UK Factoring & Invoice Discounting Market Research Summary – Part 1
16th March 2011

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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" 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 16th March 2011 which while somewhat dated will still be of interest to anyone with an interest in the UK invoice finance industry.

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 Potential Size of the Invoice Finance Market

We have estimated the number of UK businesses that are potentially eligible for invoice finance although growth of the market is apparently being limited by a number of key issues which will be explored later.

According to statistics from BIS (The Department for Business Innovation & Skills), there were 4.8 million private enterprises in the UK at the beginning of 2008 (excluding the not for profit sector).

A well known data warehouse currently records almost 3.4 million of these businesses on their database which represents approximately 71% of the total population of businesses.

From that database we selected only those businesses that are categorised as being within industry sectors that are likely to be eligible for some form of invoice finance e.g. recruitment businesses, manufacturing etc. This yielded a total of just over 880,000 UK businesses.

We then applied a size criterion and excluded any businesses turning over less than £200,000 per annum. This reduced the number of potentially eligible businesses to c. 291,000.

There are a further c. 142,000 businesses, within those eligible industry sectors, that have annual turnovers of between £100,000 and £200,000 per annum. Including these would increase the total target market for invoice finance to 433,000 UK businesses.

According to statistics from the ABFA (Asset Based Finance Association), at the end of September 2010 their members were servicing 40,746 existing factoring & invoice discounting clients.

These existing clients represent just 9.4%
of the potential target market for invoice finance

They represent c. 0.85% of the total number of businesses in the UK as estimated above. Even accounting for the clients of non ABFA members and striking out a proportion of the target market that may not be suitable for other reasons, the market share of the invoice finance companies is still small.

The potential prize to the invoice finance industry is the possibility of substantial growth in client numbers for those invoice finance companies that are bold enough to address some of the issues that are currently inhibiting growth of the industry.

Why More Businesses Don't Use Invoice Finance

The statistics prompted the question "Why don't more businesses use invoice finance?"

To answer this question we conducted a number of pieces of market research amongst randomly selected SMEs (Small & Medium Sized Businesses) to understand the causes. The results were surprising and we identified costs and low levels of promotion and advertising within the industry as key factors.

Of the 100 SME businesses that were surveyed:

42% were unable to name even
a single invoice finance company

This is little surprise when:

80% of respondents said that, over the last year,
they had not seen any invoice finance
related advertising whatsoever

These findings were corroborated when we questioned another group of 100 SMEs about the reasons why they thought that the take up of invoice finance was so low:

31% thought so few businesses use invoice finance
because it is not promoted enough
and/or businesses had not heard of it

The most popular reason given for the low take up of invoice finance was:

Cost which was stated as the biggest issue
by 41% of respondents

We have made it our mission to get this message out to everyone within the industry as no single organisation can address the issues alone. The potential growth for our industry could be significant if we can raise the profile of these flexible cash flow products so that they can achieve their rightful market share.

Which Invoice Finance Companies Are Most Actively Marketing

As part of our investigation into the reasons for the relatively small number of invoice finance users in the UK, we wanted to find out which invoice finance companies were most actively contacting prospective customers, regarding invoice finance.

To do this we selected a sample of 100 SME businesses which were all of an appropriate size and within industry sectors that would be suitable for invoice finance. They were contacted and asked which invoice finance companies had contacted them during the last 12 months, in order to promote their services.

82% of these businesses said
that they had not heard from ANY invoice finance
companies over the last year

It seems of little surprise that client numbers are so low when such a large number of target customers appear untapped.

That leaves the 18% of businesses that had been approached by an invoice finance company. We asked them to name the company that had contacted them and the results were as follows:

- 11% Bank owned invoice financiers
- 4% A single independent invoice finance company
- 3% A single invoice finance brokerage

Of the respondents that said they were contacted by a bank, four different banks were mentioned. However, only one respondent said that it was NOT their own bank that had contacted them.

The implication is that the banks with invoice financing arms appear to be the most active in terms of contacting prospective invoice finance customers but they also appear focused on their existing banking customers.

Only one of the independent invoice finance companies appeared in the results, accounting for 4% of the responses.

