# Asset finance

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*Asset finance, in its various forms, is widely used in the United Kingdom. Indeed, one survey has shown it is the largest type of funding for almost a quarter of those small and medium-sized enterprises (SMEs)[1] that use external finance. Some forms of asset finance have grown rapidly in recent years, while others have not; and some new asset finance products have been brought in from the United States. This article provides an overview of asset finance from a UK perspective.*

## Introduction

Asset finance is a generic term often used to describe the three main elements—invoice finance, leasing and hire purchase and, more recently, asset-based lending (ABL). The term derives from the fact that the finance is based on specific assets of the borrower, about which the asset financier has specialist knowledge. This article describes the basic characteristics of the three main elements of asset finance and outlines some advantages and disadvantages of asset finance compared with traditional bank finance. It then examines the current usage of asset finance in the United Kingdom, and discusses some recent trends in the market. Finally the relevance of asset finance to smaller firms is considered.

## Definition and basic characteristics of asset finance

Factoring and invoice discounting, together known as invoice finance, are primarily used as a form of short-term working capital finance. Leasing and hire purchase typically provide longer-term fixed capital finance. ABL may be used to finance fixed or working capital and is usually part of a bigger package of finance. Except in some forms of ABL, financiers gain or retain ownership of the assets concerned for the duration of the contract. Unlike traditional bank lending, where future cash-flow projections for the business as a whole play a pivotal role in the lending decision, asset financiers' decisions are primarily based on the value of specific assets. More detailed explanations of the three main types of asset finance are given in the box on page 208.

### Invoice finance

This may be provided on a 'recourse' basis, where the financier has recourse to demand repayment by the vendor of any advances made against a debt which has subsequently gone bad. Alternatively, it may be conducted on a 'non-recourse' basis, where for an additional fee the financier assumes the risk that the debtor does not pay.[2] Thus, non-recourse invoice finance is a form of funded trade credit insurance.[3]

Recourse invoice finance is recorded on the borrowing firm's balance sheet in much the same way as ordinary short-term bank finance, as it is essentially a short-term secured advance and the borrower remains liable for the sum advanced until the borrower's customer pays the amount due on the invoice. The situation with non-recourse finance is more complicated and depends on whether the borrower has any potential liability at all to the financier in the event of non-payment (eg a dispute between the borrower and its customer about the actual performance of the contract). Table A shows the (simplified) effects of bank lending, recourse and non-recourse invoice finance on the balance sheet of a company seeking £100 in working-capital finance and holding an invoice worth £100. It should be noted, however, that the quantity of non-recourse invoice finance (in this illustrative case the prepayment was £85, representing a typical advance rate of 85% of the

(1) Competition Commission (2002)—see also Table C below.
(2) Delayed payment due to disputes between the vendor and the debtor is excluded from the cover.
(3) That is, insurance against the loss or deterioration of book debts. For an overview of trade credit insurance, see Dowding (2002).

## The three main types of asset finance

### Invoice finance

Both invoice discounting and factoring involve the assignment by a vendor to its financier of the proceeds due on outstanding invoices (receivables), in return for an immediate payment of up to around 85% of the invoices' face values and the remainder (less fees and finance charges) upon payment of the debts by the vendor's customers. Thus, the finance is extended for the length of the trade debt (the average payment period in the United Kingdom was around 55 days in 2002).(1) The main difference between factoring and invoice discounting is that in the latter the vendor retains control of its sales ledger and remains responsible for collecting debts, whereas factoring involves the transfer of this function to the financier. Partly for this reason, larger firms tend to use invoice discounting, whereas factoring is more suitable for many smaller firms.

### Asset-based lending

This is finance for the acquisition of assets such as raw materials, unsold stock and plant and machinery. For stock finance, the financier may provide a monthly revolving facility secured on the pool of assets. For fixed and intangible assets, the finance is similar to a secured term loan. In some cases, the financier may take ownership of the assets and sell them to the firm on credit terms.(2) ABL is almost invariably a minority part of a finance package centred on invoice finance.

### Leasing and hire purchase

A lease is a contract between a lessor and a lessee that gives the lessee possession and use of a specific asset for a period of time in return for paying rentals to the lessor.(3) The lessor retains ownership of the asset for the duration of the lease, retains the right to any capital allowances associated with the purchase of the asset (although the lessee is allowed tax relief on the rent payments), and the lessee does not generally have the right to purchase the asset when the lease terminates.

A hire purchase arrangement is a rental agreement that allows the hirer to purchase the asset at the end of the rental period. If the payment for this is nominal (as it almost always is in the United Kingdom), capital allowances—which always accrue to the buyer of the asset—will accrue to the hirer, because the hirer is effectively purchasing the asset by taking the option to buy at a cost far below market price.

(1) Credit Management Research Centre (2003). Normally, invoice financiers would not extend credit beyond 90 days.
(2) For a more detailed description, see Hawkins, Peers and Wilde (2000), pages 15–19.
(3) PriceWaterhouseCoopers (2001).

