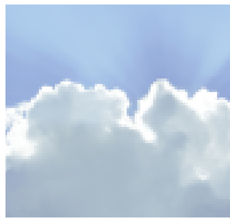

Silver lining

BOTH BANKS AND THEIR CORPORATE CLIENTS ARE TURNING TO INVOICE FINANCING TO HELP RELIEVE THE LIQUIDITY SQUEEZE. **GRAHAM BUCK** REPORTS.

The economic downturn of the past four years has not been all bad news. It has spurred strong growth in Europe's invoice finance market, whose aggregated worth jumped from €843.8bn in 2009 to €990.7bn in 2010 and last year hit €1.09 trillion.

A recent research report from working capital solutions group Demica, The Hidden Player: Sizing the Invoice Finance Market, reviews the rise of the European market, which has three main components: factoring and invoice discounting, supply chain finance and trade receivables securitisation. The market also includes specialist activities such as forfeiting and asset-based lending, together with more recent variations on the invoice finance theme such as distributor finance and the funding of selected obligor receivables with a supplier's portfolio.

The various parts of the market may overlap. For example, an invoice discounter might refinance by securitising the pool of invoice debt it is currently financing. Alternatively, supply chain finance schemes that use invoices as collateral might be regarded as a form of factoring – and indeed are sometimes referred to as "reverse factoring".

As the report notes, recent expansion reflects the growing interest in non-bank financing products. Much of this has come from banks seeking to provide clients with funding that does not require them to set aside the heavy reserve capital levels demanded both by local regulators and Basel III.

From the corporate perspective, lending volumes are withering as European banks clean up their balance sheets. With liquidity under sustained pressure, companies have fallen back on their cash reserves but cannot do so indefinitely.

The report cites the view of a UK bank: "The type of secured financing we provide is an attractive use of capital for banks given the Basel III changes ahead of us. This is reinforced by the internal push towards efficient capital funding, which can be realised by invoice financing. Companies used to focus on earnings; now they are looking at the optimisation of liquidity, and trade receivables securitisation and invoice discounting are very sensible ways to maximise working capital. Bankers and investors now give credit to this, which they might not necessarily have done prior to the crisis in 2007."

The report finds growing support for factoring and invoice discounting on both sides of the Channel, particularly from SMEs. It also concludes that the UK market is the most advanced in Europe. "The fact that factoring is less highly regulated than relationship bank lending in various parts of Europe may also have contributed to this growth," it observes.

Supply chain financing (SCF) programmes are also growing in popularity across Europe, often involving asset-based structures where the key asset is outstanding invoice debt owed to smaller suppliers by a large, highly rated customer.

Unlike factoring, SCF schemes are arranged between the bank and the large buyer, and offered to participants in the supply chain. The report predicts that SCF growth over the next few years will primarily be driven by developed markets and the BRIC economies, with annual growth rates of 10–30% in the former and 20-25% in the latter.

Demica's own research suggests that the strength of the SCF market is partly due to the efforts of the major banks in creating and marketing new products. Banks' risk departments are keener to get loans collateralised because it mitigates risk.

It also forecasts that trade receivables securitisation (TRS) will continue to be an important funding source for receivables and working capital transactions, helped by the focus on return on equity and top-line revenue figures. Banks regard TRS as a capital-efficient form of providing liquidity, as shown by the increasing number of club deals in which a group of banks share receivables transactions.

Demica notes that TRS has been "one of the great survivors" of the financial crisis, with volumes experiencing a temporary drop-off post-2008 but now undergoing a revival.

Finally, the report suggests that the invoice finance market in Europe will continue to grow while traditional credit remains squeezed, national and international regulators impose more stringent capital adequacy rules, and banks look for new ways of funding customers without escalating the cost of doing so.

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