The Cash Flow Solution for Today’s Businesses

In this guide, you’ll learn about who uses factoring, when you should factor, how factoring works compared to other financing options, and much more! After reading this guide, you will be able to make business decisions about how factoring could benefit your business and tips on how to choosing the right factoring partner. North America’s leading factoring companies want their customers to be educated consumers – and this guide will get you on the road toward becoming more knowledgeable about factoring as a cash flow solution for you.
EXECUTIVE SUMMARY

Factoring is a popular and easy-to-access answer for businesses seeking to quickly improve their financial situation. This type of financial service pays businesses upfront on what they are owed for completed work. Factoring, also called “accounts receivable financing” or “invoice factoring” or “alternative funding,” provides companies with immediate payment on their invoices. Companies get their money quickly for necessary expenses, business expansion, and other costs. Companies speed up their cash flow, without waiting for customers to pay them and without having to take out a loan.

Factoring Overview

Factoring has been a tried-and-true source of funds for business people for centuries. For an example of how factoring worked hundreds of years ago, think of a weaver sending off a shipment of fabrics to a merchant overseas. The weaver hopes to be paid someday once the merchant sells the fabrics and sends the money back to him. However, the weaver has expenses to meet in the meantime and wants to hire seamstresses to expand his business.

The answer to this weaver’s cash flow problem: factoring. A person who could “factor” the cost of the fabrics could bridge this gap in the weaver’s cash flow by paying him most of the value of the shipment upfront. The person handling the factoring would reserve a portion of the amount to cover his risks and efforts to collect from the overseas merchant.

Today the process has evolved to a fast-paced and sophisticated business-to-business financial service, but the principle remains the same. A third party buys a company’s invoices at a discount in order for that company to maintain operations and raise capital for expansion. The factoring firm advances the company most of the value of an invoice, collects on the invoice on the company’s behalf, and then pays the balance when the company’s customers have paid in full.

In addition, some factoring companies offer added services for their clients, such as handling back-office tasks and paperwork. This might include preparing, mailing and storing invoices in addition to managing the collections process. Some factoring firms offer their clients additional benefits tailored to their industries, such as payroll processing for staffing companies or discount fuel cards for transportation companies.

You do not need extensive collateral or assets to qualify for factoring, nor do you need a high credit score or strong credit history. Well-established factoring companies don’t require that you have managed your company or worked in your industry for a certain number of years. Rather, factoring professionals evaluate applicants based on the creditworthiness of the applicant’s customers.

If the factoring company is satisfied with your customer’s payment history and ability to pay for your services or products, the factoring firm pays you up front the majority of the invoice amount. You receive the balance once your customer has paid the invoice, minus a small factoring fee. Unlike a loan from a bank, your funds are not restricted and grow as your invoices grow. Most factoring companies give you access to the cash you need in as few as 24 hours.
Who uses factoring?
Factoring helps companies ranging from small business start-ups to large corporations. Any business that sells a product or a service to customers who wait 30, 60, or even 90 days to pay their invoices would be a good candidate for factoring their invoices. Businesses in the following industries commonly rely on factoring for improved cash flow:

- Agriculture
- Distribution
- Food and beverage
- Government contracting
- Health care
- Information technology
- Manufacturing
- Oil and gas
- Printing
- Service providers
- Staffing agencies
- Transportation and trucking
- Wholesalers

Could Your Business Benefit from Factoring?

- Do you deliver goods or services on schedule, but don’t get paid for weeks?
- Do you have trouble keeping up with day-to-day expenses while waiting for payment?
- Do you lack significant reserves to comfortably meet payroll each week and office costs every month?
- Do you put off getting out your invoices and making collections calls due to lack of staff?

If you answered “yes” to any of these questions, it could be time to explore invoice factoring. When you factor your invoices, you don’t need to wait 30, 60, or even 90 days for your clients to pay you. You can be paid in advance on those invoices and use that cash for expenses – and have a financial “cushion” for paying bills and growing your business.

Here are a few benefits of factoring your accounts receivable:

- Free up your time
- Improve your financial planning
- Protect your business from debt
- Maintain control of your finances
- Keep your collateral safe
- Improve your credit score
- Turn over “back office” invoicing and collection chores
Factoring vs. Bank Loan

People often wonder about the differences between factoring your invoices and taking on a bank loan. Factoring is not the same as a bank loan; you do not incur debt when you sign a factoring agreement. You are receiving an advance on work completed, not a loan based on unpredictable future revenues.

