UK Factoring & Invoice Discounting Market Research Summary – Part 3
14th May 2013

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Introduction

FundInvoice LLP offer the UK's first market research led invoice finance advice and search service http://www.fundinvoice.co.uk. We also publish "FundingVoice" a free magazine which offers expert tips, advice and articles about improving business cash flow and funding.

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This document summarises that market research findings prior to the 14th May 2013 and is the third in a series of summaries.

This market research summary is based on a number of individual surveys and is also enhanced with some anecdotal feedback received from businesses seeking invoice finance.

The conclusions from the previous two research summaries were:

1) Invoice Finance Has Growth Potential – the invoice finance industry has the potential to grow if the profiles of these products and providers were raised with potential customers.

2) Invoice Financing Costs Are High But Also Misunderstood – cost is clearly a key issue inhibiting the expansion of the invoice finance market. However to some degree prospective customers may also be over estimating the cost of invoice finance. Promotion of more transparent costing would help.

3) Product & Brand Awareness Is Low – greater awareness of the benefits of invoice finance, and of the businesses providing these services, would lead to a greater uptake of invoice finance.

4) Invoice Finance Can Have Funding Advantages Over Overdraft – clearly overdraft is currently used far more widely than invoice finance. However, the levels of funding raised through invoice finance, as a percentage of outstanding debtors, can be significantly higher than that available via overdraft. Overdrafts also appear to have been reduced or removed in some cases.

5) Customers Want More Flexible, Unrestricted Funding – with the exception of cost, funding restrictions were the top issues for potential customers. They also wanted more flexibility around the provision of funding.

6) Customers Want Instant Online Setup And Approval – the second most requested improvement to invoice finance generally was the requirement for facilities to be able to be approved instantly via the internet.

7) Product Awareness Is Low – customers did not appear to understand the full range of invoice finance products that are currently on the market. Several existing products already addressed requirements that respondents raised during the research.

8) Customers Think Invoice Finance Is Overpriced – by an average of c.19% and a 25% price reduction would satisfy some 75% of potential customers.

9) Banks And Accountants Are Key To Invoice Finance Growth – potential customers saw promotion of invoice finance via banks and accountants as the key. They also advocated more general industry marketing and felt that government support for invoice finance would also play a role in growing the market.

Businesses Don't Understand How Easy It Is To Get Invoice Finance

Invoice Finance companies are actively seeking customers to fund. It is very rare that they are unable to help a prospective client, regardless of circumstances. Overdrafts on the other hand have become harder and harder to get and we have spoken to a number of clients that have had their overdraft removed or reduced.

So in an invoice finance related research survey, amongst 100 randomly selected SMEs, we wanted to find out if businesses realised how comparatively easy it was to get invoice finance. Therefore, we asked them: "For businesses generally do you think it would be easier, harder or about the same level of difficulty to qualify for invoice finance as it would for overdraft?".

The answer was surprising:

Only 7% of respondents thought that it would be easier to get invoice finance than to get an overdraft

This reveals an enormous gulf between reality and the perceptions of businesses.

Perceptions Of Qualification Criteria For Invoice Finance Versus Overdraft

73% of respondents thought that it would be just as hard to qualify for invoice finance as to qualify for an overdraft. This indicates a huge misunderstanding about how easy it is to get invoice finance rather than an overdraft.

We went on to ask those respondents why they though it would be as hard to get invoice finance as it would be to get an overdraft. Of those that said it would be equally hard:

89% of them said the reason for their answer was that they thought it would be the "same process" to qualify for invoice finance as it would be to get an overdraft

This is another major misunderstanding as the credit underwriting processes for invoice finance and overdraft are completely different. Qualification criteria for invoice finance are based primarily on analysis of the quality of the sales ledger and debtors of a business. Underwriting criteria for overdraft tend to focus on the financial accounts and other tangible assets of the business or its owners/directors. Significant levels of funding can be raised through invoice finance even where a business has a no worth in its balance sheet and is currently not trading at a profit.

The remaining:

11% that thought it was equally difficult to qualify for invoice finance and overdraft said that they thought that their "credit rating" would be the key issue

. . . in both cases.

Once again this is not the case. Credit rating may be important when granting an overdraft but previous adverse credit history can often be overlooked by invoice finance companies as their prime concern is ensuring that the quality of the debtor book is strong. In this way even businesses with poor financials and previous adverse credit history can still get funding through invoice finance products such as factoring although overdraft and loan products may not be available.

20% of respondents actually thought that it would be harder to get invoice finance than to get an overdraft

There is a great amount of misunderstanding here as invoice finance is freely available to businesses that would not qualify for an equivalent overdraft in many cases.

