

Factoring: The Fastest Growing Financing Option Today

Factoring is the process of purchasing commercial accounts receivable (invoices) from a business at a discount. This process provides businesses with cash today—cash that would normally remain tied up in accounts receivable for several weeks or even months. Factoring eliminates the problems companies face when customers with slow payment habits create uneven cash flow. Although factoring originated with the Greeks and Romans, over 4000 years ago, small to medium sized companies have only recently begun to use it. Most people associate factoring with the textile and garment industries, but recently it has spread to all types of product and service-driven industries. Indeed, it is becoming the fastest growing financing option of companies today.

When your customers take 30 to 90 days to pay an invoice, you are financing their business. They are using the money that is actually owed you to run their operation—money you could be using to pay your employees, purchase new equipment or grow your business in other ways. Factoring allows you to overcome the problems created by your slow-to-pay customers by advancing a percentage of the invoice amount. This way you have money as soon as your service or product has been delivered, not 30 or more days later. Unlike traditional forms of financing, such as bank loans and

venture capital, factors primarily look at the creditworthiness of your customers, not you. In short, factors are more likely to say “yes” when banks and investors say “no.” Therefore, even if you are a start-up business, factoring can open previously closed doors to increased profits and growth.

Most factors buy your invoices using a recourse arrangement. This means that a factor reserves the right to seek repayment from you if your customers fail to pay their invoices after a pre-agreed upon length of time. In other words, if a factor is unable to collect the amount due on an invoice, he may look to you to return any advance you have received.

The factoring approval process can take less than a week. After the initial funding, your advance funds can be in your company in hours. The key to a speedy approval process is a complete and accurate client profile. You can save the factor hours, even days, when you are up front and honest. You should give details about your clients and the age of their accounts. Beyond a client profile, you may need to provide specifics about your company, such as a list of the customers, length of time in business, monthly sales volume, and a description of your operation. Your discount rate for a \$5000 invoice will not be as good a deal as with an invoice of \$500,000. Factoring costs more than a bank loan but when

weighed against the cost of lost business or losing your business entirely, the importance of the discount associated with factoring diminishes considerably. After the agreement has been signed, the funding process begins. The factor conducts due diligence by researching your customers' credit and any liens placed against your company. The factor also confirms the legitimacy of your invoice before buying your receivables and advancing money to you.

For most businesses, the factor becomes your financial partner providing immediate cash as needed. Most factoring firms can take the place of your collections department and eliminate some of the costs and problems associated with late payment, bad checks, credit checks and bad debts. This appeals to many business owners because it frees the accounting staff from the tasks of issuing late payment notices and conducting credit checks. Factors will sometimes offer cash advances on purchase orders, giving you money in hand before the order is even complete. Purchase order funding helps those who have the orders, but lack the capital needed to fill the orders. Purchase order funding usually involves a manufacturing company.

If you have collectable and creditworthy invoices to sell, you could be a good candidate for factoring. Factoring can be used in every kind of industry. It helps

companies at every stage—from promising start-ups to those working through Chapter 11 bankruptcy. The flexibility and unique problem-solving ability offered by factoring appeals to business owners. In some situations, when factoring is not the best option (or not an option at all), a factor can often help direct you to some creative alternatives, such as equipment leasing, government financing, credit card advances or bank loans.

As stated before, factoring discounts will be higher than loan interest charged by a bank. The key to knowing if you can afford to factor is not to look only at the bottom line discount, but to consider how your company may increase its profits through factoring. Weigh unearned income and lost opportunities due to your lack of cash flow. Also consider the savings you could experience with factoring. You can eliminate late payment fees and take advantage of early payments to your vendors. Plus, think about whether or not factoring will allow you to scale down your accounting department by reducing the amount of overtime used on collections and credit checks. It is rare that companies decide not to factor because they could not afford to. As a matter of fact, in most cases, companies decide to factor because they can't afford not to. Factoring can give you the peace of mind, the time, and the money to do what you do best—grow your company.

- Joy Ann Venverloh

Joy Ann Venverloh is the owner of Lexx Funding, Inc., which specializes in providing working capital for companies through the purchase of accounts receivables, purchase orders, equipment leasing and financing, and business notes. Writer's note: Factoring is also known as Accounts Receivable Financing.



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