete a transaction, goods often had to be shipped to faraway lands where payment was made in physical currency with payment not settled until the return journey completed (Electronic Funds Transfer would have been great in 500 AD). You can appreciate the cash flow pressures faced by these early businesses and the important role played by their financiers.

Debtor Finance today

Fast forward to today and debtor finance remains a common working capital tool for businesses that trade on credit terms.

Instead of waiting for your customers to make payment, funds tied up in your accounts receivable can be accessed now to fund business expenditure, such as to:

- pay wages
- pay creditors
- purchase inventory
- purchase equipment/machinery

Debtor finance is well suited to growing businesses with capital available to the borrower that grows in line with sales. Typically, 80% of the Accounts Receivable ledger is accessible by the borrower. In fact, when a company requires a relatively high amount of capital, debtor finance is usually the most appropriate product. There is generally no requirement for property security to be pledged, instead, the credit quality of the borrower's debtors is of primary importance to the financier. This can be a real benefit to early-stage companies, traditionally seen as a higher credit risk, that are trading with larger more established businesses.

How does debtor finance work?

At a high level, all debtor finance products operate in a similar fashion.

Funds provided by the financier are secured against the underlying accounts receivable of the business. The balance owed is reduced by customer payments as and when they pay over time. Technically at the contractual level, the borrower is selling their accounts receivable assets to the financier. Seems simple enough right? Not so fast, individual products can differ substantially in their implementation although the majority align with two broad models -invoice factoring and invoice discounting.

What is invoice factoring?

Invoice Factoring is a disclosed facility, in that the borrower relinquishes the Accounts Receivable collections process to the debtor financier.

The borrower's debtors are made aware of the financier's involvement and can expect ongoing communications from them. This style of funding is generally better suited to early-stage companies with immature bookkeeping and collections processes or companies operating in higher risk industries.

The administration demand placed on the customer is high with detailed invoice and reconciliation information required to be provided (often manually) to the financier, effectively doubling the borrowers bookkeeping efforts. Due to the impact on the borrower's customers and the effort involved, this style of funding is generally less desirable.

What is invoice discounting?

The key difference with Invoice Discounting is that the borrower maintains the Accounts Receivable collections process and the relationship with their customers.

In this model, the borrower's customers are not aware of the debtor financier's involvement. Whilst the provision of data to the financier is still manual, generally only aggregate accounts relievable information is provided and thus less of a burden when compared to Invoice Factoring data requirements.

The mechanics of invoice discounting products means it operates much like a revolving line of credit. It is for these reasons that Invoice Discounting is generally considered more desirable. Unfortunately, the product has traditionally only been available to much larger businesses with mature back office processes.

How to set up invoice factoring or invoice discounting.

A borrower looking to set up an Invoice Factoring or Invoice Discounting Facility can expect to provide to the financier the following at a minimum:

- Historical and current Financial Statements
- Detailed Accounts Receivable and Accounts Payable reports
- Copies of invoices
- Related invoices documentation (e.g. Customer Purchase Orders and Contracts)
- Proof of identity

The sheer volume of information required means that the on-boarding process typically takes weeks to complete, with multiple months not uncommon. Many financiers also include a site visit as a condition of any finance approval.

Where does Waddle fit in?

Waddle aligns to the Invoice Discounting model in that it's a confidential facility, and thanks to its technology platform, Waddle is available to business of all sizes such as wholesaler Eclipse Organics, and it can be set up within 24 hours. Learn if Waddle is a good fit for you. More and more Finance Brokers are referring their clients to Waddle's modern invoice finance over factoring.

The ongoing use of the facility is simplified as the platform integrates seamlessly with the business's existing accounting and back-office processes. See how Waddle compares to other types of invoice finance.

Get in touch today to see how we can help your business.