Allianz

Allianz Trade

Financial safeguards that empower business expansion

How a careful mix of short-term financing and strategic business risk protection can be an enabler of SME growth strategies.

Allianz Trade is the trademark used to designate a range of services provided by Euler Hermes.

Six ways to protect your cash flow from late payers

Maintaining a healthy cash flow is the hallmark of any well-run business. But the ever-present risk of late or non-paying buyers can quickly jeopardize that stability, especially in a climate of economic uncertainty and growing insolvencies.[1] Several approaches can offer you early warning signs of distressed buyers who may be struggling to pay, as well as provide varying levels of protection against bad debt. Here are six strategies that are worth considering when seeking to safeguard your business against growth-inhibiting cash flow disruptions – each with its own pros and cons:

1. Invoice factoring

How it works:
A popular finance option for businesses of all sizes across a variety of sectors, invoice factoring (sometimes called debt factoring) involves selling your unpaid invoices to a third-party finance provider (or factor) – but at a discount on their paid-up value. The factor then takes on the responsibility of collecting payments from your customers.

Benefits:
- Immediate cash flow from outstanding invoices, enhancing business stability, especially in sectors where payment terms can be prolonged.
- The factor assumes the credit risk, reducing your exposure.
- Allows your company to free up working capital, unlocking purchasing power and new opportunities.
- Invoice factoring is also non-recourse: if a customer doesn't pay the factor, you're not on the hook to repay the money.
- It takes the sting out of collections, allowing finance teams to focus on forward-looking business activities.

Considerations:
- Factoring fees can be relatively high (typically invoices are sold for 70% to 90% of their face value), which can impact your profit margins.
- Invoices are often sold in bundles, with good payers and laggards lumped together, so you may be paying a price for passing on invoices from some of your more reliable customers.
- To reduce its risk, the factor may want to run credit and other due diligence checks on your customers before purchasing the invoices.
- A number of your customers may feel uncomfortable working with third-party collectors, potentially affecting good business relationships.

If a customer doesn't pay the factor, you're not on the hook to repay the money.

1. Allianz Trade's Economic Research team suggests global business insolvencies will accelerate by +10% during the year.

2. Invoice financing

Invoice financing is particularly useful for providing short-term liquidity when a business encounters an unexpected but temporary cash flow issue.

How it works:
Rather than selling your invoices, invoicing financing (also referred to as invoice discounting or accounts receivable financing) involves borrowing against a proportion of the value of your outstanding invoices. With invoice financing, you still own the debt, whereas with invoicing factoring you sell the debt and collection is handled by the factoring company. You can think of invoice financing as a short-term overdraft facility secured against an asset with a track record: your accounts receivables.

Benefits:
- It's fast: an injection of funds can be arranged and be supporting cash flow within a matter of a few days.
- When a significant amount of your current assets is locked up in receivables, invoice financing can help provide the working capital needed to take advantage of new opportunities.
- It keeps open your option of extending the payment terms of select customers, making you more competitive.
- Invoice factoring can be particularly useful for providing short-term liquidity when a business encounters an unexpected but temporary cash flow issue (for example, when its supply chain is interrupted by a logistics crisis such as the blocking of the Suez Canal in March 2021).

Considerations:
- Like any loan, invoice financing involves fees and interest, which can eat into your profit margins: contract fees can amount to as much as 4% of the portion of receivables used in the contract.
- Invoice financing can be structured so that customers are unaware that their invoices have been financed, preserving your good relationships with them.
- Collecting on invoices remains your responsibility.
- The loan may become a burden if large numbers of invoices remain unpaid for too long.
- Non-payment risk: you still face the risk that your customer may be unable to settle the invoice in good time.

3. Letters of credit

How it works:
A letter of credit is a guarantee from a bank that the seller will receive payment as long as certain delivery conditions are met. It is commonly used in international trade.

Benefits:
- Letters of credit reduce the risk of non-payment, especially in international transactions.
- They provide security for both buyer and seller.
- Can help build trust with new customers, especially in unfamiliar markets.

Considerations:
- Compared to other options for protecting cash flow from late or non-payments, letters of credit can be complex and potentially time-consuming to set up.
- Fees and administrative costs may be higher than other methods.

4.

Trade credit insurance

How it works:
While invoice factoring and invoice financing/discounting can be useful for dealing with periodic cash flow issues, trade credit insurance stands out as a more stable and strategic way of protecting yourself against financial risk. The approach safeguards your cash flow against the risk of non-payment due to customer insolvency, protracted default, or geopolitical instability.