We asked those 20 respondents why they thought it would be harder to get invoice finance than an overdraft and their reasons were as follows:

- 9 said more paperwork & boxes to tick
- 3 said there is more risk involved with invoice finance
- 1 said that invoice finance companies won't look at small companies

- 1 said that there is more money involved with invoice finance
- 1 said everybody has an overdraft so it must be easier
- 1 said higher volumes involved
- 1 said more hassle involved
- 1 said strict process
- 1 said its not offered to everyone like an overdraft
- 1 said there is a lot more involved with the set up

Most of these reasons are incorrect. We have addressed each of them in turn below:

More paperwork & boxes to tick - the amount of paperwork is probably not dissimilar and this does not detract from the key point that qualifying for invoice finance such as factoring and invoice discounting can be much easier than qualifying for an overdraft. The decision is based mainly on the quality of the sales ledger so poor financials and adverse credit history are not so important.

There is more risk involved with invoice finance - no, the risk is less as the invoice finance company has greater control over the sales ledger of the business than a bank has with an overdraft. This reduces the risk – banks often move higher risk clients to invoice finance from overdraft as the risk controls are better.

Invoice finance companies won't look at small companies - no, invoice finance is available to any size of business and some factoring companies do not have any minimum turnover criteria.

That there is more money involved with invoice finance - well that is often true but it does not make invoice finance harder to qualify for. Invoice finance does tend to release more money than bank overdraft. See the answer to the next question for a comparative of the level of funding between overdraft and invoice finance.

Everybody has an overdraft so it must be easier - again there is some truth in the observation that everyone has an overdraft – our previous research found that 88% of 100 businesses that we surveyed had an overdraft but once again it does not make it easier to qualify for one. Invoice finance is just not well known and not promoted widely enough. Our previous research also showed that on average a business overdraft was equivalent to just 2.6% of debtor outstandings whereas according ABFA figures to June 2010, pure invoice finance advances against debt represented an average of over 42% of the client's debtors outstanding.

Higher volumes involved - again see the above answer which compares the volumes of funding involved.

More hassle involved - This might be fair comment to some extent, there is generally more involved with running invoice finance than overdraft but once again it doesn't make invoice finance harder to qualify for. Also, the benefits of that additional work can be huge e.g. if you are using a factoring company to undertake all your credit control for you – this is not the case with overdraft.

Strict process - no stricter than any form of lending and finance.

Its not offered to everyone like an overdraft - the types of business that are suited to invoice finance are narrower than the criteria for overdraft. However, this has broadened recently with invoice finance offerings covering sectors such as construction and even retail.

There is a lot more involved with the set up - again maybe that is true in some cases but it does not make the qualification for invoice finance harder.

Overall, we have identified a large amount of misunderstanding about the criteria to qualify for invoice finance.

Why Do Only A Few Businesses Understand That Invoice Finance Is Easier To Get Than Overdraft?

Only 7% of businesses think that it is easier to qualify for invoice finance than a bank overdraft.

Of those businesses that said that they thought it would be easier to qualify for invoice finance than overdraft we went on to ask them why.

These were the reasons they gave:

- 3 said "flexibility"
- 1 said an invoice finance company monitors constantly, funding grows with you, more of a relationship
- 1 said less restrictions
- 1 said the factor (factoring company) has control
- 1 said their overdraft was taken away, they looked into factoring and it was up and running in 2 weeks

These reasons are all aspects of why it is easier to qualify for invoice finance than overdraft, however very few businesses seem to be aware of these factors.

Which Invoice Finance Product Do Businesses Think Is Easiest To Get Factoring Or Invoice Discounting?

Anyone that works within the invoice finance industry will consider it common knowledge that qualification for invoice discounting is harder than qualification for factoring. With a factoring facility the factoring company has more control over the client's sales ledger (their security) as the factoring company undertakes the credit control function for the client. Hence the qualification criteria for factoring are more lenient.

With invoice discounting the credit control is undertaken by the client, giving the invoice discounting company less involvement, which also reduces the cost. However, the lesser degree of control and involvement means that the invoice finance company perceives their risk as being higher and hence it is more difficult to qualify for invoice discounting as the qualification criteria are higher.

We wanted to know if businesses understood this difference so we asked 100 randomly selected SME businesses: "Do you think that for businesses generally it would be easier to qualify for factoring or invoice discounting?".

87% of respondents said that they didn't know if it was easier to qualify for factoring or invoice discounting

The majority of businesses simply do not seem to understand the differences between invoice finance products even at this high level, let alone at a detailed level.

Do Businesses Prefer A Tariff Of Invoice Finance Charges Or A Fixed Fee System?

