

# Ask the Experts: ABL

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## Meeting the needs of SMEs



- **ABL Q&A**

*Business owners put their questions to the panel*

- **SIC Codes**

*How independent providers and banks differ*

- **Late payment of debts**

*The experts respond to the government fast-tracking the EU late payment directive*

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**This month's experts include:**

# The experts



Andrew Rutherford is Sales Director at Centric Commercial Finance, an independent financial services group focused on delivering event-driven invoice discounting and asset based lending transactions to companies with revenues of more than £1m. Rutherford has a depth of experience gained from senior level sales roles within the asset based lending industry. As a recognised dealmaker, he has developed an extensive network of professional corporate advisers across the UK.



Phil Woodward, Managing Director of Leumi ABL, set up the company in 2006 with its Chief Executive Paul Hird. The Brighton-based company, which is the Asset Based Lending subsidiary of Bank Leumi (UK), has a growing UK regional presence. It operates across a variety of sectors to provide funding in the range £1m to £25m by funding against invoices, stock and plant & machinery, plus trade and property finance via Bank Leumi.



Elaine Shelley is responsible for developing new asset based lending valuation work in the UK & Europe for Go Industry (UK). She has worked within the asset based lending industry in various risk, audit and valuation roles in GMAC Commercial Finance and in the professional service firms PricewaterhouseCoopers and Baker Tilly. She has also provided valuation training and support for UK and European lenders and the Asset Based Finance Association.



**Sally Bradshaw** is a solicitor with over 20 years' experience of commercial finance in the City and leads the commercial finance team at Francis Wilks and Jones LLP. Francis Wilks and Jones LLP specialises in advising many of the UK's asset based lenders on all aspects of debt finance, security and recovery.

## SME Q&A

ACQ puts some questions, received from curious business owners, to panel members.



**Q: Tracy, Idea Medica Ltd, Director:**

“Looking at invoice finance options, I would like the benefits of Factoring versus Invoice Discounting explained.”

**A:** “Both factoring and invoice discounting are excellent solutions for boosting business cashflow in many business-to-business scenarios and across a wide range of sectors,” replied Phil Woodward. “Both solutions give you immediate cash availability, by bridging the gap between you raising your invoice and your customer paying that invoice. As financing is linked to your current sales, the level of funding available grows as your business grows.”

“The key differences are:

- Factoring is available to growing businesses, including start ups with a sound business plan, whereas invoice discounting tends to benefit larger businesses, with established credit control systems and resources in place.
- Factoring providers manage the administration of your sales ledger and contact your customers directly to chase payment, freeing up more of your time to focus on new business. Many providers offer the facility for factoring clients to handle some of their own credit control, so that they agree only to contact and chase the customers you wish them to.
- Unlike invoice discounting which can be a confidential facility, your customers will be aware of your financing arrangement with a factoring provider as they will be contacting your customers directly for payment of your outstanding invoices.
- With a confidential invoice discounting facility, you retain direct relationships with your customers and manage the administration of your sales ledger, sending out monthly statements and collecting your sales invoices. In this way, your customers remain unaware of your financing arrangement. Payments from your customers are made into a designated bank account in your name – this is how the facility remains confidential.

“Always consider the reputation of the finance provider and assess how well they might meet your requirements – for example, will you have a dedicated

client manager, how quickly are funding decisions made and how flexible is their approach?”

“Both services, Factoring and Invoice Discounting, provide a high percentage of finance secured against your invoices,” replied Elaine Shelley. “Typically, this is set at about 85% of invoice values. Factoring provides the additional advantage of a full sales ledger and collections service under which the Factor takes on the responsibility for your sales ledger. Under an Invoice Discounting service, you continue to administer the sales ledger and the funding relationship can be completely confidential, so that your customers are unaware of the facility.”

**Q: Andy Thomas, Sole Trader, Thomas Clark Specialist Dry Cleaning & Laundry:**

“Do asset based lending or invoice finance providers offer anything that’s equivalent to an overdraft facility for companies like mine with a 30 day turnover?”

**A:** “The answer as to the reticence to offer such a facility is tied up with the nature of the security issues associated with overdraft facilities amongst lenders., explained Elaine Shelley. “A key year in relation to the popularity of overdraft facilities with traditional lenders was 2001 – the Brumark case. A decision by the Privy Council in the Brumark case stated that a company’s outstanding debts should not come within the terms of a fixed charge but were incorporated within the floating charge instead. This mean that banks lost their preferential status, which meant converting much of their overdraft lending to SME’s onto their factoring subsidiaries where both returns and security were enhanced.”



## Ask the experts

## Dispelling the doom & gloom

ACQ's quarterly ABL catch up sees our expert panel tackling some burning issues

**SIC Codes, SME optimism, late payment and credit easing are all pertinent topics to our ABL experts who, with a wealth of ABL and legal knowledge between them, offer their opinions.**

### SIC codes

**Andrew Rutherford, Executive Director, Centric Commercial Finance:**

"Larger banks, because of their scale of operations, are driven by SIC codes which segment their portfolios and measure the risk profile of their lending books. However, these assessments can be too general, and can result in healthy businesses being refused funding.

