Title:
Receivables Factoring: An Easy Way to Free Up Cash from Unpaid Invoices

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Summary:
Receivables factoring is a quick and effective way to get working capital for your business.

Keywords:
Receivables Factoring, receivables factoring, invoice factoring, factoring loan

Article Body:
If your business is facing cash flow challenges, account receivables factoring may be the ideal solution to the problem. With receivables factoring, you sell your accounts receivable or invoices to generate quick cash. Receivables factoring is a common practice that’s been used for centuries by businesses around the world to manage cash flow. In fact, receivables factoring transactions in the United States, alone, exceed $60 billion per year, according to the Commercial Finance Association.

Benefits of Receivables Factoring

There are a number of benefits to receivables factoring. A major reason is that it gives you the ability to immediately access cash owed to your company. For some businesses, this minimizes the need to incur debt for operations while waiting for invoices to be paid.

Another advantage of factoring is that it provides a smoother, more consistent cash flow. Instead of wondering if or when you will receive payment from your customers, you can accurately predict when you’ll receive payment based on the terms of your relationship with the receivables factoring company. Businesses typically must wait 30, 60, or even 90 days to receive payment on invoices for products or services that have been delivered. During this time, these funds are tied up and inaccessible to the business. However, receivables factoring can eliminate long billing cycles and enhance cash flow.

Also, factoring eliminates the need for you to handle your own collections. Factoring companies are run by professionals who specialize in collecting and tracking invoices. This translates into an overall reduction in the amount of bad debts and fewer headaches for your business.

Receivables factoring can give you access to cash within 24 hours, which can help you effectively meet short-term cash flow crunches. It also can help you:

• Accelerate cash flow, making it easier to make payroll, pay taxes and fulfill new orders.

• Offer better terms to large customers and increase sales.

• Extend credit to large customers without asking for COD.

• Pay your suppliers faster; take advantage of early pay discounts.

• Purchase equipment, inventory and supplies.

Qualification for Receivables Factoring

Just about every type of industry that generates commercial invoices can and does use receivables factoring. In general, if you pay for labor or materials prior to receiving payment from your customers, factoring can help your business. Or if your business is growing faster than you can generate additional working capital—from private sources or from a bank—factoring can probably provide the cash you need for steady growth. Also, if you have a fairly new business that can’t qualify for bank financing, factoring may be ideal for you.

To qualify for receivables factoring, your company will have to meet to two basic conditions. There can be no existing primary liens on your invoices, meaning no other company should have a claim on the payments when they come in. Also, your customers must also be creditworthy. The factoring company will evaluate your customers on the basis of how quickly they’re likely to pay their invoices.

Prime Candidates for Receivables Factoring

Is your business a prime candidate for receivables factoring? Receivables factoring may be the perfect solution if:

• Long billing cycles are putting a strain on your business cash flow.

• You’re spending too much time collecting from slow paying customers and not enough time building your business?

• The bank has denied your request for a traditional loan because of your lack of years in business, profitability, assets or overall financial strength.

• Your business could increase sales by offering better terms to your new and larger customers.

On the other hand, receivables factoring may not be a good fit if your business is running on low margins—less than 10 percent. Receivables factoring also won’t make sense for your business if you have ample working capital and cash flow isn’t a problem.

How It Works

With receivables factoring, you essentially liquidate or sell outstanding invoices to a factoring company to receive immediate working capital. The company buys the invoice from you for a cash advance amount slightly less than face value, and then later collects the full amount when the receivable is due. Once the factoring company receives full payment for the invoice, you'll receive the remaining amount—minus a fee. Generally, the receivables factoring fee amounts to three to five percent of the invoice value.

Factoring companies have different fee structures, but factoring fees typically involve:

• Advanced funding - When you send in an invoice to be factored, you’ll usually receive 70 to 90 percent funding of the invoice amount within 24 hours after the invoice has been verified. Then the advanced funding is wired to your business bank account.

• Discount rate or factoring fee - The factoring fee can range between 2.5 percent and 3.5 percent per 30 days, or .1 percent for every day the invoice is unpaid after factoring. (Factoring fees can be customized to the individual needs of your business and customer base.)

• Remainder of the advance minus the factoring fee - When your customer pays the invoice, you will receive the remainder of the advanced funding, minus the factoring fee or discount rate.

Here’s an example of how receivables factoring works. Suppose you have a customer XYZ Company, which owes your business $100,000 for a shipment of your gadgets that were just delivered. XYZ Company is a large customer that has good credit, but they never pay their suppliers (you) any sooner than 45 days.

Instead of waiting 45 days to receive payment for your $100,000, you decide to take advantage of receivables factoring. The factoring company verifies your invoice to XYZ Company and you receive 80 percent of the $100,000 ($80,000) within 24 hours, wired to your bank account.

If you have a discount rate similar to the one previously given and XYZ Company pays the $100,000 invoice in about 45 days, this equals a factoring fee of 4.5 percent of the original $100,000 ($4,500). Since you have already received an advance of $80,000 from the factor, you’ll receive the remaining $20,000 minus the factoring fee of $4,500 ($15,500). Ultimately, you’ll collect $95,500 of the original $100,000 invoice.

Keep in mind that the percentage charged by a receivables factoring company is generally more than you would pay for a short-term commercial loan. For that reason, factoring is best used to generate quick cash—not as a long-term solution. Also, receivables factoring companies make their money based on the volume of invoices they purchase. So you may have a slightly harder time finding a factoring company if you have invoices less than $10,000.