

Inside



**CREATE
PROFITABLE
GROWTH USING
FACTORING
SERVICES**



Your Guide to Invoice Factoring Services

What You Should Know About Factoring and How to Choose a Provider

When your business needs a source of quick cash but may not qualify for a traditional loan, a business factoring loan is an alternative worth considering. Factoring is used when a firm's available cash balance is insufficient to meet its current obligations and promote business growth. This guide is designed to answer your questions about factoring and help you find a factoring service provider who can meet your company's needs.

What Is Invoice Factoring?

Factoring is a financial transaction whereby a business sells, at a discounted rate, its accounts receivable, or invoices, to a third party, called a factor. This sale allows the company to receive immediate cash to finance continued business growth. Factors can make funds available even when a bank loan is not feasible because the primary focus is on the credit worthiness of your company's debtors.

What are the Benefits of Invoice Factoring?

There are a number of advantages to a business cash advance. Using factoring to obtain cash for your immediate needs will allow your company to maintain a smaller ongoing cash balance. By reducing the size of your cash balances, you will have more money available for investment in your firm's growth.

Factoring is a relatively simple way to obtain cash to help your business through a slow period or to cover expenses. If your business qualifies, the process for obtaining a business cash advance from a factor is quicker and easier than applying for a traditional business loan.

How Does Invoice Factoring Work?

Factoring is different from a bank loan in three important aspects:

- The factor does not give you a loan; factoring is the sale of your financial assets-- your receivables.
- Factoring focuses on the value of your receivables rather than your company's credit worthiness.



- Factoring involves three parties: the company selling receivables, the factor purchasing them, and the debtor. Bank loans are simply a contract between two parties.

Your receivables constitute a financial asset based upon money owed to you by your customer, the debtor, for goods or services. You, the seller, can sell one or more of your invoices, or receivables, at a discount to the third party, the factor, in exchange for cash. This transaction essentially transfers ownership of the receivables to the factor, who is then entitled to receive any payments from the debtor toward the invoice amount.

The factor is solely responsible for collecting the debts and also accepts any loss should the debtor default on the loan. Once the sale of the receivables is complete, the debtor will be notified of the sale and the factor will bill the debtor for the amount of the invoice.

The factoring transaction has three key parts:

1. The advance, which is a percentage of the value of the invoice. This is the amount that the factor pays the seller.
2. The reserve, which is the remainder of the total invoice amount. This amount is paid back to the seller when the debtor pays the invoice.
3. The fee charged the seller for the transaction. This is deducted from the reserve that is paid back to the seller.

Some factoring services will charge the seller not only a service fee, but also interest based on the length of time the factor must wait for payments from the debtor. The factor may also deduct a projected amount to cover the possibility of the debtor's non-payment of the debt. This would further reduce the total amount paid back to the seller. The total profit the factor receives is the difference between the price paid for the invoice and the amount received from the debtor.



Is Factoring Right For Your Business?

Factoring can be an ideal solution if:

- Your business is seasonal in nature or if you have a number of clients who take two or three months to remit payment. Factoring can help you maintain a steady cash flow by selling these accounts at a discount. Not only does this give you the immediate cash you need, but it also transfers the risk and responsibility for collecting payment onto the factor.
- Your business could use an immediate boost from a lump sum of cash, but you don't qualify for or prefer not to obtain a traditional loan.
- You want a greater degree of flexibility than a traditional loan would offer. Factoring agreements come with flexible repayment terms and factors are typically more open to renegotiation than traditional lenders.
- You need to avoid additional credit obligations. Because factoring is not the same as a loan, the advance you receive will not appear on your credit report.
- Repaying the advance will not create excessive financial strain for your company. Keep in mind that your payments will be based on a percentage of your sales and will increase or decrease according to your sales volume.
- Your company's sales are projected to remain steady or to increase and you have a substantial amount of receivable accounts
- You do not own property or equipment that could be used as collateral to obtain a bank loan.
- You have credit worthy customers. Your fees will be lower when there is less risk of default. Some factoring services will agree to purchase only a specified portion of your customer accounts or invoices, allowing you to maintain control over some of your receivable accounts.



How to Choose a Good Factoring Company

Research the history of several providers to find out how long they have been in the business and what companies they have worked with. You will want a provider with a strong background and experience in helping businesses with their financial needs.

Here are some important qualities to look for:

Professionalism - your factor will be collecting payments from some of your most important customers, so be sure to choose a company with a high degree of professionalism and excellent customer service.

Experience level - again, you want your customers or clients to be treated well, and an experienced factoring provider will likely have developed top quality customer service skills.

Accessibility - You will need to communicate frequently during the application process and possibly throughout the repayment process.