"Centric Commercial Finance recently provided funding to a tractor tyre manufacturer that lost its bank's support when it was reclassified as an automotive supplier – a sector that the bank had decided was a credit risk. After a seven year relationship, the business was simply dismissed by its bank. This 'template' approach just doesn't make sense and leaves many clients completely bewildered.

"We believe you can only get close to a deal by walking the shop floor and meeting the management team. Examining the basics and looking at how businesses operate on a day to day basis can clear up a lot of misconceptions and help financiers to make an informed decision.

"The ABL sector is not a mass market operator and is far more entrepreneurial in its approach than the big banks. The sector is not constrained by codes; instead we try to spot the winners, aligning ourselves with businesses that have got real potential – regardless of what category they fall under.

"At Centric Commercial Finance the reason we can do this is because, unlike the banks, which are often slow to respond to funding enquiries, we are not hampered by codes and are always available for 'onsite' meetings within 48 hours. Add to this a credit backed Heads of Terms two to three days later and you can see that the banks are being pushed by this type of approach, tenacity and service levels and that ABL is gaining wider recognition in the marketplace.

"In relative terms, ABL is still growing but we keep on proving that it is a viable alternative, not just for the short term, but for the future. We are primed and ready to show UK SMEs what they have to gain from this form of finance, and that we are willing to accommodate the

needs of individual businesses, without the constraints of SIC codes."

**Phil Woodward, Managing Director of Leumi ABL:**

"Larger banking operations that are driven by SIC codes to help determine risk profile do so often at the expense of long term customer interest. This can not only affect new customers but also existing and sometimes long standing relationships, which often result in the customer looking elsewhere for a more understanding financial partner.

"It is rare for a myriad of differing business requirements to fit perfectly with an approach which is both product and sector driven, yet all too often we hear reports of businesses suffering from the formulaic approach adopted by larger banks. Limited product portfolios and low touch credit management due to a relatively high client to client manager ratio can combine to make customers feel there may be little understanding of their current and future needs. Particularly in times of uncertainty and economic instability business need more than a relationship that is managed at arm's length.

"By contrast, taking a solutions driven approach which is client focused and inclusive right from day one is increasingly valued by both clients and their professional advisers. Many independent providers, less constrained by rigid formulas, are well placed to offer exactly this approach. Their lower client to client manager ratio and overall 'can do' attitude to building long term partnerships can make a big difference. High service levels plus a proactive culture and the ability to move quickly to service clients' needs all help to set them apart from competitors.

"Leumi ABL recently supported the Management Buy In of Dawson Home Group, a £30m supplier of luxury home textile products, being sold by parent Dawson International Plc. The MBI team had begun the search for financing by talking to some of the major UK banks, but soon realised that the more specialised and entrepreneurial approach of Leumi ABL was what they needed. Leumi ABL looked at the requirements of Dawson Home Group and realised that a 60% invoice finance / 40% stock finance ratio was the best solution.

"Leumi ABL was able to react quickly and provide a high level of one-on-one attention. The eight-figure ABL deal will fuel further growth and help to strengthen Dawson Home Group's competitive position.

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**Elaine Shelley, Head of Valuation Business Development, Go Industry (UK):**

“Both the clearing banks and independents adopt sound risk management strategies and utilise sophisticated software that measures all aspects of portfolio management. Inevitably, the larger the organisation and the more hierarchical or decentralised the corporate structure, the more specific rules there are in respect of portfolio categorisation and management and the more strict adherence there has to be. By their very nature, independent providers can take a view that is less ‘rules-based’. However, SIC Codes are not always coded accurately at source and can be classified incorrectly within an unfavourable category. For these reasons, there have been a number of instances where the financier’s perspective of risk will be affected at the expense of the client and, consequently, facilities can be limited, withdrawn or managed away.”

**SME optimism**

Refreshing recent research shows SMEs believing their growth prospects are not being hindered, despite the current climate. What does that mean for ABL?

**Elaine Shelley:**

“Around 60 per cent of small businesses surveyed by ECI Partners expect turnover growth to reach double digit figures in the coming year. This should be excellent news for asset-based lenders. Not only does ABL provide a significant injection of working capital, the evergreen element of the facility provides ongoing cash keeping pace with business growth. With stabilising asset valuations and a buoyant second user market for plant & machinery, the future looks bright for asset-based lending.”

**Phil Woodward:**

“The better run SME’s are looking forward and realising that the recession, whilst deep and long, will still generate some exciting opportunities for them to grow their businesses. These businesses are looking to new markets and possibly to export markets.

“One example is Leumi ABL’s client, SMS Electronics, a specialist in bespoke electronic manufacturing services. Funding of over £4m from Leumi ABL has helped to power growth for the business, which earlier this year secured the number one slot in the Sunday Times

International Track 100 ranking. SMS Electronics led the league table of private firms with the fastest growing international sales, which have soared by 418% a year to an impressive £18.7m in 2010.”

