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Alternative invoice finance- areas for innovation

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Igor Zax, managing director, Tenzor Ltd., explores the scope of innovation in the current alternative invoice finance market

As traditional bank services in the receivables finance space come under criticism, alternative finance players continue to edge towards the centre of the picture, backed by both private and public investment. When we look at the now strongly contested area of receivables finance, it's important to investigate the actual scope of innovation, and to understand what value proposition it creates, as well as what niches are open to the different providers.

Fundamentally, the value chain for invoice finance consists of the following areas, each of which can operate in a variety of ways: origination; risk assessment (credit, fraud, operational, etc.); administration; risk mitigation; and funding. A closer look at each of these can tell us how conducive they are to an innovative approach in the current market, and understand which type of provider is best set to capitalise in a given area of operation.

Origination. Theoretically, banks should have a massive advantage in ability to originate, due to branch network and proximity to the customer (unsurprisingly, alternative financiers were keen on government support in forcing banks to refer business clients). The reality is that lack of internal communication, poor training at branch level, and reputational factors reduce this to only a marginal advantage – indeed, challenger banks can gain an edge here, by better addressing these issues than their larger counterparts. The platforms, while not having their own distribution channels, have formed partnerships in many cases (banks, brokers, accounting firms, etc.), while some other companies have placed themselves within the supply chain ecosystem (either downstream to multi-layer suppliers or upstream to distributors, VARs, etc.), providing a single source for access to large customer pools.

Risk Assessment. For transaction-based businesses,both banks and alternative players rely predominantly on scoring models for risk assessments, with a limiting number of data providers. What may differ is risk appetite, including the fundamental structural issue of single invoice financing. Both factoring and credit insurance companies have traditionally tried to stay away from this business, recognising that while, statistically, scoring remains satisfactory, it is very unreliable on an individual basis, and facing adverse selection is a major issue. Other risk prevention areas (particularly fraud) are a major cost and focus for traditional financiers, and it's yet to be seen which alternative players will develop superior expertise in this area (the main issue with fraud is that it's not granular; instead, once weakness has been established, it can easily become an avalanche).

Administration. This is one area where new players have an obvious edge – they have better IT solutions; while cutting bureaucracy and improving efficiency can be more easily achieved outside of traditional banking.

Risk Mitigation. Fundamental differences between traditional and platform solutions exist in risk mitigation - while the former have the capital cushion to absorb losses, platforms directly pass the loss to funders. In both cases, external tools such as credit insurance may be used to partially reduce the risk, though residual issues are treated differently. This has an effect on margins, as traditional financiers have to price it in in exchange for cheaper funding, while platforms can pass it on, for higher, but riskier, returns to investors.

Funding. The traditional banking model has long been based on very cheap funding (as deposits were protected by government guarantees) in exchange for high regulatory burden and capital requirements. With this pressure increasing, the trade-off may shift, as alternative financiers find that they can afford to overpay for funding in exchange for operational flexibility, while the market for investors in invoice-based products continues to grow. What remains unclear is the regulatory and market reaction if large losses are absorbed by unsophisticated investors – the ability of the industry to manage this will be key for its future.

Igor Zax

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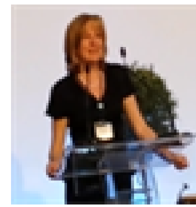
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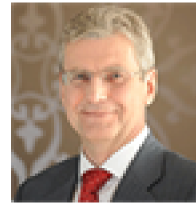
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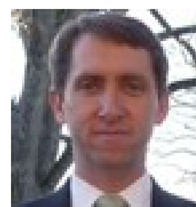
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Market data

Polish factoring market Y2013: Turnover of PFA members (22 companies) PLN96.58 billion (EUR23.2 billion); Total Market Turnover (40 companies) - PLN125 billion (PFA estimates); Annual Growth – +15pc;

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