**Table A**[(a)]
**Balance sheet effects of invoice finance compared with bank lending**

| | Assets | Liabilities |
|---|---|---|
| Normal bank lending | 100 (debtors) | 100 (short-term bank finance) |
| Recourse invoice finance | 85 (cash)<br>15 (debtors) | 85 (short-term invoice finance)<br>15 (short-term bank finance) |
| Non-recourse invoice finance | 15 (debtors) | 15 (short-term bank finance) |

(a) Assuming for non-recourse invoice finance that the borrower has *no* liability to the financier. Such circumstances are not common.

invoice's face value) must be disclosed in the notes to the accounts.

The Factors and Discounters Association (FDA)(1) estimates that around 80% of its members' invoice discounting business is conducted on a confidential basis, where the financier agrees not to make buyers aware that their supplier is using his services. This desire for confidentiality arose during the time when many held the view that factors and discounters were exclusively 'lenders of last resort' for struggling businesses, although perceptions are now changing to meet the reality that invoice finance is used by many viable and prospering businesses. It has generally not been possible to conduct confidential factoring, because it is very difficult for financiers to pursue debts without revealing their identity to debtors, although confidential factoring is now becoming available from some financiers.

### Asset-based lending

Many UK invoice financiers now provide asset-based lending (ABL), a product imported from the United States in the 1990s. ABL differs from traditional bank finance in two respects. First, a monthly revolving

(1) The FDA is the trade association for the invoice finance industry in the United Kingdom and also covers the Republic of Ireland. It estimates that its 40 members provide around 95% of invoice finance in the United Kingdom.

facility for financing stocks may be more flexible than an overdraft, the limit on which is normally only reviewed annually. Second, asset financiers may be prepared to lend more than a bank would through a normal term loan and/or to accept a wider range of assets as security.

ABL arrangements are usually part of a package of finance centred around a core invoice discounting facility, which would typically constitute around 70% of the package. This proportion may vary widely, particularly for larger deals where the financier may also include some finance based on cash-flow projections. Some larger deals may also involve some element of equity finance, although this is by no means essential. Advance rates against fixed assets and current assets other than receivables will typically be lower than those in the invoice discounting facility (see Table B)—raw materials, for example, are unlikely to attract an advance of more than 50% of their value because there is no guarantee that they will be converted into finished goods and subsequently sold.

### Table B
### Indicative maximum advance rates in asset-based lending(a)

Per cent

| | GE Capital | GMAC |
|---|---|---|
| Receivables | 90 | 90 |
| Plant and machinery | 80 | 80 |
| Finished goods | 60 | 50 |
| Commercial property | 50 | 70 |
| Raw materials | 30 | Not specified |

Sources: GE Capital, GMAC Commercial Finance.

(a) GMAC Commercial Finance advance rates on plant and machinery for up to 90 days and on property for up to 365 days. Figures for both companies are indicative maxima only.

### Leasing and hire purchase

There are essentially two forms of lease in the United Kingdom: the finance lease and the operating lease. Finance leases confer upon the lessee substantially all the economic risks and rewards of ownership of the asset, because the lessee repays substantially all of the asset's cost to the lessor. At the end of the lease, the lessor may sell the asset and pay to the lessee most of the proceeds. Alternatively, the lessee may continue to lease the asset at a nominal 'peppercorn' rental. Under an operating lease, the lessor retains some or all of the economic risks and rewards of ownership. This is mainly because the economic life of the asset is likely to be longer than the length of the lease. When an operating lease terminates, the asset is simply returned to the lessor, who may lease it out again.

Assets subject to hire purchase arrangements are recorded on the lessee's balance sheet in much the same way as if it were a finance lease, provided that the cost to the lessee of exercising the option to purchase the asset is negligible (which, in the vast majority of cases in the United Kingdom, it is).

## Advantages and disadvantages of asset finance compared with traditional bank finance

### Advantages

First, asset finance gives financiers better security, because the financier is the legal owner of the assets financed (receivables or leased equipment), rather than simply holding a charge over them. This mitigates the information asymmetries inherent in lending and can make an asset financier more willing to provide finance than a traditional lender.

Second, asset financiers often possess a high degree of specialist knowledge on the value of the assets concerned, and how best to realise that value. Invoice financiers build up large databases on the creditworthiness of their clients' trading partners and are therefore in a strong position to determine accurately the likelihood of delayed or non-payment. Lessors often specialise in providing certain forms of capital assets, and therefore have a good knowledge of conditions in the market for those assets, old or new. This specialist knowledge may also mean that an asset financier is more willing to provide finance than a traditional lender, who may lack specialist knowledge of the borrower and of the assets used to secure the loan.

Third, asset finance may be more suited to new, growing businesses. These may lack the track record or assets that a traditional lender may require. For example, an invoice financier may be better able to help such a firm, because its credit risk is based on the firm's customers, rather than the firm itself; and a lessor will finance the whole of a fixed-asset acquisition whereas a traditional lender will only lend part. Furthermore, as the business grows, the asset finance provision can grow automatically with it (subject to the creditworthiness of the customers and/or the market for the particular fixed assets sought).