Knowledge - The provider should be able to explain the application and repayment process thoroughly and answer any questions you may have.

Reputation - Look for a factoring service with a solid and established history in providing financial services to businesses similar to yours.

Additional points to consider when choosing a factor:

- There are two types of factoring agreements to choose from: **recourse** and **non-recourse**. With recourse factoring, you are obligated to pay for any funds the factor does not receive from the debtor. This is a less expensive option than non-recourse factoring. If you choose non-recourse factoring, you will pay higher fees, but the factor will take on all the risk.
- Look for a company that provides **digital invoicing** to bill your customers, accepts digital payments, and can deliver your money wirelessly. Paperless processes will save you cash and minimize the personnel expenses associated with printing and mailing invoices and processing incoming payments.
- Reputable factoring service providers use sophisticated **credit score screening** applications that are not widely available to smaller companies. This can be a great help in making wise decisions when extending credit to your customers.



- Find a factoring service that provides data encryption and other **safety features**. Look for security icons from companies such as VeriSign and GoDaddy. A small padlock icon should appear when engaging in secure online transactions with the company.

Once you have narrowed your choices, asking each provider a few key questions will help you select the right factoring service for your business:

1. Find out whether the factor is open to accepting fewer invoices with larger amounts. This can lower your fees and save time for the factoring service.
2. Ask the provider if you might be able to negotiate for a higher amount of cash up front. Will the factor allow for a larger sum in the beginning of the accounts receivable financing process in exchange for a higher discount rate?
3. Inquire about the factor's collection process. Find out how much time they allow each debtor to pay their invoices. How does the company deal with past due accounts? At what point do they turn a debtor over to collections? Ask to see a typical collection letter to make sure the wording is courteous and professional.
4. Finally, be sure your factoring service vendor provides web access and 24-hour consumer support both online and by phone.

A quality factoring service provider can be an immense help in keeping your business on track and reaching your goals. InsideUp can help you find a factoring service that matches your company's needs. Feel free to use our business matching service to receive custom quotes from pre-screened providers.



Glossary

Account Debtor

The customer of a factoring client that owes money on an invoice.

Accounts Receivable

Money currently owed to a business for products and services rendered. Accounts Receivables are listed as an asset on a company's balance sheet.

Accounts Receivable Factoring

This is a financing strategy that allows a business to leverage their current accounts receivable for quick cash. A factoring company will advance the business capital for a portion of their accounts receivable, then assuming the responsibility of collecting on the purchased invoices. When the full invoice has been paid to the factoring company, the remainder of the invoice minus any applicable fees will be paid to the original company.

Advance Rate

This is the rate that the factoring company will pay on the invoices or assets that they are purchasing; most commonly ranging from 70 to 90 percent.

Bad Debt/Charge Back

This is the amount that a factoring company will write off in the event that an account does not pay their invoices. In some factoring relationships the business who sold the invoice is responsible for paying the factoring company back (recourse), while other financial arrangements do not require this re-payment (non-recourse).

Creditor

The business or party to whom money is currently owed.

Debtor

The party that owes money to a creditor.

Dilution

The term that refers to the amount of risk associated with the transaction to the factoring company. This risk includes non-payment, returns, slow pay and charge backs.



Due Diligence

The background process that is typically performed by a factoring company on a new debtor or on the accounts receivable account that is being sold to the factoring company.

Factor

Refers to the company factoring invoices, accounts receivable or purchase orders for a client.

Factoring

The process of selling invoices or accounts receivable to a third party company or organization for a discount in exchange for capital funding.

Factoring Fee

The fee charged the seller of invoices or accounts receivable in a factoring transaction.

Factoring Verification

The process that a factoring company uses to verify that products and services billed were actually delivered to the debtor.

Full Recourse Factoring

The factor is protected in the event that a customer does not pay their invoice. If this occurs, the customer is responsible for full re-payment of the advanced funds to the factoring company.

Non-Notification

In this type of factoring relationship, the customer paying the invoice to the client is not notified of the factoring relationship.

Non-Recourse Factoring

This type of factoring relationship requires the factoring company to assume the financial risk of non-payment. In the event that a client does not pay the purchased invoice, the client is not responsible for repaying the funds that were advanced by the factoring company.



Purchase Order Financing

This refers to the process of purchasing a company's or client's purchase orders at a discount. Companies often leverage this financial service when they need capital to complete a large sales order or large manufacturing order for a client.

Reserve

This refers to the amount that is not advanced to the client when the invoice or accounts receivables are purchased. This amount is often paid to the client minus any applicable fees once the customer has paid the invoice to the factoring company.

Reserve Release

When the factoring company releases the funds held in reserve to their client upon payment of the respective invoice.