Benefits:
- Credit insurance protects your trading receivables against non-payment and supports your cash flow by maintaining an active profile of the creditworthiness of your customers, allowing you to decide which ones you can safely do business with.
- It also gives you the confidence to define maximum credit limits for those customers, safe in the knowledge that your business is protected against non-payments.
- As companies expand into new markets or diversify their customer base, the risk of bad debt increases; trade credit insurers can provide global protection and support across multiple regions and sectors.
- A trade credit insurance policy also gives peace of mind to your finance partners. Your bankers and other lenders can be reassured about the financial stability of your company and more inclined to offer financing.
- It supports availability of working capital, lifting uncertainty regarding your cash flow, and securing your company's ability to grow.

Considerations:
- Credit insurance is especially useful when you need rock-solid protection against potential debtors – no matter their location or sector. As a global provider, Allianz Trade has underwriters, legal teams, and local negotiators ready to help reduce your exposure to trading risk and empower your success.
- Although trade credit insurance comes at a premium, it is often the more cost-effective option in the longer term, as it covers a broader range of potential losses. Short-term cash flow issues might be better solved by alternatives.

Trade credit insurers can provide global protection and support across multiple regions and sectors.

5. In-house credit control and monitoring

Allianz Trade maintains an active global database of over 85 million companies.

How it works:
Implementing stricter credit control policies and monitoring of customer payment behavior can go a long way to mitigate the risks associated with non-payment and enhance your business's cash flow. This involves setting clear credit limits, conducting regular credit checks, and actively monitoring the financial health of customers and prospects. But that doesn't have to be a challenge you take on single-handedly. As a part of its global trade credit insurance operations, Allianz Trade maintains an active global database of over 85 million companies and supports customers through its teams of country and sector experts with deep knowledge of local companies and risks.

Benefits:

- Visibility into the creditworthiness of your customers (either directly or with the help of your credit insurance partner) provides you with greater understanding and control over credit risks.
- Allows you to customize credit terms based on your trading history with certain customers.

Considerations:

- Without the help of credit insurance and credit-grading companies, the challenge of credit monitoring and control can be even more time-consuming and resource-intensive, requiring you to devote additional staff to the process.
- While you may know your customers well, there will always be circumstances when their financial health comes under pressure, interrupting their ability to meet agreed payment terms. A lack of protection from such occurrences can leave you exposed to bad debt.

6.

Advance payments

While the option of payment terms has been one of the foundations of business for hundreds of years, there are plenty of modern business environments even today where credit is not an option. Many B2B companies have still not found a way to offer net terms when selling online – though that is changing fast with the emergence of e-commerce solutions such as Allianz Trade pay.

How it works:
To receive goods or services, customers are required to pay a portion or the full amount upfront.

Benefits:

- By its nature, advance payment eliminates most of the risk associated with non-payment and solves cash flow challenges immediately.
- It reduces the need for extensive credit checks on customers.
- Customers' willingness to pay upfront provides a strong indicator of the strength of your product and your customer commitment.

Considerations:

- Upfront payment is not standard practice in most B2B environments. Customers who prefer credit terms may find the absence of a deferred payment option off-putting, possibly to the point where they walk away from the deal.
- That can impact your business's competitiveness and perceptions of its maturity, especially in markets where credit terms are the norm – whether the buyer is online or trading in a more traditional way.
- Applied selectively, advance payment can be a necessary way of protecting your cash flow, especially in territories and sectors where you have little or no track record.

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The solution set that supports your goals

In today's volatile global market, managing cash flow well and safeguarding the business against credit risks are critical challenges for any finance team. Companies are increasingly looking to optimize their working capital by leveraging a mix of trade credit insurance, invoice factoring and invoice financing, as well as maintaining tighter credit controls and requiring some customers to pay upfront for goods. While select measures may provide short-term liquidity, trade credit insurance offers both financial protection and strategic value, preserving customer relationships, enabling business expansion, and providing cost-effective risk management.

Businesses should seek out the solution set that best aligns with their immediate and strategic business needs and risk tolerance. Each approach has its pros and cons, so it's important to carefully consider which options support your cash flow objectives and customer relationships.

As a global leader in trade credit insurance, Allianz Trade provides world-class solutions, underpinned by a global knowledge network of experts who are there to bring confidence – and success – to your trading decisions. To find out more, go to allianz-trade.com

TO PROTECT YOUR BUSINESS AGAINST THE RISKS OF INTERNATIONAL TRADING WHILE TAKING ADVANTAGE OF EXPORT OPPORTUNITIES, DISCOVER MORE ABOUT ALLIANZ TRADE'S CREDIT INSURANCE SOLUTIONS.

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