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Debtor Financing: A Great Way To Finance Your SME In 2015

Many small and medium sized businesses (SMEs) experience ongoing cash flow difficulties which are a major obstacle to growth. Without adequate funding, it is impossible to build a platform to competitively supply the market and become a sustainable enterprise.

What can debtor financing do for you?

In short, you convert your sales invoices to cash. Banks and certain finance providers will pay a business a percentage of the value of its invoice upon presentation of the invoice and proof of supply – this is usually 75% to 80% of the invoice value although some institutions advance more than this. If the business normally collects its debtors in, say, sixty days, it now receives the specified percentage on the date of invoice or a day or so thereafter. Effectively, the business either solves, or substantially improves, its liquidity position.

This increased flexibility means the entity can finance increased sales. In addition it can drive down costs by taking advantage of settlement discounts offered by suppliers.

In most instances, this gives the SME the leverage to become a sustainable business.

How does it work?

In practice there are several different models for debtor financing. **As costs vary depending on the model, seek advice from your accountant.**

The main procedures usually followed are:

- The financial institution will do an audit of the debtors' books, stock and internal controls,
- They will assess how sustainable the business is,
- The institution will require some form of security – usually a cession of debtors and sureties from the owners,
- When the invoice is paid by the customer, the amount originally advanced by the finance institution is refunded to it. With factoring, the remaining retention percentage is then refunded to you (i.e. the amount of the invoice less the 75% or 80% advance).

Types of debtor financing

There are two models used, one is known as **invoice discounting** and the other **factoring**.

With invoice discounting, you keep control of your debtors and operationally there is little change to your business. Thus, you collect your debtors and, apart from the cash inflow from invoice discounting, there is little change in your business.

In factoring, the full debtor's function is now managed by the factoring institution you contract with. They will collect your debt and assist in managing your credit policies.

Some businesses prefer invoice discounting as there is no visible change to the business from the customers' perspective and thus they will not be aware the organisation has cash flow difficulties. Also, many businesses actively use their customers as a marketing tool and as a tool to grow their business e.g. giving a discount to certain customers or allowing them an extra 30 days to pay for a large order. This will be more difficult to do if you use factoring.

Your choice also depends on your particular circumstances - many businesses find that factoring suits them as they get a professional debtor administration service with the ability to distance themselves from any robust collection action required against slow-paying debtors.

What are the costs?

With invoice discounting, there is a monthly administration fee (usually around R10,000 per month) – this fee covers a monthly audit by the financial institution of invoices, credit notes and monies paid by debtors.

With factoring there is a factoring fee per invoice (generally between 0,5% and 2,5% but check before you commit).

In both cases, interest is charged on the monies advanced by the institutions.

As a rule of thumb it is cheaper to use factoring up to R500,000 monthly sales and thereafter invoice discounting gets progressively cheaper, but there may be other factors at play so ask your accountant for advice on your particular circumstances.

Bear in mind also that if you choose factoring and then later decide to discontinue debtor financing, you lose the factor's assistance in collecting debts and so will face the practical challenge, disruption and cost of having to take the full debtors' function back into your business.

The bottom line is that as these types of facilities can be the boost your business needs to achieve sustainability, the cost is not excessive.

Shareholder Resolutions - Be Careful Of The Round Robin

Shareholders ultimately carry the most power in a company. Decisions are carried out via shareholders' resolutions and it is important that these resolutions are correctly done.

The Companies Act ("the Act") specifically addresses the issue of resolutions. It also allows the Memorandum of Incorporation (MOI) to have a substantial impact on resolutions. The MOI can set the requisite number of votes to pass an ordinary or special resolution. It can also dictate when ordinary or special resolutions are required.

How to pass resolutions

These can be passed -

- At a shareholders' meeting or other meeting such as the annual general meeting, or
- By round robin resolution, or
- In the case of a sole shareholder, without any of the prescribed formalities.

A voting anomaly with round robin resolutions

Round robin resolutions are conducted by correspondence, usually by email. Formal notice needs to be given and needs to adequately inform shareholders of the purpose of the resolution. Voting is to take place within 20 business days of the resolution being sent and shareholders are to be informed of the result of the resolution within 10 business days of the resolution being finalised.

The curious aspect of round robin resolutions is that the Act is not clear as to the number of voting rights needed to carry a resolution. In terms of other meetings, there must always be a quorum present – the Act speaks of a quorum as 25% of the voting rights.

With round robin resolutions, there is no such certainty, and a number of contrasting views as to what will suffice. One view (possibly the majority view) is that a 25% voting response is needed. Another is that a majority of those who vote decide – in which event, in an extreme case if only 1% of the voting rights vote, they would make the decision. Other possibilities are decision by a majority of the voting rights of all issued shares, or a requirement of 100% unanimity.

