CASE STUDY:

Bridging the finance gap

This rapidly expanding textile company which specialises in the manufacture of children's garments under individual product contracts for a number of multiple stores such as Littlewoods, B.H.S., ASDA and Dunnes Stores requires new working capital finance in respect of each new contract from retail stores.

The financial director considers that for each £1 million of turnover the company requires £300,000 of additional working capital finance. The company had already negotiated a ten year term loan facility in respect of its property, a five year lease agreement on its equipment and its existing working capital requirements were financed through an overdraft and a separate invoice discounting facility. These facilities were provided by four separate Irish financial institutions which had each reached its credit limit exposure with the company.

The company was awarded a contract for the supply of its product range to a new U.K. multiple store. The dilemma facing the company was how to raise finance to complete these new contracts.

The contract was awarded in August for the supply of clothes for the following summer season. The company needed to place its order in September for delivery from its foreign cloth raw material suplliers in October and November. The garments would then be manufactured through its various stages at the company's factory headquarters in Dublin for despatch to the U.K. multiple store during the following March and April.

The company wanted to raise funds necessary to finance the period from purchase of the raw materials through to the manufacture of finished goods to despatch and receipt of payment for the goods from the U.K. customer. This represented a total financing period of 180 days.

The company had reached its overdraft limit and the invoice discounting facility would not meet this financing requirement as the bank would only make advances at time of despatch of finished goods whereas the company required the finance 120 days earlier in order to pay for its raw material supplies.

The solution according to David Murray was the negotiation of a project finance facility from a U.K. financial institution which provided the funds for the purchase of the cloth by way of payment directly to the foreign supplier on foot of the appropriate documentation and authorisation from the company. This loan advance being repaid when the company receives payment in respect of the manufactured garments from the U.K. customer.

The company had pledged all its security to the current financiers by way of a fixed and floating charge over all the assets of the company. It was necessary for the company to obtain a waiver from the current financiers of this security provision in respect of any cloth and proceeds from the subsequent manufactured garments in favour of the project finance bank.

The project finance facility grants the company the finance when it needs it says Murray, that is when the company places the purchase order with its foreign supplier. If the company had not the finance at this stage then it would not be in a position to reach the stage of completed manufacture when it can factor or discount its invoices to customers under existing facilities. In this case the project financiers provided a revolving credit facility in the amount of £600,000 for the purchase of cloth and the company was in a position to expand its product range into a new group of stores throughout the U.K.

top of that the customer pays for the credit facility, which is about 2 p.c. over the bank's overdraft rate. However this charge can be negotiated as the client's credit rating increases.

It is a common misconception that factoring and invoice discounting are one and the same. They are not. Essentially when you sell your debts to a factoring company, they take control of your sales ledger, including the collection of debts. Invoice discounting leaves the company in charge of its own debt collection. Indeed debtors need never be aware of the fact that the company has a deal with the invoice discounting firm. Complete confidentiality is guaranteed with invoice discounting which avoids the image problem associated with factoring. (However, as is demonstrated in the Renew Tyres case study not every company needs or wants to keep the use of the service quiet.)

People who use factoring have found it to be generally more expensive and a messier service.

The other attraction for many firms with invoice discounting is that the service can be utilised to different degrees depending on the company's cash flow. So when cash flow is tight, invoice discounting comes into play but when it is not needed it can be set aside. Ulster Bank Commercial Services points out that the service is not suitable for every one. It does not lend itself to long term credit periods. Ulster Bank themselves usually work on a credit period of 90 days. The business needs to be pretty secure to avail of the service. Banks usually look for turnover in excess of £1 million (gross) per annum with strong growth potential. However, Joyce Irwin of Ulster Bank Commercial Services says that companies with a turnover of less than £1 million will also be considered providing they are growing fast and look like they will meet the target soon any way. A company must also have an efficient credit and stock control system in operation within the business.

Trade finance

Trade finance is an option when cash is needed earlier on in the working capital cycle. ICC offers such a service, it is known as the Service Payment Facility. If a client wishes to buy raw materials, ICC will pay the supplier and offer its client a credit period of up to 180 days. The charge typically will be in the range of 9 to 10 p.c., but depends very much on the length of credit required, and the price of money at the time