Fourth, small, growing firms are often not yet profitable, and leasing allows them to benefit from tax allowances available on the purchase of new capital equipment even though their taxable income may be inadequate. Because the lessor buys the asset, the capital allowance accrues to it, but the lessor may pass on part of the allowance to the lessee, in the form of reduced rental rates.

Fifth, asset financiers often offer 'value added' non-financial services alongside finance facilities, which would not normally be available from traditional bank lenders. Many of these services allow firms to outsource non-core functions related to the assets financed to the specialists. For example, lessors of computers and vehicles often include maintenance contracts as part of the package; and invoice financiers may offer credit control advice, debt collection services and even logistical support.

Sixth, the use of asset finance can also allow firms to transfer some risks to the specialist financier. This is particularly true in the case of operating leasing, where the lessee carries no residual value risk and simply returns the asset to the lessor at the end of the contract. International factoring and invoice discounting also allow clients to mitigate the exchange rate risk by receiving the bulk of monies owed immediately rather than at a later date.

Finally, asset finance can provide valuable competition to mainstream banks in the small and mid-corporate market. There are a significant number of non-bank providers of asset finance, particularly among lessors.

### Disadvantages

Asset finance has, however, some disadvantages compared with traditional bank lending. First, it is not available in all sectors. For example, invoice finance is not available for: businesses that invoice in stages (such as the construction industry); sales to the general public; sales done on a sale-or-return basis; or firms whose goods or services are complex in nature (because there may be a high level of rejection by customers or a need for considerable after-sales service). Leasing of highly specialist equipment may also pose difficulties, because the secondary market may be particularly thin.

Second, one of the principal disadvantages of asset finance most often cited by users of business finance is that it is expensive. The fixed costs involved in asset finance (invoice finance in particular) make it unsuitable for the smallest firms, and smaller firms will be most affected by the fees financiers charge for use of the facilities because they are typically high relative to the low values of finance required by such firms. However, comparisons between the costs of asset finance and traditional debt are complicated by the possible additional services that may be provided with asset finance.

Third, a problem commonly associated with invoice discounting is fraud by the financiers' clients. This can include the swapping of fictitious invoices between colluding firms, issuing fictitious invoices and issuing invoices before the goods have been dispatched. Anti-fraud measures by invoice discounters can be expensive and off-putting for legitimate businesses.

## Current usage of asset finance in the United Kingdom

At end-2002, advances from FDA members totalled £8.2 billion. A further £432 million was advanced by FDA members through asset-based lending. At that time, members of the Finance and Leasing Association (FLA)(1) had £65.8 billion outstanding to business clients. These amounts compare with bank lending to private sector non-financial corporations of £255.1 billion.(2) Thus, the total outstanding on asset finance facilities was just under 30% of that on bank facilities (see Chart 1).

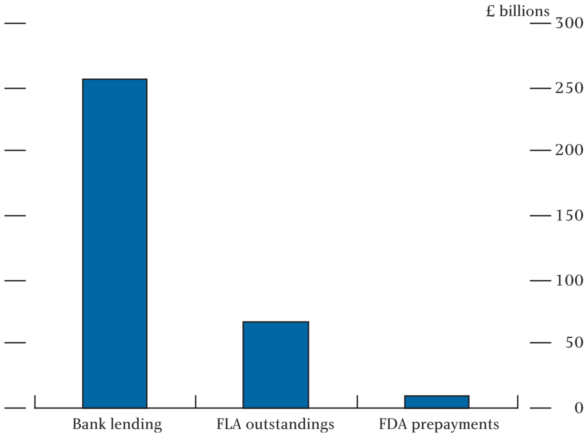
### Invoice finance

The breakdown of the total amount of invoice finance advanced at end-December 2002 by product type (see Chart 2) shows that domestic invoice discounting accounts for the great majority (80%). However, Chart 3 shows that domestic invoice discounting is used by only 37% of firms. This is because, as noted above, larger firms mainly use this form of invoice finance. Domestic factoring, which is more prevalent among smaller firms, is used by 52% of client firms but accounts for only 16% of the total amount advanced.

In total, FDA members financed client sales of £104.4 billion in 2002, the highest annual figure to date. Just over 10% of invoice finance was with no recourse to the client, ie effectively a form of trade credit insurance.

