A GUIDE TO ‘WHAT IS FACTORING?’

What is Factoring?
Factoring, or sometimes referred to as Invoice discounting, is a commonly used financing tool for small business. When a small company sells its goods or services, it generally offers payment terms to its customers rather than require cash at the time of sale. There are many sound reasons for this business practice; including increasing sales and developing long-term relationships. When such a transaction takes place, the business is left with an account receivable which it holds on its books until the customer pays it turns into cash.

What is a Factoring Company?
A factoring company specializes in invoice financing for small to medium businesses that are non-bankable, offering working capital solutions. Typically, a factoring company buys your invoices from a creditworthy client. After this, they will advance you up to 90% of the invoice amount immediately and will give the remaining balance when your clients settle in full. You may submit Invoices for factoring directly upon completion of work or product delivery. Revenue flows directly and instantly to you with no delays or collection hassles. The better, more experienced factoring companies often non-recourse factoring, assuming credit risk and responsibility for client payment.

What Are the Benefits of Invoice Factoring?
- **CASH IN YOUR HANDS IN AS LITTLE AS 24 HOURS**
- **UP TO 90% ADVANCED ON YOUR INVOICES**
- **THE FACTOR BECOMES YOUR CREDIT DEPARTMENT**
- **PAYROLL FUNDING**
- **IRS ISSUES AND LIENS CAN OFTEN BE A NON-FACTOR**
- **PRE-APPROVE YOUR CLIENT’S CREDIT**
- **25 YEARS SERVICING INDUSTRIES OF ALL KINDS**

What is the Factoring Process?
The factoring process is very straightforward. Acting under a simple agreement a business sells its accounts receivable to a finance company
(a “Factor”) in return for an immediate cash advance—usually 80-90% of the invoice amount. Invoice discounting is typically conducted under what is called full notification. Meaning, the account debtor is made aware that the invoice has been sold, and is directed to make payment directly to the finance company. The Factor then follows for payment of the receivable, deducts its fees from the proceeds, and remits the balance to the business. Invoice discounting is the selling of accounts receivable to a third party to improve cash flow.

**STEP 1 – INVOICES INTO CASH**

You have Open B2B or B2G Invoices and need cash now.

**STEP 2 – VERIFICATION**

The factor verifies your customers are creditworthy and love your product and services.

**STEP 3 – SAME DAY CASH**

The same day the factoring company will wire you 80-90% of all your open Invoices.

**STEP 4 – BALANCE RECEIVED**

In 30-60 days, your customer pays the lockbox, and you get the balance less the factor’s minimal fees.

**STEP 5 – REPEAT**

Repeat when you have new invoices for continued, unlimited working capital!

**Is Factoring Considered Debt?**

Factoring is not debt. When the account receivable is sold for cash, it is just that—a sale. For this reason, small businesses are often free to enter into factoring arrangements with a finance company even if they already have a relationship in place with a bank. Also, given the simplicity of the transaction, factoring arrangements are typically consummated quickly—often within a few days.

**What is Non-Recourse Factoring vs. Recourse?**

With Non-Recourse Factoring, the factoring company gives you a credit guarantee that they are responsible for the collection of your invoices. It might be all your invoices or just those from specific clients. Typically, this guarantee is in case your client files for bankruptcy. It is critical to
understand that it is not a guarantee that you are protected for good or services that your client disputes for not meeting specifications. You are also not protected if your clients pay slower than usual. However, this “insurance policy” against bankruptcy is critical for your survival. Toys R Us, Vitamin World, Gymboree, Payless ShoeSource, Gander Mountain could be your ‘risk-free’ client, yet these are examples of thriving companies that filed bankruptcy.

In Recourse Factoring, if your client does not pay the invoice by a specific date, the factoring company can charge that invoice back to you, or you can replace that invoice with another good invoice. In some ways, this is similar to a line of credit from a bank with a borrowing base as one of the loan requirements. If an invoice becomes unpaid, for example, longer than 90 days a bank won’t let you borrow against it, or a factor will ask you to replace either the advanced funds or give them another good unfunded invoice.

What is Factoring vs. Purchase Order Financing?
Factoring is both a cost-effective and relatively simple process. Your creditworthy client receives the product, and the factoring company verifies a few essential facts. Your customer’s happiness with the quality, quantity, and timeliness of your product (documentation requirements are also confirmed). You will receive an advance up to 90% of the invoice amount now. Also, in the future receive the balance less the factoring fee when your client pays the factoring company.

