

DEBTOR FINANCE:

Bank Overdraft VS Debtor Finance

“A Bank overdraft and Debtor Finance are both forms of short term finance”

When you have a cash flow problem there are a few options available to you, those may include personal equity, selling shares, overdraft, sell out the business or Debtor Finance. If you scale back these options the two most viable would be an Overdraft and Debtor Finance.

A Bank Overdraft and Debtor Finance are both forms of short term finance. However It's hard to know which one is more suitable to you, your business and your cash flow needs. In this White Paper we are going to define what each type of finance is, compare them and from there you can decide which is the best option for you.

**Some information on overdrafts sourced from <http://www.businessdictionary.com>*

What is Debtor Finance?

Debtor Finance is a form of short-term borrowing often used to improve a company's working capital and cash flow position. It allows a business to withdraw money against its invoices before the customer has actually paid. To do this, the business borrows a percentage of the value of its receivables ledger from a financier, effectively using the unpaid invoices as collateral for the borrowing.

What is an overdraft?

A Bank Overdraft is a Loan arrangement under which a bank extends credit up to a maximum amount (called overdraft limit) against which a current account customer can write cheques or make withdrawals. An overdraft is approved only for a fixed period (usually one year) after which it is must be renegotiated and is almost always secured by real estate.

What types of businesses use Debtor Finance or a Bank Overdraft?

A lot of businesses can use Debtor Finance and a Bank Overdraft. These include retail and wholesalers.

So what are some differences between Debtor Finance and a Bank overdraft?

There are quite a few differences between Debtor Finance and a Bank overdraft, some of these differences will be the decider in which option you choose to go with. Although a bank overdraft is more commonly advised, it's not often the best option for small business.

- The main difference and the most important is that with a Bank overdraft the loan is secured by your property where as the collateral for Debtor Finance is the invoice.
- A Bank Overdraft facility can be cancelled at any time by the lender at its discretion and without any warning, notice or explanation. If the overdraft is secured by an asset or property, the lender has the right to foreclose on the collateral in case the account holder does not pay.

- With a Bank Overdraft there can be lots of limits in place. In most cases you are required to start paying it on demand straight away with interest, and you are governed by a strict limit. Banks typically set and determine limits based on your business history. This creates a lack of flexibility in the amount you are approved to loan.
- With a Bank Overdraft there are copious amounts of red tape. You will be required to show a proven track record of your business history, expect lots of paper work plus bricks and mortar security. With Debtor finance we look at your profitability going forward, your history isn't our focus.
- Often especially since the GFC, small businesses still won't qualify. Yes the banks are beginning to lighten on the idea of lending to small business but they are still very restrictive and inflexible.
- With a Bank Overdraft you are tied to an asset, so you are ultimately stuck with your facility amount. With Debtor finance it grows with the sales you make along the way.

- To use an overdraft effectively you need to be disciplined. You can get access to funds up to the value of your asset; you may be biting off more than you can chew. As opposed to Debtor Finance where the loan is only good till the invoice is paid, effectively eliminating any repayments by you.
- With Debtor Finance there is much more flexibility as you are not restricted by a capped limit. Debtor finance is geared to your company's turnover and not your history.
- Debtor Finance relies on the strength of your debtor not the strength of your business or the collateral you have to put on the line.
- Often when you put collateral on the line it is in someone else's name like say your partner, so with Debtor Finance you're not using someone else's personal assets, it's purely based on the businesses turnover - secured only by the invoice.

Misconceptions

Earlier we touched on how a Bank Overdraft is the most commonly suggested cash flow fix to raise working capital. This is also due to a few misconceptions about Debtor Finance. They are listed below.

- You only use Debtor Finance when your business is going under – not true, most clients that qualify are thriving SMES continuing to grow, in fact their cash flow needs are a result of success.
- Too expensive –If you're going to borrow money there's going to be costs associated with it. In saying that Debtor Finance fees are not that much more expensive than that of a banks fee. The difference is we will lend you money when the banks wont
- Interferes with your customers – you can choose to have a disclosed or undisclosed facility. However even when dealing with your customers we are professional and customer service focused. Plus most clients appreciate not having to do the debt collecting themselves.

Rates

Rates between a Bank Overdraft and Debtor Finance do vary, that's because our facilities are very different. So what's the difference in fees or interest charges? Which works out to be more expensive?

With a Bank Overdraft Interest is charged on the amount overdrawn - at a rate that is above the Bank Base Rate. The bank may also charge an overdraft facility fee; with a bank overdraft you are charged monthly interest that is usually worked out based on your business risk factor and your ability to make repayments.

Debtor Finance can be slightly more expensive due to the risk the financier takes on by not securing any collateral like your property. From this they are likely to increase credit monitoring which results in higher administration, so a premium is charged to cover this. However most Debtor Financiers offer extra services like debt collecting which you wouldn't get with an overdraft.

Debtor Finance VS Bank Overdraft

Below is a simple overview comparing the differences between Debtor Finance and a Bank Overdraft.

	<i>Debtor Finance</i>	<i>Bank Overdraft</i>
<i>Simple Application</i>	<i>Y</i>	<i>N</i>
<i>Time to settlement</i>	<i>24 hours – 3 weeks</i>	<i>4 weeks – 6 months</i>
<i>Red Tape</i>	<i>N</i>	<i>Y</i>
<i>Collateral required</i>	<i>Invoices</i>	<i>Property</i>
<i>Profitability History?</i>	<i>Y (Going forward)</i>	<i>Y (History)</i>
<i>Finance Due Diligence</i>	<i>Y</i>	<i>Y</i>
<i>Funding to start ups?</i>	<i>Y</i>	<i>N</i>
<i>Funding limited to sales</i>	<i>Y</i>	<i>N</i>

To talk to a product specialist and book in an appointment please call the office on 1300 652 158.

For more information visit our website and check out our latest video at www.arcashflow.com.au/videos



Connect with us through:



More whitepaper downloads at www.arcashflow.com.au/whitepapers