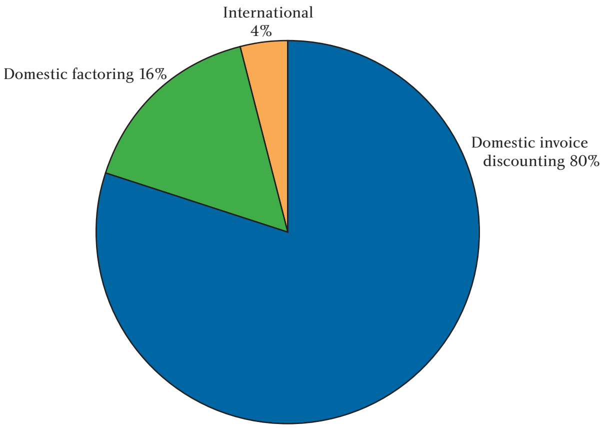
(1) The FLA is the main UK trade body for the leasing and consumer finance industries. It currently has over 50 members providing business finance in the United Kingdom.
(2) Figure includes lending by deposit-taking institutions only; as such it excludes the leasing activities of banks' asset finance subsidiaries but will include, for example, Barclays' asset finance activities because they are carried out within Barclays plc.

### Chart 1
### Asset finance and bank finance outstanding, end-2002



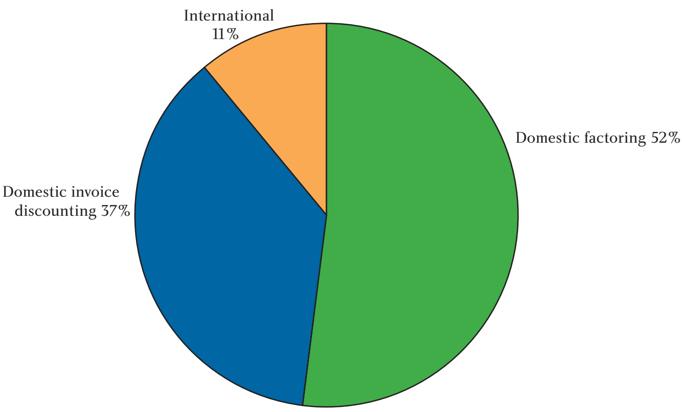

Sources: Bank of England, Factors and Discounters Association and Finance and Leasing Association.

### Chart 2
### Total invoice finance advances, by type of product, end-2002




Source: Factors and Discounters Association.

### Chart 3
### Invoice financiers' client numbers by product, end-2002

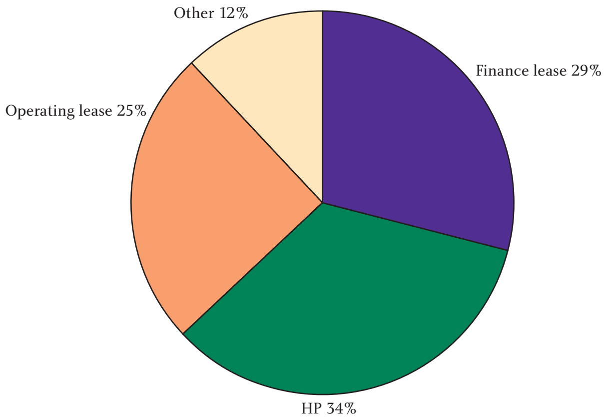



Source: Factors and Discounters Association.

## Leasing and hire purchase (HP)

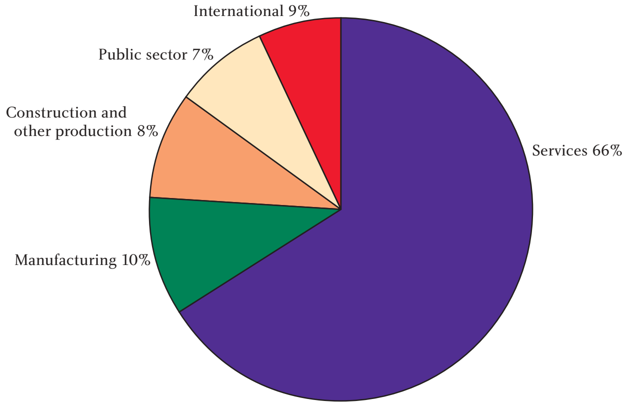
FLA members, whose finance is typically extended for longer periods than invoice finance, completed some

### Chart 4
### Leasing/HP new business by product type, 2001




Source: Finance and Leasing Association.

### Chart 5
### Leasing/HP new business by type of client, 2001



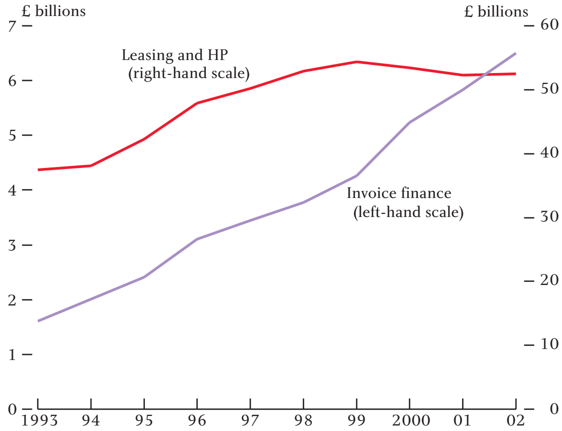

Source: Finance and Leasing Association.

