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Asset Smarter

INDUSTRY INSIGHT

Why Stakeholders are Turning to Invoice Discounting, its Future and the Role it Plays in Asset Based Lending

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Invoice discounting is a form of working capital financing where companies borrow against outstanding customer invoices, using the invoices as collateral for a credit facility.

In a world where customers seek payment terms of 60, 90 or even 120 days, sellers accumulate substantial accounts receivable balances, leading to short-term cash flow pressures. Invoice discounting bridges this gap by providing sellers with financing, satisfying short-term cash flow needs and unlocking greater prospects for long-term growth. Sellers collect payment into bank accounts that are pledged to the lender, reducing the outstanding balance of funds drawn, until new invoices are assigned, and additional cash is advanced to the seller.

Why More Lenders Are Offering Invoice Discounting

As the invoice finance market has matured, many lenders have increasingly favoured invoice discounting structures over traditional factoring arrangements. As a result, the cost to operate an invoice financing facility has decreased, typically resulting in lower fees for borrowers.

Advantages For Both Lenders and Borrowers

Lenders

A Decrease in Resourcing Requirements

Invoice discounting facilities require fewer operational resources to operate, making them more attractive for lenders looking to establish facilities with sellers who have large debtor bases and higher invoice volumes.

Fast Set-Up and Onboarding of New Facilities

Onboarding times have reduced, as customers typically no longer need to be notified of facilities, alongside the control of the ledger now remaining with the seller as opposed to being given to the lender.

Easier Monitoring of ABL Facilities

Invoice discounters now appraise availability via a borrowing base that shows excluded accounts, ineligible debt, reserves, dilution and the net availability after an advance rate has been applied.

Borrowers

Retain Control of Customer Relationships

As credit control and collection is retained by the seller, sellers are better able to manage disputes and billing issues diplomatically, where previously, this was managed by the funder or a third party who prioritised collection.

More Confidential Borrowing

Sellers no longer need to notify their customers of invoice financing facilities, allowing companies to maintain greater financial independence and confidentially.

The Role of Invoice Discounting in an ABL Facility

Invoice discounting is considered to be the lead asset, at the heart of an ABL facility. ABL provides a holistic view of the balance sheet, with the liquid nature of receivables making it the most attractive asset class, helping unlock lending against the less liquid asset classes of inventory, plant & machinery, real estate and intellectual property.

While some lenders hesitate to lend against slow-moving assets in isolation, pairing them with the highly liquid receivables collateral pool reduces the overall risk profile of an ABL facility, making the structure more attractive to funders. The lower risk profile associated with a multi-asset ABL facility can also result in a higher advance rate across all asset classes. The liquid nature of receivables often sees lenders provide an advance rate of up to 90% of eligible debtor balances.

The Future of Invoice Discounting

Looking ahead to the future of invoice discounting, it is hard to look past the impact that technology will have on how funders underwrite and manage credit facilities, and how sellers invoice and manage debtor collection. As real-time and process automation improve, the industry is expected to move away from periodic, manual reporting toward a model of constant real-time API (application programming interface) driven connectivity between lenders and borrowers.

Real-Time Underwriting & Risk

Early adopters are already integrating AI into the underwriting process, performing real-time credit risk analysis by analysing live transactional data and payment behaviour.

Integrated Finance

Invoice discounting is evolving from a standalone product into an integrated feature within the tools businesses already use. It is expected that in the future, accounting software will identify cash flow gaps and prompt sellers to seek financing arrangements, such as invoice discounting, to bridge forecasted shortfalls.

Fraud Mitigation

Smart contracts and secure digital verification protocols are transforming the operational landscape; by automating the verification of invoices at the point of origin, lenders will be able to reduce approval times and lower the risk of fraud.

Legislative Tailwinds

Across Europe, some governments have mandated the use of Electronic Data Interchange (EDI) for billing to provide greater transparency into VAT liabilities. As invoices are increasingly logged, verified, and acknowledged by buyers in real-time via secure government or private portals, the "trust gap" in invoice financing is rapidly closing.

Ultimately, technological advancements will lower the cost and risk of an ABL facility, making it more attractive to both borrowers and funders, unlocking collateral that is currently deemed too risky or too costly to manage. As a result, we expect the ABL world to continue gaining momentum, with technology enabling an increase in the size and number of ABL/invoice discounting facilities.

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