Unlike bank loans, factoring does
• Not incur debt
• Not require collateral to apply
• Not require a strong credit history
• Not take weeks for approval

Because you are receiving payment on work that’s already been completed with factoring rather than borrowing against unknown future income, you are not adding debt to your balance sheet when you choose to factor. Your application for funding is approved based on the creditworthiness – the payment history – of your customers, not what you own or how long you have taken to pay your own bills. Lastly, getting set up with a factoring company is invariably much faster than getting a loan from a bank.

Here are some situations in which factoring can be more helpful than borrowing from a bank:

1. If your business is new: Factoring can help almost any B2B company, old or new, but start-ups especially benefit. If your business hasn’t built up the equity and credit record that you need to get a loan, then factoring is a good alternative for you.

2. If you’re waiting too long for customers to pay you for your work: Whether you’re selling a service to corporate clients or a product to other businesses, you are likely waiting 30, 60, or sometimes 90 days to get paid. Yet, it can be challenging when you have fixed expenses that must be paid on time, regardless of the payment terms your customers chose. Accounts receivable factoring gets you the money you need without waiting.

3. If you’re spending too much time on invoicing and collections: As your business grows, have you seen how much time you and your staff are spending on preparing, checking, and mailing invoices and then following up with the customers who didn’t pay on time? You could use those hours more effectively and productively: you could focus on running other important parts of your business. Whether you’ve outsourced your back-office invoicing work and hired an agency to handle collections or you are struggling to do this all yourself, you can quickly free up your time by letting a factoring company take care of these tasks for you. Banks don’t provide you these services.

4. If you can save with early payment or volume discounts: Depending on your type of business, you could be able to take advantage of certain trade discounts if you have cash on hand to order larger quantities or submit payment earlier. Purchasing in bulk can give you significant cost breaks. You could borrow from a bank to have that opportunity or you could factor your invoices and use your improved cash flow to pay bills within 10 days to get a few percentage points knocked off your bill. Or you could choose factoring and enjoy these savings. Another bonus: you’ll improve your credit score at the same time you’re saving money.
4 Myths About Factoring

Factoring helps companies ranging from small Invoice factoring is sometimes misunderstood. Although it is an ancient method of maintaining a healthy cash flow, factoring has become particularly popular over the last 25 years and some people have misconceptions. Here’s a quick look at a few common “factoring myths” followed by what factoring really represents in today’s marketplace.

Myth 1. Factoring companies are a last resort
While some companies factor their invoices to turn around their financial prospects, many thriving companies rely on factoring to speed up their cash flow. They want to use the money that’s been sitting in their accounts receivable for months; they prefer to be paid now rather than later. Getting paid for work they have completed appeals to all business owners, not just companies with financial challenges.

Myth 2. Factoring companies are lenders
Factoring companies are not like merchant cash lenders, payday loan companies, or even banks. Factoring firms do not lend you money that you must pay back. Instead they promptly provide you cash for work you have completed. Factoring allows you to get paid right away what you are owed – without you owing a dime. You are not incurring debt as you would be when you borrow from companies in the business of lending cash.

Myth 3. Factoring companies are collection agencies
Factoring companies advance you what you are owed and help you manage your collections, but they are much more than collectors. Factoring clients can also take advantage of valuable services through their factoring company. These can include, for instance, invoice preparation and processing, payroll management for staffing agencies, and discount fuel cards for trucking companies.

Myth 4. Factoring companies might affect my relationships with my customers
Actually, your customers are likely to be very familiar with factoring companies. They know that when their vendor is working with a factoring company, they can rest assured that this is one supplier or service company that will have the financial resources to take care of their orders. When your customers know you are working with a factoring company, they know you have the working capital you need to complete your work. They’ll be more willing to use your company for more projects.

Why is factoring popular with small and medium-sized companies?
In the past, invoice factoring was a financing option typically used by large corporations. However, today, an increasing number of small and medium-sized businesses are turning to factoring companies for customized cash flow solutions tailored to their needs. For many companies, turning invoices into immediate cash has become their preferred way to finance their businesses. Experts have identified a variety of reasons behind factoring’s popularity.
Factoring Agreement

When you sign up with a factoring company, you will sign a factoring agreement that outlines what you can expect from your factoring company and what they can expect from you. Agreement details vary, but invoice factoring agreements should describe each party’s responsibilities, the processes that each will follow, and the fees. You can expect the following in a factoring agreement:

- A confirmation that the client will "sell, transfer, convey, and assign" selected invoices to the factoring firm
- An agreement that the client will provide accurate and true financial information at all times
- A description of the Notice of Assignment process that directs the client’s customers to send in their payments to the factoring firm rather than to the client
- An agreement for the factoring firm to provide continually updated reports on invoices they have purchased, payments sent and received, and other information
- A list of steps that could be taken to secure payment of any indebtedness owed to the factoring firm in the case of a customer's default or insolvency
- A fee schedule with the factoring percentage rate and the advance rate
- A time limit for the agreement

The Cost of Factoring

When you ask a factoring professional to quote factoring rates for your business, your answers to two questions will help determine how much you will pay for factoring. Your factoring rate will depend on your factoring volume (how much you plan to factor) and payment terms (how long your customers take to pay their bills).