£23.5 billion of new business in 2001 (£21.4 billion if international business is excluded). HP agreements were the single most common form of finance provided by FLA members, accounting for around a third of all new business (see Chart 4), closely followed by finance leases (29%) and operating leases (25%). However, there has been a trend towards the increasing use of operating leases (see below). Around two thirds of all FLA member finance was provided to firms in the service sector (see Chart 5).

## Recent trends in asset finance

As Chart 6 shows, invoice finance has increased rapidly in the past decade, growing by over 300% in real terms between 1993 and 2002. The leasing and HP industry, by contrast, grew by around 50% in real terms up to the mid-1990s, but has remained roughly stable since 1998. By comparison, bank lending to private non-financial corporations grew in real terms by 43% between 1993 and 2002. It should be remembered that, although invoice finance has experienced much stronger growth, it was from a much lower base than leasing and HP.

**Chart 6**
**Real growth in business finance provided by invoice financiers and lessors (at 1993 prices)**




Sources: Factors and Discounters Association and Finance and Leasing Association.

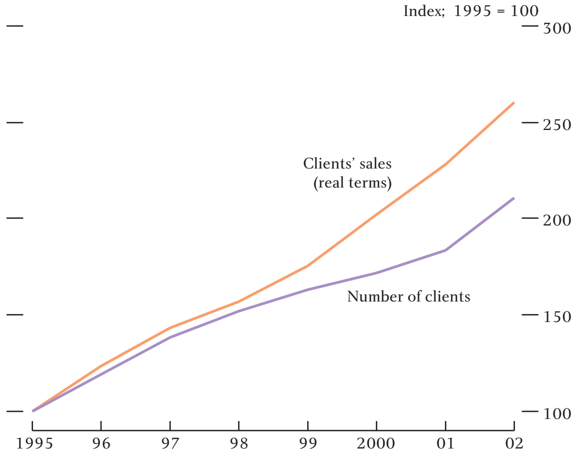
## Invoice finance

Overall, growth in the invoice finance industry seems to have been driven both by an increase in the number of businesses using invoice finance and by the growth in sales experienced by those client businesses (see Chart 7). Indeed, the growth in clients' sales has exceeded the growth in GDP in every year since 1987, except for 1991 (see Chart 8).

There are a number of potential explanations for these trends. First, there is anecdotal evidence(1) that, following the early-1990s' recession, when banks suffered significant losses on traditional term lending and overdraft business, many banks encouraged overdraft customers to transfer to invoice discounting products in order to improve the banks' security. More recently, the Brumark judgement(2) may have helped sustain and strengthen this trend, by questioning whether fixed charges taken by banks over receivables could be effective. Second, advances in IT have made it possible to provide invoice finance on a cost-effective basis to more smaller businesses. Finally, the industry has had some success in countering its previous image as a 'lender of last resort' for failing businesses.

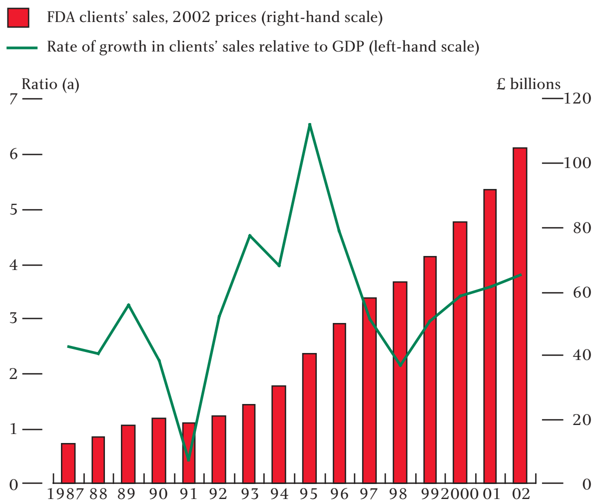
The main contributor to the growth in invoice finance has been invoice discounting, as shown in Chart 9.(3)

**Chart 7**
**Numbers of businesses using invoice finance and sales by those businesses**




Sources: Bank of England and Factors and Discounters Association.

**Chart 8**
**Growth of UK invoice finance, at 2002 prices and as a percentage of GDP**



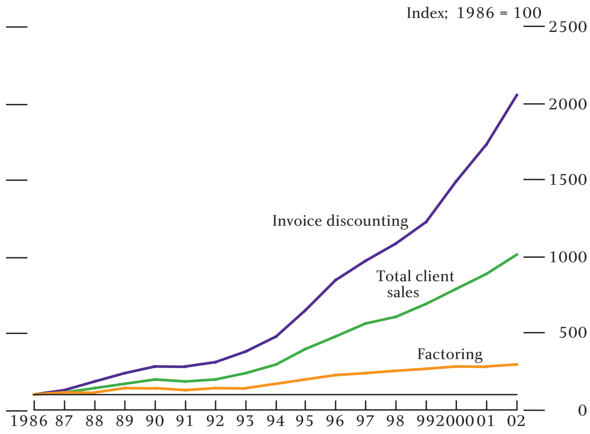

Sources: Bank of England, Factors and Discounters Association, Hawkins (1993) and Office for National Statistics.

