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Putting an End to Risky Business

With insolvencies at a record high and faced with unprecedented levels of bad debt, effective risk management has never been more crucial to a business' survival. David Thomson, Chief Executive Officer of Close Invoice Finance outlines how a business can ensure it emerges from the downturn intact and position itself ready to make the most of the fabled "green shoots of recovery" as they appear.

For the past year, SMEs have languished in arguably the worst trading conditions in living memory. Insolvency statistics are currently running at an all time high with 5,110 new corporate liquidations reported in Q1 2009 – up 7.8% on the previous quarter* – with those businesses who have weathered the storm faced with a tide of bad debt, customer failure and poor credit terms.

However, with a leading think tank, the National Institute for Economic and Social Research (NIESR), heralding the first increase in industrial output in more than a year during Q2 2009 and the equity markets rallying once more, there's just the faintest suggestion that we might be turning the corner on the sharpest slump since World War 2. New SME research from Close Invoice Finance reflects this cautious air of optimism, with 20% of business owners questioned claiming that they expect to expand the business in the coming months and a further 45% anticipating maintaining stable over the same period. ►



David Thomson
Chief Executive Officer,
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* BACS Payment Scheme Report (2009)

This “can do” attitude from SMEs is truly commendable and I am confident that robust businesses will be rewarded once the upswing takes hold. For the moment, however, we are still operating in relatively poor conditions, so it’s vital to take the time to ensure a business’ risk management strategy is water tight to avoid being left vulnerable to bad debt or cash flow issues in the longer term.

As part of its regular Small Business Finance barometer, Close Invoice Finance asked a series of questions on risk management to over 500 SMEs of varying sizes. The results pinpoint some alarming discrepancies in approach.

The Issue of Ageing Debt

The survey found that companies with between 100 and 250 employees are 20% more likely than smaller businesses to have debt on their books for longer than 60 days. While three in five smaller SMEs (with between 1 and 50 employees) have less than 10% of debt on their books for longer than 60 days. The majority of larger SMEs admitted they hold ageing debt contributing between 11% and 50% of their debt book.

Evidence suggests that many larger firms are now delaying payments to smaller suppliers. Latest figures from BACS (Bankers Automated Clearing System) show that British SMEs are waiting an average of 41.5 days beyond agreed payment terms for invoices to be settled. Tying up large amounts of stock in their sales ledger, in this way, could lead to a shortage of funds to pay for stock, staff and overheads. Worse still, the reduction in liquidity means that businesses can struggle to service any short term debt. All of these factors are felt most by small enterprises that traditionally operate on the tightest of margins. So it’s imperative for SMEs to address this issue going forward.

Over reliance on a single customer

The survey also found that 10% of SMEs with 50 – 100 employees – equating to approximately 470,000 SMEs nationwide – admit to relying on a single customer for over 75% of turnover.

By relying heavily on one single customer companies put themselves at serious risk of business failure should this customer fall into financial difficulty - effectively creating a “domino” effect where company A fails to pay company B, which can mean company B is then unable to pay its invoices to creditors. Ordinarily, a business could reconcile the situation by taking a short term bridging loan from a bank, but in the current climate these loans are limited. ►

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In general, our findings suggest that smaller SMEs are more successful than their larger cousins at managing exposure to the risk of bad debt. This potentially is due to the management teams in micro companies being more able to take a “hands on” approach to cash flow management and better placed to identify and deal with potential problems quickly. But, with late payment and bad debt having such a destabilising effect on a business, such close supervision of cash flow is critical for all successful businesses.

As more and more businesses are impacted by late payment and bad debt, insurance, which protects a business from “bad debt”, is becoming increasingly important. To date, our survey suggests that the majority of SMEs (61%) do not have this protection. Close Invoice Finance is known for responding quickly to meet the changing needs of clients and we recently upgraded our award-winning invoice discounting product, IDeal™, to include bad debt protection cover in view of its critical importance to businesses. IDeal™ now offers our clients all the benefits of the real-time exchange of payment, plus the extra peace of mind of that comes with knowing they are fully covered should any of their customers fail to meet payment terms. This is just one step towards ensuring our clients are in great shape to capitalise on the green shoots of recovery once they start to grow.

For further information on Close Invoice Finance and our portfolio of products, contact us on 0800 220 257 or info@closeinvoice.co.uk. ●

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