1. Decide which invoices you’ll factor.
   Some factoring companies require you to factor all invoices; other companies allow you to pick and choose the invoices you want to factor. Maybe you have some customers who pay more quickly than others and you don’t need a cash flow solution for those invoices.

   Typically, the higher the dollar figure you expect to factor, the lower your factoring rate. If your factoring volume is low – meaning you have few invoices to factor and those invoices are for smaller dollar amounts, then your factoring rate could be higher.

2. Figure out your customers’ average days to pay (“DTP”).
   In some cases, even though your agreed-upon payment terms might be a standard 30 days, some customers may typically take longer and you may need to estimate 40 DTP for those customers. If you give your customers extended credit terms, like Net 45 or 60, your average DTP is going to be higher.

   Example: You want to factor $100,000 per month and your customers pay in 40 days on average. If your factoring rate is 2%, your monthly cost of factoring could be $2,000. However, you need to know more than just the rate. Some factoring companies advertise very low factoring rates, but they may add on “hidden” fees for services. Look beyond the advertised rate and read the fine print to discover any fees that could increase your actual factoring costs.
Recourse vs. Non-Recourse

Most factoring companies offer recourse factoring, but a few factoring companies provide both recourse and non-recourse factoring. A few also offer a modified version of non-recourse factoring. These different types of factoring relate to who assumes responsibility when a customer does not pay what they owe (when a customer defaults on their invoice). What’s the difference?

**Recourse factoring:**
By far, the most common type of factoring is recourse factoring. If a client’s customer defaults on its payment for work that the client has completed, then the factoring company is contractually entitled to pursue reimbursement of the funds it has advanced to the client for that invoice. The factoring company will expect its client to repay what they were advanced. The good news is that this non-payment scenario does not happen very often with well-established factoring companies for two reasons: the factoring company’s rigorous credit checking process at the front end of a transaction and their professional collections team working diligently throughout the process.

Established factoring companies have in-house credit departments that continually evaluate the creditworthiness of their clients’ customers. If a customer’s credit history raises red flags, the factoring company will not factor that customer’s invoice and the client will be informed. Once the invoice has been purchased, the in-house collections department goes to work monitoring the payment and identifying any issues that could affect prompt payment before those issues become a problem. In the case of any missed payment dates, these collections professionals focus on collecting these funds as soon as possible.

Even with these two powerful deterrents against non-payment, if a customer still did not remit payment, the client assumes the risk for lost revenue. The factoring company will recoup their advance on that invoice. However, by not assuming risk for non-payment, the factoring company can keep its factoring rates low.

**Non-Recourse Factoring:**
In non-recourse factoring, the factoring company takes on 100% of the risk of non-payment and the full responsibility for collecting the amount owed on the invoices. The client receives funding, even when their customer doesn’t pay what they owe for the services or products that they received. The client does not have to repay the advance back to the factoring company.

With non-recourse factoring, the factoring company assumes more risk. In exchange for the possible default on the customer’s payment, the factoring company will charge a higher – sometimes much higher – factoring fee. The factoring company will also enforce a variety of conditions on non-recourse transactions: credit limits, concentration restrictions, and other specific criteria. The option can be useful for some situations, but business owners seeking non-recourse factoring should have a good understanding of their factoring agreement and any “fine print” and restrictions.

**Modified Non-Recourse Factoring:**
This concept features elements of both recourse and non-recourse factoring. In modified non-recourse factoring, the factoring company assumes the credit risk of its client’s customer for a limited time after the factored invoice becomes due. In most factoring agreements, this credit risk means a customer’s potential bankruptcy. In a modified non-recourse arrangement, the factoring company is essentially vouching for the client’s customer up to a point.

For example, a typical modified non-recourse arrangement might protect the factoring company’s client from any potential customer’s bankruptcy filing for 60 days after the due date of the invoice. If the customer files for bankruptcy between the date the invoice is factored and 60 days later, the factoring company takes the loss. If the customer does not pay their invoice for any other reason or declares bankruptcy after the 60-day time period, the client must repay their advance back to the factoring company.
4 Signs that your Business Needs Factoring

1. You have a long list of slow-paying clients
   It’s not uncommon to wait 30, 60 or 90 days for clients to pay, but this turnaround time can put a lot of pressure on your business. When you partner with a factoring company, you receive a large portion of your invoice within days as soon as your paperwork has been approved.