(a) Calculated by dividing percentage annual growth in clients' sales by percentage annual growth in GDP. A result of 1 indicates equal growth in clients' sales and GDP, 2 that clients' sales grew at twice the rate of growth in GDP, etc.

Chart 2 above showed that invoice discounting now accounts for 80% of invoice finance. This has not always been the case: in the industry's infancy in the 1970s and 1980s, the proportion was well below 50%. This growth in invoice discounting may reflect the fact that an increasing proportion of client sales is accounted for by the industry's largest customers, who generally do not

(1) See, for example, comments made by David Marsden of RDM Factors and former FDA Chairman in Breakell (2002).
(2) The Brumark decision was given by the Judicial Committee of the Privy Council on 5 June 2001. The judges decided that a debenture over book debts that are still available to the borrower to collect and use the proceeds freely could not create a fixed charge for the lender over those assets. Rather it could create only a floating charge—a claim junior to preferential creditors in the event of an insolvency. By migrating customers to invoice discounting, banks can retain their fixed charges over borrowers' book debts by demonstrating that control over those assets rests with the lender rather than the borrower. For more information, see Bank of England (2002), pages 29–30.
(3) Data for years 1986–92 in Chart 8 and 1987–92 in Chart 9 extrapolated from chart on page 205 of Hawkins (1993), and refer to clients of Association of British Factors and Discounters member firms only.

**Chart 9**
**Real growth of UK invoice finance by value**

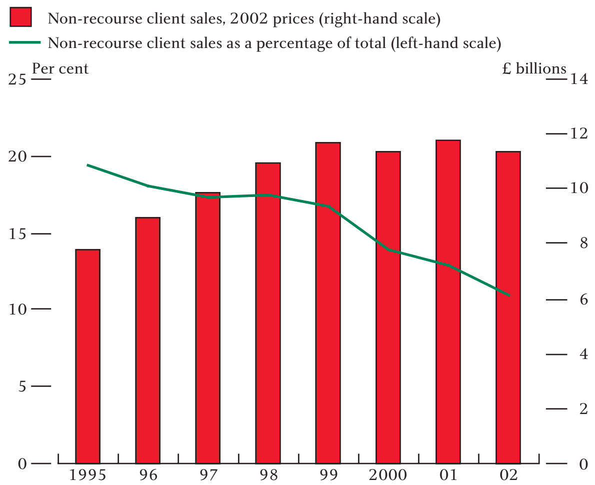



Sources: Bank of England, Factors and Discounters Association and Hawkins (1993).

require factoring: between 1996 and 2002 the proportion of invoice finance accounted for by clients with an annual turnover in excess of £10 million grew from 25% to 44%.

As noted above, the proportion of clients' sales financed on a 'non-recourse' basis was just over 10% in 2002 Q4. This proportion has declined since 1995, when it was just under 20%—see Chart 10. This may be associated with growth in the use of invoice finance by larger firms, who may feel less need for the credit protection offered by non-recourse finance, because they have in-house credit control functions. Relatively low company failure rates in the mid to late-1990s may also have led some clients to shy away from the more expensive credit-protected option—turnover insured by specialist trade credit insurers did not grow in real terms between 1997 and 2001, despite rapidly falling premiums.

**Chart 10**
**Non-recourse (credit protected) client sales**



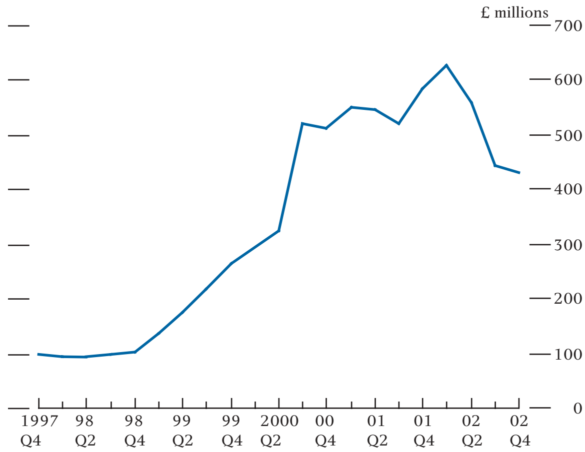

Source: Factors and Discounters Association.

Finally, as competition in the industry has become more intense—there are now over 50 invoice finance providers—players may have taken on riskier propositions to gain and maintain market share. This may have led to a reduction in financiers' willingness to advance funds on a non-recourse basis.

## Asset-based lending

ABL is growing in importance, particularly in larger deals. Between end-1997 (when data were first collected) and the end of 2002 Q1, the amount lent by invoice financiers on assets other than receivables grew from £98 million to £629 million, although this has fallen back to £432 million by end-2002 (see Chart 11). Anecdotal evidence suggests that this recent decline in lending was due to borrowers' reluctance to take up the full amount of credit facilities offered to them by the invoice financiers, a result of depressed demand.

