

PUTTING CASH IN THE BANK

If you think debtor finance is a step on the slippery downhill slope to business failure it's time to get with the program. This could be your cashflow saviour. **By Rob Lamers**

Profitable businesses too often fail through simply not having enough cash. Even when the business model is sound and the business is successful, having working capital tied up in accounts receivables can sound the business' death knell. To grow their businesses, an increasing number of Australian SMEs are looking to debtor financing to turn receivables into much needed cash in the bank. These businesses are successful and they're taking the attitude that money in the bank is better than receivables on the books.

HOW IT WORKS

Debtor finance converts receivables into cash. The business hands over its invoices to the debtor financier in return for receiving a sizeable proportion of the amount owed (around 80 percent) up front in cash. The remainder of the money is paid when the invoice is paid. The overall cost to the

business is around one-to-two percent of the invoice amount.

Debtor financing can be a way to "have your cake and eat it too". With debtor financing you no longer need to offer customers a hefty two-to-five percent discount to encourage prompt or early payment, so you don't give away a slice of your profits to improve your cashflow. Instead, with the money you get from your debtor financier for your invoices, you can go to your own suppliers and negotiate a discount for early payment. The result is that not only do you pay less for your supplies but you also won't forsake profits by discounting your own invoices.

WHO'S DOING IT?

Debtor finance is one of the fastest growing small business finance tools. All the leading banks offer debtor finance facilities to their customers and the industry has experienced growth of between 20 and

30 percent per year for the last 10 years. Debtor finance is designed most specifically for SMEs, with those turning over 1-to-30 million dollars comprising around 90 percent of the businesses making use of it. Already some 5,500 Australian small businesses trade their invoices for improved cashflow and of these some 1,000 have started using a debtor finance facility within the last year.

buy more stock and grow the business. Another benefit is in terms of security and the amount of cash you have access to. Unlike credit options such as an overdraft, debtor finance is not secured by the net equity in real property such as the business owners' houses. Instead it is secured against the success of the business making it an option for businesses where it is inappropriate, impossible

BECAUSE SMEs TYPICALLY DON'T HAVE THE SAME KIND OF IT SECURITY THAT AN ENTERPRISE HAS, THEY HAVE FEWER SAFEGUARDS IN PLACE

WHY IT MAKES SENSE

If you're not taking advantage of debtor finance you're missing out on some key benefits to your business and its owners. On the one hand you're missing out on an opportunity of turning a balance sheet asset, your receivables, into cash that you can use to grow your business. By converting accounts receivable into working capital your business can find the cash it needs to employ more people,

or undesirable to offer real property as security such as where you don't have equity available. In addition, because the amount of debtor finance is tied to the business success and to the value of the accounts receivable, when the total value of the business' invoices grows, the debtor finance amount grows too. If you're operating a secured overdraft, you can generally only increase its value when the equity in the secured

property increases which may not happen when the business needs cash.

If you're using debtor finance you have the equivalent of a line of credit that grows with your business' success and that is guaranteed by it.

GETTING YOUR MONEY

One common misconception held about debtor finance is the complexity of administering it. While this was the case in the past, it is no longer so. Advances in information technology have reduced the administrative requirements for debtor financing so all that is generally required is to draw the data from your accounting

software such as MYOB or QuickBooks and to email it to your financier. The entire process is almost seamless and has resulted in a dramatic reduction in administration costs to both business and the financiers which, combined with increasing competitiveness in the market, has reduced the cost of debtor finance to around half the cost today of a similar facility 10 years ago.

THE NUTS AND BOLTS

The basics of putting together a debtor financing package are relatively straightforward. You will need to prove that your business is in a sound financial position and the financier will

analyse your debtors ledger, assessing it for the quality of debtors, the aging of debts and the spread of debtors. In some cases you'll be able to be selective about those debtors you hand over to the debtor financier in other cases it will assume all of them. If you're able to select the debtors to hand over, you'll generally be required to commit all the invoices you send to that debtor.

OUTSOURCE IT ALL

In many cases, along with utilising debtor financing, a business can also opt to outsource all its debtor administration tasks. This has advantages in reducing the

costs to your business of debt collection and credit control. It also gives your business access to credit professionals using expert systems who can manage all aspects of credit control from credit checks to collecting accounts and identifying risks to your business. As a business owner you can be secure in the knowledge that debtor administration is being handled by experts allowing you to direct your time to running and building the business rather than managing debtors.

Next time you look at your cashflow, ask yourself if there are things that you could do if you had cash in the bank rather than debtors on the books? If there are, then debtor financing might be just the financial tool you're looking for. ■

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