2. Your business is taking on debt to cover expenses
   Bank loans take time and add debt to your business. Merchant cash advances may be fast, but can incur costly fees and high interest rates that can cut deep into any potential profit margin. Factoring your invoices gives you payment upfront on what you are already owed. You can cover expenses, without incurring debt or paying high borrowing costs.

3. You have customers that require payment flexibility
   If you have clients that have long payment cycles, factoring allows you to give them this type of flexibility without affecting your bottom-line or cash flow. This means you can take on new clients and your business.

4. Waiting for payment is holding you back
   If the wait for your customers’ payments is keeping you from growing your business, your company is not reaching its potential. Instant access to the cash you have earned means that you will have the funds you need to invest in your business. Whether you want to hire a new salesperson who will bring in more business or add another truck to your fleet, you need money to achieve these goals. Factoring companies can put you in the financial position you need to grow.

5 Points to Consider When Choosing a Factoring Company

When you’re ready to factor your accounts receivable and enjoy the benefits that come with increased working capital and financial stability, how will you choose your factoring company? Keep in mind these five variables as you make your choice:

1. The company’s experience in the factoring industry:
   Older companies tend to have greater stability and proven track records of helping clients succeed. They have weathered different business cycles and employ individuals with extensive experience in serving their clients effectively. Plus, they often have the expertise and resources to develop value-added programs to benefit their clients.

2. Exceptional customer service:
   Timing is critical when it comes to receiving advances on your invoices and you do not want to have to spend extra time sorting out funding issues. Well-established factoring companies take customer service very seriously and provide clients with a single point of contact for questions about their funding. Clients are assigned dedicated account managers who are trained to help.

3. Ease of managing your account:
   Leading factoring companies have invested in on-line management systems that make submitting funding requests quick and easy. You can save time and energy if it’s easy to track payments and get a bird’s eye view of your accounts.

4. The company’s experience in your industry:
   Different industries work on different business models. Your factoring company should know your industry and offer you tailored solutions for how you work.

5. Rates and numbers:
   Ask each factoring company about advance rates, the percentage they charge for each invoice that they factor, and about any additional “hidden” fees. Make sure you understand exactly what all costs represent.
Six questions to ask before factoring your invoices

Not all invoice financing companies are the same, with one program and one price. Some factoring companies specialize in niche industries, while others are generalists. Some may offer low rates, but provide little or no client services. It’s worth doing your homework before signing up, to ensure that you know what you’ll get from the partnership and how you’ll interact with the company. Here are six questions you can ask your potential factoring company:

1. **What are the fees?** Find out if you will be paying a flat factoring rate only or if other costs are involved, like money transfer costs and collection fees.

2. **What is the length of my contract?** A longer term contract may be more beneficial if the invoice financing company can offer you more flexible rates or other benefits. Most companies offer a 12-month contract, but some might be willing to negotiate with you for a shorter contract.

3. **What other services can you offer me?** Some factoring companies will provide a full suite of time-saving and convenient services to handle the back-office work associated with your invoicing.

4. **How long have you been in business?** A well-established factoring company will have years of experience with a wide variety of clients and will have stood the test of time in different business climates.

5. **Do you understand my industry?** Whatever your industry, it’s worth going with a factoring company with professionals who have an in-depth understanding of how your business works.

6. **Can you offer me flexibility in the number of invoices I will factor?** You may not wish to factor all your invoices. You may have different quick pay agreements with some of your customers. Discuss your needs and see if the company will be able to accommodate your requests.

Small and Medium-Sized Businesses need Flexible Financing Alternatives:

Unlike a fixed-limit bank loan or line of credit, factoring provides you with your most flexible funding options without incurring debt. When you factor your invoices, your funding can grow with your business.

Companies can make important purchases:

Without a positive cash flow, you aren’t able to invest in critical equipment, vehicles, or other capital purchases that your company needs. With factoring, you can make sure your cash isn’t tied up in aging accounts receivable, an important concern for smaller businesses.

Payment Terms Have Lengthened:

With customers calling the shots on payment terms and extending their payment due dates to 60, 75, and even 90 days, many companies can’t keep up with their fixed expenses while they wait to be paid. With factoring, those companies can turn the money sitting in their accounts receivable into fast cash. They don’t have to turn away business based on a potential customer’s payment terms.
CONCLUSION

This brief introduction to the world of factoring and its benefits can get you started on evaluating how factoring could work for your company. When you’re ready to take a closer look at a cash flow solution that does not incur debt and that grows with your business, contact a respected, well-established factoring company. Experienced factoring professionals can answer your questions and quickly help get you on the road to maintaining and growing your business. You can take your first step toward a brighter financial future soon.

Contact us today to learn more!

Call 877-974-3484

or go online to

www.factoringcompanyguide.com