“The business has a strong manufacturing heritage spanning over one hundred years and more latterly has thrived under private ownership since a management buyout in 2002 by the current senior management team.

“At the beginning of 2010 existing funding arrangements could no longer meet the needs of SMS and after considering proposals from a number of main clearing banks and specialist ABL providers, Leumi ABL was selected on the strength of the flexibility we could deliver. As with all of our clients, we took the time to understand the finer details of the business, together with the risks and opportunities their growth plans would create.

“There are many other businesses making bolt on acquisitions or taking on new customers as some less able competitors fall away, proving that even in times of recession good, progressive thinking companies are able to prosper. Having the right financing package in place from a provider who can be relied upon to support the business in the longer term is vital.”

**Late Payment**

**Solicitor Sally Bradshaw, Senior Associate at Francis Wilks and Jones LLP, examines the coalition’s plans to fast track the EU late payment directive into UK law a year early.**

“The problems faced by all businesses when their customers pay invoices late are well known: the adverse impact on liquidity and financial covenants can be devastating, even triggering business failure with the consequential losses to the wider economy.

“Whilst asset based lending (ABL) provides a solution to the cash flow problems caused by customers’ late payment of debts for an ever increasing large number of businesses, for the remainder the options remain a contractual claim and debt recovery, which may be expensive and cumbersome and have the character of a reaction to the problem rather than preventing its occurrence in the first place.

“The Late Payment of Commercial Debts Regulations 2002 was the first statutory measure introduced to try and discourage the damaging practice, whether deliberate or accidental, of companies not paying

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## Ask the experts

their suppliers of goods and services within the contractual payment period. Unfortunately these Regulations have not had the desired effect; the problem persists and may even be getting worse as companies delay paying their debts as a means of improving their own cash flow and providing them with cheap credit."

### Directive 2011/7/EU on combating late payment in commercial transactions (Directive)

"In recognition of the continued problem that the late payment of debts is causing to Member States' economies, the EU published the Directive in March 2011. The Directive is an update and replacement of the existing law on late payments that Member States are required to implement into their national law by 16 March 2013.

"The first thing to notice is that the Directive does not outlaw the practice of not paying debts within any contractual period for payment, but instead aims to incentivise prompt payment by penalising companies who pay late. Reflecting the substantive number of commercial transactions entered into by public bodies, for example the sub-contracting for the supply of services, the Directive applies equally to business to business or business to public authority transactions.

"The key features of the Directive are:

- A creditor is entitled to interest on unpaid debts where he has performed his contractual obligations but not received payment by the due time due to the fault of the debtor.
- For contracts that do not specify a payment period, the Directive provides that the supplier will be entitled to interest for late payment after 30 days of the date of receipt of the supplier's invoice or the date of receipt of the goods or services or the date of expiry of a period for verification or acceptance of the goods where this process is permitted.
- It is open to parties to agree a longer payment period in their contract. In the case of business to business transactions this can be up to 60 days, or a longer period if expressly agreed by both parties and that is not "grossly unfair" to the supplier. In the case of business to public authority transactions, the Directive provides that the payment period should not exceed 30 days unless the public authority engages in certain specified economic activities or healthcare in which case a payment period of up to 60 days can only be agreed if it can be fairly justified in the context of the transaction.

- There is an automatic right to charge interest on outstanding debts (the whole amount or any unpaid instalment) at a statutory rate from the day after the due date for payment. There is no requirement for a creditor to serve a separate notice charging interest. The Directive provides that the statutory interest is 8% above the reference rate.

- Compensation costs are also automatically payable to the supplier. These costs are a fixed sum of Euro 40 to cover the supplier's internal debt recovery expenses together with the right to charge the reasonable costs of instructing solicitors or external debt recovery agents.

- It is not possible to contract out of an obligation to pay interest for late payment or compensation for recovery costs. Any clause which purports to do this will be treated as unenforceable and may give rise to a claim for damages in favour of the creditor if grossly unfair."

### Early implementation and the benefits for businesses

"In September 2011, the UK Government announced that it proposes to accelerate implementation of the Directive to bring it into force in the first half of 2012. In the present economic climate, where anecdotal evidence is that the practice of paying suppliers late, particularly by larger companies, is on the rise, this will be welcome news to those businesses who find themselves currently in a weaker negotiating position. There will be a presumption that payment periods of more than 60 days will be unfair, unless clearly negotiated and justified by the circumstances, and a significant additional cost for creditors, as interest will be automatically added to the contract price together with a liability to pay the supplier's debt recovery costs."

"It remains to be seen whether the Government will exercise the option in the Directive to apply its provisions to contracts entered into before 16 March 2013. If they did, this would enable businesses to benefit from the enhanced rights against slow paying customers immediately from implementation and in respect of an increased number of contracts."

**To read more of Ms Bradshaw and the rest of our panel's thoughts on the EU late payment directive and George Osborne's credit easing plans go to the ABL section at [www.acqmagazine.com](http://www.acqmagazine.com) where you can also read previous panel discussions.**

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