The opportunities appear the greatest amongst the 82% of respondents that said they had not been contacted by any invoice finance companies in the last year. This untapped pool of invoice finance prospects is also likely to be subject to lower levels of competition from other providers.

Anecdotal Feedback From Prospects

We have set out below our interpretation of what customers say they want based on the anecdotal feedback we have received from the potential invoice finance customers that we have spoken to through our brokerage activities:

1) Flexible contracts – customers are often put off by extended contract periods and long periods of notice of termination. They respond to very short termination periods, so that they are not tied in if they choose to leave. In practice they rarely leave anyway, but if they do, they want an easy, simplified transfer process to support them in moving providers.

2) Reduced cost version of invoice discounting – many customers are comparing the cost of invoice discounting with an overdraft or loan. A low cost version of invoice discounting would enable invoice discounters to recruit numbers of customers that might otherwise use an overdraft or loan. Whilst the argument that "invoice discounting releases more funding than overdraft" is often true, the price premium often makes invoice discounting unattractive to the customer.

3) Widen the pricing differential between factoring & invoice discounting - it often doesn't sufficiently reflect the significantly lower workload for the invoice discounter that the customer perceives invoice discounting to involve.

Our research suggests that customers assume that invoice discounting will be half the price of factoring

4) Separate funding from credit limits – increasingly the funding given against debtors has become linked to the credit limit (for bad debt protection) that can be written on the debtor. This prohibits many customers from using invoice finance, as credit limits in the current climate are often insufficient to release enough funding.

5) Small business pricing – for the smallest of businesses i.e. those turning over less than £150K pa, even minimum service charges of

£3K per annum are hard to afford. A lower cost model for the smallest businesses would open up a large segment of the market.

6) No premium for selective products – some customers are interested in selective invoice finance where they can select certain debtors to receive funding against rather than their whole ledger. A few financiers will allow this but it is often charged at a premium which puts customers off.

7) Modular pricing – customers appear to like the idea that they pay for a core service e.g. funding, and then they can bolt on further services, in some cases for just the short term, for example collections support.

8) Remove hidden charges – customers are often put off by the perception that there will be unexpected "hidden charges" – this could be addressed by simplifying the pricing approach. Many customers find an "all inclusive" rate attractive.

These are some of the issues that are barriers to customers buying factoring and invoice discounting products. Some of these ideas may not be palatable from an invoice finance company's perspective but nonetheless these are the things that customers seem to want. If the factoring and invoice discounting companies were able to address some or all of these issues it could lead to a dramatic expansion of the invoice finance market.

The 8 Most Well Known Invoice Finance Companies

As 42% of SME's hadn't been able to name a single invoice finance company when asked, we asked the remaining 58% of respondents to name one. This is the list of the 8 invoice finance companies that were mentioned by those respondents:

- 24% Lloyds TSB Commercial Finance
- 13% RBS Invoice Finance
- 8% Barclays Sales Financing
- 5% Bibby Factors
- 3% HSBC
- 2% Close Invoice Finance
- 2% Venture Finance
- 1% GE

It is interesting that only 8 different providers were mentioned. It is also clear from these results that over 80% of those that were able to name an invoice finance company named one of the major bank owned invoice financiers rather than one of the independent companies which appear to be much less well known.

This may not be surprising when you consider that only 20% of the SME's that we questioned had seen any advertising regarding invoice finance over the last year and all of those that had seen advertising said that it came from a bank owned invoice finance company.

These results suggest that there remains a huge opportunity for all invoice finance companies, but perhaps in particular independent invoice finance companies, to raise awareness of their brands amongst SME's in order to grow their market share.

Research Regarding Overdraft

There has been much talk in the press about the need to increase lending to UK businesses so we conducted a small survey in order to determine what was happening to overdraft lending to a random sample of 100 SMEs (Small and Medium Sized Enterprises).

The results were interesting. We found that:

88% of respondents actually had an overdraft facility

Clearly the use of overdraft is far more prevalent than the use of invoice finance which we have estimated above to be used by less than 1% of businesses because the products are not well known.