In companies with only a few shareholders this will probably not be an issue but as the shareholder numbers grow, the potential to manipulate decisions via round robin resolutions exists. It is unclear what stance our courts will adopt in the event of any dispute over the validity of a round robin resolution, so take professional advice if you are in doubt.

Remove all doubt

In any event, in view of this lack of clarity, one solution would be to remove all doubt by specifying in the MOI the number of voting rights necessary to pass a round robin resolution.

Inequality In South Africa: An Alternative Narrative

We are often warned that inequality in South Africa will, if not addressed, result in our own “Arab Spring”.

We all agree that the country needs to redistribute income to the poorer communities.

Generally, we hear negative sentiments about inequality. So how in fact are we doing and can we remedy the situation?

The facts

Recently, the World Bank did an interesting study of how well South Africa redistributes wealth via fiscal policy - taxes and government expenditure such as pensions, social grants, housing, education and health care. There were some interesting statistics -

- Extreme poverty (less than $1.25 per day) has more than halved from 34.4% of the population to 16.5%.
- 3.6 million people have been lifted out of poverty (income of $2.50 per day).
- In terms of our middle income peers (countries such as Brazil, Mexico and Argentina), we have the most efficient redistribution system.
- Inequality in SA has declined 25% as a result - from a Gini coefficient of 77 to 59 (the Gini coefficient is the globally accepted mechanism to measure inequality - the closer a country gets to 100, the higher the inequality).

That’s impressive, but …..

With a Gini coefficient at 59, South Africa still remains one of the most unequal countries in the world. The country is also reaching its fiscal limits in terms of redistributing wealth – government debt has risen, the currency has declined and we are running a large trade deficit. In his recent Medium Term Budget, the Minister of Finance acknowledged this.

So what can we do?

Comparing South Africa to Brazil is informative. In the 1990s, Brazil had a higher Gini coefficient than South Africa. Since 2000, it has rapidly dropped and is set to go below 50. What is interesting about Brazil is that incomes amongst the poorest sections of the community have risen five times faster than incomes of the richest category. This has been achieved by improving education and rapidly increasing semi-skilled jobs, particularly in agriculture.

Since 2000, the standard of Brazil’s education has risen and Brazilians have leveraged this so that semi-skilled labour has often moved to skilled jobs.

With fiscal policy no longer a viable lever South Africa needs to look to creating jobs to reduce inequality, especially as unemployment is 25% (some argue 40% as this figure includes people who have given up looking for work).

We can still improve the quality of education. We can spread the beneficial impact of BEE. This together with the relaxing of labour laws would encourage job creation.

Merging Tax Profiles Will Reduce Your Admin Time

In a commendable effort to reduce the cost of doing business particularly in small and medium sized entities (SMEs), SARS recently introduced a single registration process whereby a taxpayer now only needs to register once to be able to register for Income Tax, VAT, PAYE and Customs and Excise.

Now SARS has built on this via the merging of tax profiles. In effect this means that the person responsible for the taxpayer's affairs (be it an individual taxpayer, a public officer or a tax practitioner) can merge all of the taxpayer's affairs under the representative's profile.

This will reduce administration time and will make it easier for SARS to manage taxpayers' affairs.

SARS – Latest Tax Stats Looking Good

Generally, we are looking good in international terms -

- South Africa's total tax rate is 29% versus a global tax rate of 41%.
- South African companies average 7 tax payments per year versus a global average of 26 payments (the rest of Africa average 36 annual payments).

Preliminary statistics from the 2014 tax year (up to November 2014) show that compliance from taxpayers is improving whilst the efficiency of SARS is similarly increasing. Here are some highlights -

- 94.49% of eligible taxpayers submitted returns on time – an increase of 10.1% from the 3.7 million submitted in 2013
- A total number of 5.32 million returns were received timeously by 21 November 2014
- 99.91 % of returns were submitted electronically
- 94.98% of returns were assessed within 3 seconds
- 98.0% of refunds were paid in 72 hours
- Over R15.2 billion in tax refunds were paid to 2.1 million taxpayers
- 1.02 million tax returns from previous years were submitted
- SARS collected R436 million in outstanding penalties.

This vindicates the whole eFiling process and effectively means that SARS can quickly assess individual, non-provisional taxpayers and focus on the provisional taxpayers who owe the most tax.

Your Tax Deadlines For January

Provisional taxpayers (individuals and trusts) need to submit their eFiling returns by 30 January 2015.

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