We wanted to find out about the views of businesses regarding the fixed fee deals which are being offered by several factors at the moment. We wanted to gauge opinion regarding the option of a tariff of charges or a fixed fee system.

Therefore, we asked 100 randomly selected businesses: "For businesses that use invoice finance, do you think that they would prefer an all inclusive single charge for the service or a tariff of charges where they pay for specific services each time they use them?".

The result was that:

74% of businesses said that they thought a tariff of charges would be preferred over a fixed fee system

The remaining 26% said that they would prefer a single fixed fee.

Clearly the results demonstrate that there is a market demand for both, and there are options for clients in both cases. However, it is interesting to see the weighting towards the tariff approach – this should be considered by factoring companies when they are designing new invoice finance products.

Construction Finance – How Many Businesses Raise Applications For Payment?

One of the key issues within the construction sector is that in many cases businesses do not raise invoice for payment but they present applications for payment to their customers against which the payments are received.

Traditionally this would have been a problem for invoice finance companies as they fund against invoices but there are now options for construction businesses to receive funding against applications for payment rather than invoices and these can even be funded if they are uncertified, or not yet approved.

We asked a sample of 100 randomly selected construction sector businesses “do you raise applications for payment?”:

75% of construction sector businesses said that they did raise applications for payment

Hence our research found that only 25% of construction businesses do not raise applications for payment.

Construction Finance – Would Businesses Benefit From Immediate Payments Against Uncertified Applications For Payment?

To measure the level of demand for funding against uncertified applications for payment we asked our sample of construction businesses: “Would your business benefit from receiving immediate funding against applications for payment which haven’t yet been approved?”. The result was that:

85% of respondents (that raised applications for payment) said that they would benefit from receiving funding against such applications for payment

. . . this demonstrates a clear demand for these niche funding services for the construction sector.

Do Construction Businesses Use Invoice Finance Or Applications For Payment Finance?

We asked our sample if they used any form of invoice finance or finance against applications for payment and of the 100 businesses interviewed:

Only 2% said that they used invoice finance or applications for payment finance

We then asked them specifically which invoice finance companies they used for their construction finance – one used Lloyds TSB Commercial Finance and the other used Bibby Financial Services.

This suggests that the market penetration of this sector is very low – there are a lot more construction businesses that could be benefiting from this type of sector specific finance. There are also other invoice finance companies, besides the two that were mentioned, that now service this sector, although their market share is clearly even lower.

65% Of Construction Businesses Need To Raise Finance

We went on to question them about their future funding requirements and:

65% said that they expected to need to raise further finance during the next 12 months

This should present a huge potential funding opportunity for the invoice finance sector to provide funding to construction businesses.

Only 19% Of Construction Businesses Have Had An Invoice Finance/Applications Finance Quotation

We asked these construction sector businesses if they had ever received a quotation for invoice finance/applications for payment finance (construction finance):

Only 19% said that they had received a quotation for construction finance

81% of construction sector businesses that we interviewed said that they had not received a quotation for invoice finance/applications for payment finance.

This creates an interesting pipeline of statistics regarding construction sector businesses:

- 65% need to raise finance
- Only 19% have had construction finance quotes
- Only 2% actually use construction finance

This pipeline reveals a demand that is not being fully met by the invoice finance sector currently.

Construction finance remains an ideal solution for these businesses to meet that funding gap – if the majority with a funding need haven't even had a quote for construction finance it suggests that there is a lack of market awareness of the options that are available.

The Reasons Why Only 2% Use Construction Finance

As only 2% of construction sector businesses that were interviewed used construction finance we asked those that didn't use construction finance why not. These are the reasons they gave for not using it were as follows:

- 42% had never heard of it
- 22% said they were cash rich or didn't need finance
- 12% said it was too expensive
- 9% said they used an overdraft or bank loan instead
- 6% said they didn't think they would be suited to construction finance
- 4% said they had been turned down
- 3% said they had never considered it as an option
- 2% already use invoice finance

So the results suggest that the biggest issue for financing this sector is a lack of knowledge that construction finance is even available with:

42% never having heard of invoice finance/finance against applications for payment

. . . and a further 3% never having considered it as an option. There appears to be a great deal of scope to raise awareness of the availability of this type of finance within the construction sector.

Analysis Of The 75% That Raise Applications For Payment

Of the 75% of construction businesses that raise applications for payment:

- 79% see the need to raise finance over the next year
- 69% also say they would benefit from payments against uncertified applications for payment
- 45% also say that they have not had a quote for such a funding product

- Of the 45% that could be suitable prospects for construction finance, 79% had never heard of such a funding product

The numbers may seem complicated but it boils down to a significant volume of construction sector businesses that have a need for funding but have never heard of funding against uncertified applications for payment – a product that is available from several providers within the market place.