We asked the SMEs to quantify the percentage of their sales ledger that their overdraft represented and on average they stated that their:

. . . overdraft represented just 2.6% of their debtor outstandings

This is interesting as invoice finance could potentially unlock significantly higher levels of funding for some of these customers, with the ABFA figures to September 2010 showing:

. . . pure invoice finance advances against debt to represent an average of over 42% of client's debtor outstandings

We went on to ask the SMEs if they had seen their overdraft increase, decrease or remain the same over the last year. The result was startling:

None of the respondents reported an increase in their overdraft
39% reported a decrease in their overdraft
11% said that their overdraft had been taken away

The opportunity to further support UK SMEs through invoice finance remains significant.

How Businesses Choose An Invoice Finance Company

In order to decide how to market and sell invoice finance it is important to understand how prospective clients make choices between different providers.

We started out by trying to understand whether prospective clients had a preference for bank owned invoice finance companies or independent companies. We then questioned them about the reasons for their choices and this gave a lot of insight into how they choose between different providers.

In terms of a preference between bank owned and independent invoice finance companies our survey of 100 SMEs revealed that:

- ***56% of SMEs would prefer an independent company***
- ***33% of SMEs would prefer a bank owned invoice financier***
- 11% of SMEs had no preference

Of the 56% that said they would prefer an independent provider, these were their reasons:

- 41% Personal service
- 13% Wouldn't trust banks after recent events
- 9% Customer focused
- 9% Flexibility
- 9% Reliable
- 7% Not having "all eggs in one basket"
- 5% No foreign call centres
- 5% Not being just a number
- 2% Less risk

Of the 33% that said they would prefer to use a bank owned provider, these were their reasons:

- 73% Well known name
- 15% Professional
- 12% Reliable

These results are of value to all invoice finance companies, whether bank owned or independent. The value comes from continuing to appeal to prospective clients that have a preference for your type of provider but to also in trying to exhibit the aspects of the other category of provider in order to win more business.

For example, an independent invoice finance company could work on building their brand to become a "well known name" and hence appeal to customers that may otherwise have chosen a bank owned provider. Conversely, a bank owned invoice financier could work on promoting the personal service nature of their service in order to capture some of the market share that would have naturally gone to an independent provider.

Detailed Breakdown Of Customer's Pricing Expectations

In order to better understand client's expectations regarding the price of factoring we questioned a random sample of 100 SMEs about the percentage of their turnover they would expect to pay for factoring.

On average businesses estimated the cost of factoring to be 3.93% of annual turnover

In some cases though the price of factoring can be way below this estimate, maybe between 1 and 2% of turnover which suggests that expectations are that the cost of factoring is going to be more expensive than it is likely to be in practice, in some cases.

We found an interesting quirk in the response data. We compared those that said they would prefer to use a bank owned invoice financing company with those that said they would opt for an independently owned financier. When we compared their expectations about pricing we found that:

Those that said they would choose an independent invoice finance company estimated the price to be 57% higher than those that said they would choose a bank owned financier

This does not necessarily reflect actual pricing but it reveals something about customer's expectations depending upon their choices and preferences.
The details of our research results into what percentage of turnover customers expect to pay for factoring (their estimates of the costs) were as follows:

- 3% of SMEs expected to pay 10% of turnover
- 64% of SMEs expected to pay 5% of turnover
- 10% of SMEs expected to pay 2% of turnover
- 23% of SMEs expected to pay 1% of turnover

The actual cost will vary between businesses but the majority of respondents have estimated the cost of factoring to be 5% or more, which may be an over estimate in many cases.

Turning to invoice discounting:

On average businesses estimated the cost of invoice discounting to be 1.97% of annual turnover

Below are further details of our research results into what percentage of turnover customers expect to pay for invoice discounting (their estimates of the costs) which were as follows:

- 3% of SMEs expected to pay 5.0% of turnover
- 64% of SMEs expected to pay 2.5% of turnover
- 10% of SMEs expected to pay 1.0% of turnover
- 23% of SMEs expected to pay 0.5% of turnover

What jumps out from these numbers is that:

Every respondent estimated the cost of invoice discounting to be 50% of the cost of factoring

This may not always be the case, our experience is that invoice discounting often costs more than 50% of the cost of factoring (although not always) which can make the added benefits of factoring e.g. an included credit control service, attractive as it can mean that a business using factoring doesn't need to employ any credit controllers.

Summary & Conclusions

To summarise:

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 many cases.

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