**Chart 11**
**Asset-based lending (amount advanced by FDA members against assets other than receivables)**



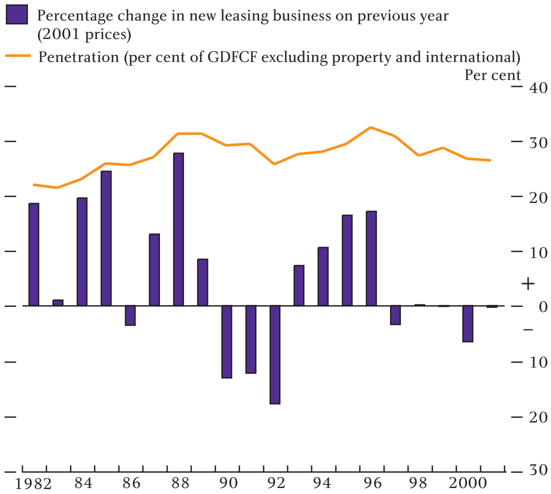

Source: Factors and Discounters Association.

## Leasing and hire purchase

The leasing business is cyclical, because it relies on potential lessees' decisions about capital investments. In its infancy in the 1960s and 1970s, the UK leasing industry had been tax-driven. Leasing largely allowed banking groups with large tax capacity to obtain the benefits of 100% first-year capital allowances for plant and machinery which lessees with lower taxable profits could not. However, the benefits were reduced in 1984, with changes in tax rules and accounting standards.(1) Nonetheless, the leasing industry grew from 1984 to 1989 (see Chart 12): during that time the penetration

(1) A reduction in first-year capital allowances to 25%, reductions in corporation tax rates and the introduction of SSAP 21 (obliging lessees to capitalise finance leases).

**Chart 12**
**FLA business investment penetration**



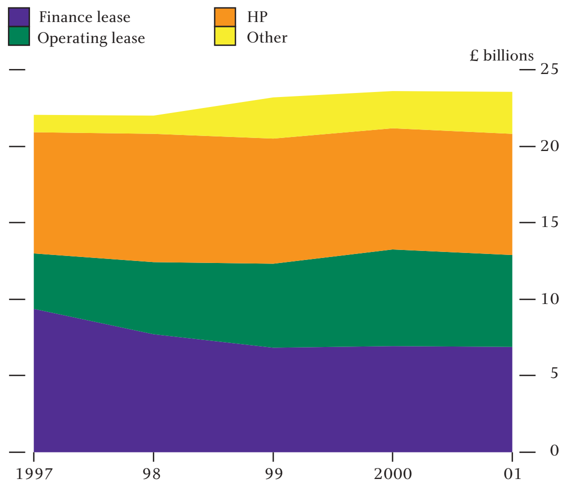

Sources: Bank calculations, Finance and Leasing Association, Higson (2002) and ONS.

ratio (the proportion of gross domestic fixed capital formation (GDFCF) financed through leasing) increased by around 8 percentage points to 31% in 1989. New leasing business subsequently fell in the early 1990s, as a result of the recession depressing capital investment.

The leasing industry recovered in the mid-1990s, with penetration reaching a peak of 31.9% of total GDFCF in 1996. However, in that year the government introduced further measures to curb the remaining tax advantages in leasing. Writing-down allowances on long-term leases (25 years and over) were reduced to just 6% and lessors were required to apportion allowances over time, so that a purchase of an asset the day before the lessor's year-end would attract only 1/365th of the writing-down allowance available. These changes have contributed to the low (in real terms negative) growth in new leasing business and to a declining penetration ratio in the past five years (see Chart 12).

Chart 13 shows that, while the use of finance leases has declined in recent years, the use of operating leases has increased. As well as the effect of the tax changes mentioned above, which removed some of the advantages of finance leasing in particular, the change could also be due to the trends towards outsourcing non-key assets through the use of operating leases—by utilising a serviced operating lease a business can reduce its balance sheet, remove risks associated with assets' residual values and allow the specialists to assume responsibility for maintaining the asset.[1] Alternatively,

**Chart 13**
**FLA new business volumes by product 1997–2001**




Source: Finance and Leasing Association.

a firm may choose to outsource the asset entirely, in which case the contractor may choose to lease the asset in order to provide it to its client.

## Asset finance and smaller firms[2]

Asset finance may be particularly appropriate for SMEs. First, they may be less able than larger companies efficiently to manage or maintain non-core assets such as trade debts or complicated computer equipment. There may, therefore, be a particularly significant efficiency gain for small firms in the 'outsourcing' of such tasks to specialist providers. Second, as discussed above, some small firms' ability to raise sufficient traditional debt may be constrained by their lack of a track record.