Invoice Finance For Construction Sector Businesses

Above we have focused on construction finance against uncertified applications for payment but in 25% of cases construction businesses raise normal sales invoices on credit terms rather than applications for payment. We didn't find that any of these 25% of construction sector businesses used invoice finance, despite raising credit invoices that could be eligible for funding.

Of that segment, 24% of them said that they had the need to raise additional finance over the next year but half of them had never heard of invoice finance and the remainder used alternative funding sources such as overdraft or bank loans.

Even invoice finance companies that don't want to fund applications for payment could attack this segment of the construction market where the client raises credit sales invoices and nearly a quarter say that they need to raise more finance.

Even Construction Companies That Don't Need Capital Would Benefit From Payments Against Applications For Payment

35% of the respondents said that they didn't foresee the need to raise any finance over the next 12 months. However just over a third of those (34%) said that their business would benefit from getting payments against uncertified applications for payment.

A slightly contradictory finding but one that supports the broad appeal of the construction finance products that are now on offer - providing funding against uncertified applications for payment.

Of those that said they would benefit from funding against applications – two thirds (67%) said that the reason they had never used construction finance against uncertified applications for payment was because they had never heard of it.

Who Quoted For Invoice Finance/Applications?

Of the 19 that said that they had received a quote for construction finance either in the form of invoice finance or finance against applications for payment 2 had subsequently taken up a facility – one with Lloyds TSB and one with Bibby.

We analysed the reasons why the other 17 didn't go ahead after getting a quote and the results were as follows:

- 10 said the quote was too expensive (6 said they were quoted by Lloyds, 1 by Calverton, 1 by Close Invoice Finance, 1 said Venture Finance who are now known as ABN AMRO Commercial Finance and 1 did not say who had quoted)
- 4 said they were declined (2 by Lloyds TSB and one each by Aldermore and SME Invoice Finance).
- 3 said they didn't think they would be suitable.

Note that the number of times that some invoice finance businesses were mentioned could simply be a reflection of how active they are within the sector. It should also be noted that since completing our survey further invoice finance companies have also moved into this construction industry niche.

Businesses Expect 14.6% Turnover Growth During The Next 12 Months

Recent figures showed a GDP (Gross Domestic Product) contraction in Q2 2012 of 0.4% but we wanted to understand the level of confidence that businesses had in future growth potential within the UK.

So as part of a recent survey of SME businesses asked 100 business owners "by what percentage do you expect to grow your business' turnover during the next 12 months". Only a handful within our sample already used invoice finance so the majority did not.

There were a range of answers but the:

Average business turnover growth expected was 14.6%

. . . of turnover during the next 12 months! This would appear to demonstrate some degree of business confidence for the forthcoming year.

Businesses Need £43.2K Funding To Grow More Than 14.6% This Year

We then asked them how much additional funding they would need within their business to exceed their projected growth figures.

On average businesses said they would need an additional £43,200 of additional funding in order to grow beyond their projections which averaged 14.6%

The interesting deduction from these findings is that with the benefit of additional funding all the businesses interviewed stated a figure (ranging from £5,000 up to £250,000) for the additional funding that would enable additional growth.

This suggests that a lack of access to adequate funding is curtailing business growth in the UK.

Summary & Conclusions

These are the additional findings from this set of research results:

1) Invoice Finance Qualification Is Not Understood – Customers do not understand the qualification criteria for invoice finance and how they compare with overdraft criteria. They also do not understand the different criteria between invoice finance products.

2) Businesses Don't Realise Invoice Is Freely Available – Very few businesses seem to understand why invoice finance may be more freely available than overdraft.

3) Tariff Based Charges Are Preferred – 74% prefer a tariff of charges over a single fixed fee system despite these systems having gained popularity within the industry in recent years.

4) There Is Demand For Construction Finance – The majority of construction businesses raise applications for payment and say they would benefit from immediate funding against them. However only 2% said they used an invoice finance/applications finance product clearly demonstrating a gap.

5) Construction Finance Awareness Is Very Low – 65% of construction sector businesses need to raise finance although only 19% have had construction finance quotations. The key reason for not using invoice finance/applications finance is not having heard of it.

6) Construction Finance Pricing Is An Issue – The key reason for not going ahead with an invoice finance/applications finance quote in the construction sector was price.

7) Businesses Expect To Grow This Year – The average growth projection was 14.6% over the next 12 months.

8) A Lack Of Access To Funding Is Curtailing Growth – Businesses stated that they needed between £5,000 and £250,000 of additional funding in order to exceed the growth projections that they gave.

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