Off balance sheet financing is key to maximising growth

To compete and drive growth in a competitive environment, businesses need to access all the funding they can get their hands on. The more working capital a business can come up with, the better it can secure top quality talent, develop and produce competitive products, and market those products to accelerate its growth. Traditionally, businesses rely on bank loans and investment to provide the capital they need. More savvy businesses, however, additionally take advantage of off-balance sheet financing to complement these tools.

Used correctly, off-balance sheet (OBS) financing allows businesses to access financing more quickly, and to better manage their debt-to-equity ratios. As a result, they can weather financial stresses more easily than competitors, even while pursuing an aggressive growth strategy.

How OBS financing works

OBS financing is any type of financing that doesn't need to be listed on a balance sheet, because no debt or equity is created. Instead of taking out a loan, businesses effectively access capital that was already theirs, but was also previously inaccessible —often due to issues of timing. The clearest example of this is invoice financing.

Invoice financing

Invoice financing is the practice of exchanging or selling an outstanding invoice to a financier. In exchange, the financial institution issues an up-front payment to the business, followed by a second payment of the remaining value when the invoice's payment is collected. The financial institution takes a predetermined fee out of the value of the invoice, leaving the business with liquid funds where it had an unpaid invoice before (which may not have been due for payment for weeks or more).

Supply chain finance

Supply chain finance is a tool that businesses can use to extend payment terms of up to 90 days for themselves, while providing earlier or timely payment to suppliers. This might appear like a loan at first glance, but it isn't. Supply chain finance does not issue any funds to the business using it. Rather, its primary purpose is to extend financing to that business' suppliers, which happens to improve its working capital position by extending the payment term for a liability that already exists.

Keeping the debt-to-equity ratio under control

Using OBS financing makes it easier for business to avoid a risky overreliance on loans for managing everyday cash flow issues. Using debt as a day-to-day funding solution can be dangerous, as it's very easy to gradually lose perspective and eventually to overborrow. The result is a high debt-to-equity ratio, which makes it much more difficult to secure further loans when they're most needed, such as when a business is gearing up for expansion.

Additionally, a high debt-to-equity ratio can signal a business' poor financial health to investors, which translates to reduced investment, and lower stock prices for publicly traded companies. That, in turn, further impacts the business' ability to secure funding in the future, and makes it much more difficult to maintain stable cash flow and to fund growth going forward. Using OBS financing allows businesses to keep their debt-to-equity ratios lower, by giving them the means to quickly access the working capital they need without taking on any new liabilities.

OBS financing maximises working capital
Making a business financially healthier for the benefit of lenders and investors isn't the primary point of off-balance sheet financing, of course. Rather, it's about helping businesses get the largest possible amount of working capital as quickly as possible. This can be enormously useful for a business that's looking to implement a very aggressive growth strategy.

Even after taking on a significant debt load, a business can use OBS financing to come up with even more capital. This allows it to make investments in its own growth and development that are disproportionate to its current size, and which otherwise similarly situated competitors can't match. On top of that, it allows businesses to get access to funds almost instantly when needed.

Timing is critical for cash flow management
Unlike more traditional forms of finance, off-balance sheet financing like invoice finance and supply chain finance are incredibly fast. Instead of waiting weeks for a loan to be approved, businesses can finance an invoice in a matter of hours. Similarly, supply chain finance, once set up, can be used to pay suppliers almost instantly. This means that businesses can react almost instantly to seize time-sensitive growth opportunities.

While some forms of OBS financing are controversial, others, like invoice finance and supply chain finance, play a vital role in every successful business' financial toolbox. Used strategically, these types of financing allow businesses to better manage cash flow, to maximise growth investment, and to promote their overall financial health.

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