What if you don’t have the money to buy the goods?
If you need an additional supply of goods, you’ll need Purchase Order Financing, or a Vendor Guarantee applies. PO Funding is where you need the factoring company to buy the products for you (Cash Against Documents (CAD) or a via a Letter of Credit) or you need to use the factor’s creditworthiness for your vendor to release the goods and be paid from the Factoring proceeds (a Vendor Guarantee).
Remember, you can have Invoice Factoring without PO Funding, but you cannot have Purchase Order Financing without Invoice Factoring.

WHAT IS INVOICE FACTORING VS PO FUNDING?

Is Factoring Viable for Start-ups or other Non-Bankable Businesses?
One can use factoring even if a company is weak or just starting. The determining element in any factoring transaction is the creditworthiness of
the account debtor, not the client company itself. This is because the finance company is being paid back directly by the account debtor, as the account receivable is collected, and not by the client. Consider, for instance, a company selling a product to Walmart. The account receivable from Walmart is considered good collateral for any cash advance made to the company. The company can expect short-term source funding regardless of its financial strength or wherewithal by selling this account receivable, irrespective of its circumstance.

- **Growth Opportunities**
- **Start-Ups**
- **Working Capital Needs**
- **Payroll Funding**
- **Slow-paying customers**
- **Government Suppliers**
- **Bank Turn-Downs**
- **Maxed-Out Lines of Credit**
- **Operating Losses**
- **Turn-arounds**
- **Undercapitalized Companies**
- **High Customer Concentrations**
- **Funding Strategy with IRS Issues – Tax Liens**
- **Seasonal Businesses**
- **Vendor Guarantees**
- **Letters of Credit**

What are Examples of Companies that Use factoring?
Many industries rely on factoring as a critical means of finance, among them staffing, healthcare, construction, apparel, and consumer goods. As a result, factoring is a widely accepted way to raise cash and accelerate cash flow, for small and big companies alike.

Does My Business Qualify for Factoring?

- **STARTUPS, TURNDOWNS, BANK EXITING OR UNDERPERFORMING BANKING RELATIONSHIPS CAN QUALIFY**
- **PERSONAL CREDIT OF OWNER IS NOT AN ISSUE; FACTORS LOOK AT YOUR CUSTOMER’S ABILITY TO PAY**
- **FAST-GROWING COMPANIES WITH SALES OF $30,000-$10,000,000 PER MONTH**
- **FACTORIZING COMPANIES CAN MOVE QUICKLY ON NEW CLIENT OR HIGH GROWTH CLIENT APPROVALS**
How Much Does Factoring Cost?

Are you wondering how the cost and fees stack up compared to MCA loans, bank business loans rates, SBA loan rates, other lenders, and their financing packages?

Invoice factoring example

- Your business sells and delivers product XYZ to Wholesale Inc., issues an invoice for $1,000 and gives the debtor 60 days to pay.
- Your business makes an agreement with a factoring company as follows:
  - 80% advance rate
  - 2% discount fee every 30 days
- You sell the invoice to the factor and receive an advance of $800.
  - On day 29 the debtor pays the invoice (usually sending a check to a bank account opened by the factor under your company’s name)
- The factoring company receives the payment and deposits it into a reserve account.
- The factor takes $20 as a factoring fee, deducts the $800 already advanced to you and wires the remaining amount $180 (sometimes called a rebate) to your company’s bank account.

What is a Typical Charge for Factoring?

**Invoice factoring** offers a flexible approach to securing funding fast for your business. The typical fees involved, often called the discount rate, are very reasonable, with an industry average that industry average varies between 1.5 – 5 percent of the total value of the factored invoices every month.

**SUMMARY**

An **application fee** is a gate to make sure businesses are serious about invoice factoring.

**Factor fees** are processing fees for each invoice.

**Credit check fees** help to protect the factoring company.

**Mailing fees** may be needed for a factoring company to communicate with your clients.
Advantages and Disadvantages of Using Invoice Factoring

**Pros**

- Quick cash flow boost for your business
- Your business can give terms to your customers without worries
- Low qualification requirements and simple application process
- High approval rates
- Cash flow without debt
- Minimal credit history requirements
- Operational support to A/R department

**Cons**

- Not accessible to B2C companies (businesses that sell only to consumers)
- More expensive than traditional bank financing
- Requires ceding some control of customer interactions regarding A/R
- Not a solution for delinquent receivables
- Liability for non-creditworthy customers (in most cases)

**SUMMARY**

Yes. Any business can use invoice factoring, but it may only be appropriate where invoices are taking 30-90+ days to get paid, to help with cash-flow.

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