White paper: Getting to grips with Direct Debits

1. Introduction

When it comes to collecting recurring revenues, the ability to use Direct Debit is hugely beneficial to maintaining and controlling positive cash flow. The Direct Debit scheme allows authorised companies to collect money from their customers’ bank accounts on a set day, thereby enabling resellers to have a much tighter control on their debtors.

Once Direct Debits instructions have been set up managing them is relatively easy. The benefits of being able to collect Direct Debits, such as reduced debtor days, reduced bad debt and better cash flow, far outweigh the challenge to set them up.

Unfortunately setting up a Direct Debit facility can be extremely confusing and problematic to many, often with even the Business Relationship Manager from your high street bank not having a clear understanding of how the scheme works. This whitepaper aims to help resellers get to grips with the process, achieve the best chance of getting an application accepted and as smooth a set up as possible.

2. Why is securing a Direct Debit facility so difficult?

Gaining a Direct Debit facility is similar to applying for bank borrowing or an overdraft facility. Essentially approved Direct Debit facilitators are given the right to withdraw an unfixed amount of money from their customers’ bank accounts. Understanding this and the reasons why will help you to better understand the hurdles to overcome.

The Direct Debit guarantee scheme requires that the banks underwrite the risk of errors and therefore banks take careful consideration on who they grant approval to (known as ‘sponsorship’) to take Direct Debits from their customers. Find out more about this at: www.directdebit.co.uk/DirectDebitExplained/Pages/DirectDebitGuarantee.aspx

3. Options

The basics of Direct Debit are centred on a Service User Number (SUN). Each approved Direct Debit facilitator is issued with a SUN which is then used within the BACS system (Bank Automatic Clearing System) for the allocation of funds and for reporting. To gain access to a SUN requires sponsorship either directly from your own bank or via a third party bureau.

Direct Debit bureaus provide a quick, easy and cost effective option to get set up with Direct Debit, particularly when you cannot gain sponsorship from your own bank. However there are some limitations that come with using a bureau service that vary from company to company.
Carefully review the following before deciding who to use:

- What are the limits on individual and total transaction values?
- Will they retain funds and for what for number of days?
- How much of a security deposit is required and how long will they retain this? (the value of deposits can vary greatly and can also increase over time)
- Will your company name appear on the customers’ bank statements?
- What is the cost per transaction?

Although bureaus remain a viable option for those who want to set up quickly, ultimately the best solution is to gain sponsorship wherever possible from your own bank. However, be aware you will still be subject to agreed restrictions on transaction values and may also be required to pay security deposits, bonds or directors personal guarantees.

4. Approaching your bank

When it comes to understanding Direct Debit you may find that your Business Relationship Manager from your bank may not have a clear understanding of setting up and administering Direct Debits. This is generally because small businesses very rarely have Direct Debit access, as the Direct Debit scheme is primarily used by large corporations in telecoms and other industries such as utilities and insurance. Therefore Business Relationship Managers have very little exposure.

This lack of experience at grass roots level of banking often leads to poor recommendations from the banks and in many cases a refusal to process an application with little or no justification.

If this occurs, our advice is to push back with your bank to seek understanding as to why they will not sponsor you, if you feel your business is justified in gaining sponsorship. Most business owners who are honest with themselves will know if their business is suitable to be sponsored or not. If in doubt ask if your business is suitable to borrow money.

The primary reasons for banks to genuinely refuse Direct Debit facilities is lack of trading history or poorly managed accounts.

5. Tips for making a successful application

Regardless of whether you go to your bank or to a third party, you need to:

- Be prepared. A sponsor will need to understand your average transaction value, expected number of transactions and the total value of the transactions you want to collect
- Keep numbers realistic. Provide reasonable and accurate forecasts and don’t be tempted to over or under estimate. These values have a direct bearing on a bank or third party’s
security provision. Remember you can always apply to increase an agreed limit at a later date

- Present the benefits. Banks always like owners to improve their cash flow
- Know your numbers. Such as cash flow and debtor days
- Empathise with the bank’s risk. Be prepared to give director’s personal guarantees if required.

6. Software requirements

When it comes to the actual process you will need access to BACS approved software to manage and facilitate the set-up of Direct Debit instructions and the actual Direct Debit transactions. This software is available either from most high street banks or most third party Direct Debit providers – generally the same ones who provide a bureau service.

Whilst banks do provide access to software it is generally more expensive and less user friendly than that of the independent providers. It is often most cost effective to gain sponsorship from your own bank and then use the software of a third party provider.

7. Timescales

Gaining approval and setting up via a third party bureau can be achieved within a few days, however to gain sponsorship from a bank will take considerably longer – typically 6-8 weeks.

8. Costs

The standard set up fee for a SUN is £250, although some banks and third party providers may also charge an admin fee on top.

Costs for software vary greatly, with banks typically charging a one-off fee of £1,000 - £2,000. Third parties will typically provide access to their software for a low monthly fee (£30-£50 per month).

In addition to the costs to set up and to access software, you are normally also required to pay on a per-transaction basis (20p-50p per transaction depending on volume) and in some cases a cost-per-file submission, typically around £3.50 per file. Some providers charge on a percentage basis, so look out for this if you have higher value transactions. Some may cap the transaction fee, whereas others may not.

9. How it works post set up

Once your Direct Debit facilities are all set up and your forms are available, each of your customers must sign a Direct Debit mandate (online and paperless options are available) to agree to pay outstanding invoices by Direct Debit.
The details of the Direct Debit mandate are used to create a Direct Debit instruction within the BACS network. Once the instruction has been set up the customer must be notified in writing that their account details have been accepted by the BACS system, before any money can be withdrawn. Some bank and third party software can automate this in the system, saving time and administrative burden.

Normally on a monthly basis you will upload a file or files with of all the transactions that are to be collected from your customers. This file will typically include the following:

- A unique customer ID
- Transaction value
- Date of collection

If you are using Inform Billing’s Eclipse billing platform to calculate your invoices, the system will automatically produce a file compatible with most bank or third party providers. Please note that Eclipse is not a BACS registered application and you will still need the software as mentioned in section 6.

It is a legal requirement that the customer be given a minimum of five working days’ notice of the value and date of collection. Typically this is done on the actual invoice by stating on the invoice something along the lines of: “The amount of this invoice will be collected on or around (XX date)” or “The amount of this invoice will be collected within 15 days.”

Once the file has been accepted in the BACS system changes cannot be made within five days of the withdrawal date, following which the monies will be taken from the customers’ accounts and deposited within the service users account – either your bank’s or the third party provider’s.

Any discrepancies such as ‘refer to payer’ or cancelled Direct Debits are generally processed within two working days, whereby money will be reclaimed by the relevant bank.

**10. In summary**

All in all the Direct Debit scheme has many complications but the benefits to credit control and cash flow at a relatively small cost make Direct Debit a sensible choice for any business with variable recurring monthly charges.

If you want to find out more, please contact us.