Lasfer and Levis (1997) support this view in respect of leasing.[3] They found that the proportions of small (first decile), medium (fifth decile) and large (tenth decile) companies making some use of leasing/HP over time were roughly equal, varying from 52.3% of large companies, to 55.7% of small companies. However, the propensity to lease (HP/lease finance as a proportion of total debt) varied inversely with firm size: for small firms it was 33.9%, for medium-sized firms 22.2% and for large firms just 12.8%. They also suggest that less profitable small firms make more use of leasing than more profitable ones; and that small firms' leasing decisions are not (unlike those of large firms) driven by tax considerations. These results suggest that leasing is important for small firms because it allows them access to finance that they would otherwise face difficulties in

(1) See Higson (2002).
(2) This section draws on the work of Higson (2002), to whom the author is indebted.
(3) The study was of published machine-readable accounts data on 3,008 companies for the period 1982–96.

**Table C**
**SMEs with external finance: proportions with different types of external finance**

| Type of external finance | Percentage of SMEs using that type of finance | Percentage of SMEs for which that type is largest source |
|---|---|---|
| Loan | 38 | 28 |
| HP | 22 | 10 |
| Leasing | 22 | 9 |
| Overdraft | 23 | 8 |
| Overdraft facility | 24 | 6 |
| Commercial mortgage | 7 | 5 |
| Invoice discounting | 5 | 3 |
| Factoring | 3 | 1 |
| Other | 19 | 10 |
| Don't know | 16 | 18 |
| **Total** (a) | | **100** |

Source: Competition Commission (2002).

(a) Components may not sum to total due to rounding.

obtaining. Evidence from the United States (Sharpe and Nguyen (1995)) also supports these findings.

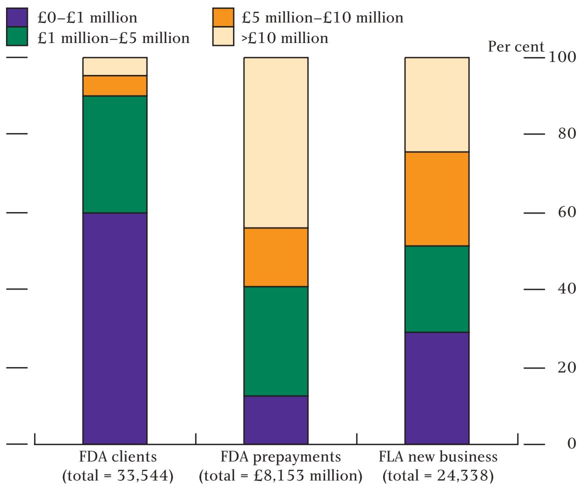
Much less work has been done on the importance of invoice finance to small firms. As noted above, because of the fixed costs involved it is probably not appropriate for the smallest firms. However, invoice finance may be particularly appropriate for SMEs with high growth potential that do not have the internal resources or expertise to manage their growing sales ledgers or make sophisticated credit risk assessments. It may also be utilised by smaller firms experiencing difficulties accessing bank finance, although, as also noted above, it is necessary for them to generate invoices to obtain the finance.

Recently published empirical evidence confirms that UK small firms continue to make use of asset finance. The Competition Commission Report (2002) on the supply of banking services to SMEs found that HP or leasing together constituted the largest source of external funding for 19% of SMEs surveyed (see Table C).(1) In comparison, bank loans were the largest source of external funding for 28% of firms surveyed, and overdrafts or overdraft facilities were the largest source for 14%. Factoring or invoice discounting were the largest source for 4%.

Cosh and Hughes (2000)(2) had earlier found similar results: 45% used some form of HP/leasing finance and 9% used factoring (approximately three out of four used some form of bank finance). They also found that 'small' firms (10–99 employees) made more use of asset finance than micro (<10 employees) or medium-sized firms (100 to 199 employees).

Small firms' importance to the asset finance industries is shown in Chart 14. Some 89% of invoice financiers' clients had annual turnovers of less than £5 million and these accounted for 41% of the funds advanced. Just over half of lessors' new business finance was provided to firms with turnovers below that amount.

**Chart 14**
**FDA clients and amounts outstanding (end-2002), and FLA new business (2002), by client turnover**




Sources: Factors and Discounters Association and Finance and Leasing Association.

## Conclusion

Asset finance offers a viable alternative to other more traditional forms of finance, both for investment projects (leasing/HP) and working capital (invoice finance and ABL), because it allows firms fully to exploit the value of their assets in securing finance. For new or smaller firms that lack a trading record or are otherwise unable to convince traditional (cash-flow based) lenders that theirs is a solid proposition, asset finance may present an alternative source of funding. It also allows firms to outsource effectively the management of non-key assets. The main constraints on its use are lack of suitability in some sectors and, in some cases, cost. In terms of actual usage, invoice finance has seen particularly strong growth over the past ten years, albeit from a low base, and asset-based lending has also grown significantly. Leasing has remained popular, and accounts for over 25% of capital investment in the United Kingdom, as the attraction of the addition of extra services has partly offset the effect of eroding tax advantages.

(1) Competition Commission (2002), Vol. 2, page 37. 1,211 SMEs with annual turnovers of up to £25 million were surveyed in September 2000.
(2) They surveyed 2,520 firms with fewer than 500 employees in 1999. A total of 1,309 responses were received.

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