



Invoice Factoring – A Financing Solution for Emerging Businesses

Historically, the lack of access to capital has prevented many small businesses from growing and capitalizing on the many opportunities that are available to them.

It is not uncommon for small companies to reject large deals or opportunities because they do not have the necessary capital to obtain the resources to service the account. However, even when small businesses do take on large contracts, they find that they are never paid immediately upon delivery of services. Most contract terms demand that the supplier provide 30 to 60 day terms. The lack of adequate capital resources, along with the necessity to offer commercial credit to clients often makes business owners "victims of their own success."

Large companies have always had a number of options that they could depend on to raise working capital for their businesses. They have access to a number of alternatives such as selling stock, issuing bonds, bank loans and invoice factoring (accounts receivable financing) among others.

But smaller companies, those that have yearly revenues of between \$500,000 and \$1,000,000, have always had a challenge trying to find capital to operate their businesses. In the last couple of decades, a relatively unknown (or understood) financial solution has become available for smaller companies...Factoring.

What is Invoice Factoring?

Accounts receivable factoring is the sale of part or all of a debt that someone owes to your company. When companies provide you financing through accounts receivable factoring, they essentially pay for your invoices as soon as you generate them at a small discount of the invoice amount. They also provide accounts receivable management services by collecting the debt directly, monitoring credit of your clients and providing aging reports.

Accounts receivable factoring is distinct from using your accounts receivable as loan collateral because you are selling some or all of your receivable to a factor, at a discount. It's considered a "self liquidating asset" to the factor, something they are comfortable leveraging. Banks make lending decisions based on the borrower's creditworthiness or availability of hard assets like real estate, but to a factor, the creditworthiness of your customers is what counts.

Who uses it?

Accounts receivable factoring makes up about a third of all financing secured by American companies using accounts receivable and inventory as collateral. Wholesalers, Distributors, Transportation, Staffing companies, Manufacturing and Business Services are some of the more common industries.

Although largely unknown until recently, the factoring industry is quite large, with over \$200 billion factored in 2001, and has been used as a financial service by multi-billion dollar corporations for many years. Only over the last several years has this service been made available to small and medium sized business as an alternative to traditional bank financing, which generally requires at least two years in business with a profit, leivable assets and personal guarantees.

How does factoring help?

Consider the following scenario: you have \$10,000 in cash on hand, most of which is currently earmarked for payroll or debt payment. As a relatively new company, you don't have the credit strength or history in business for a bank loan.

You recently won a large new account. The problem is, you only have a workforce of ten people, and the new contract will require you to increase your staff to fifteen people, purchase inventory for the client, and buy some additional office equipment.

Your \$10,000 isn't enough to do this, and you can't get a loan. But you can utilize accounts receivable factoring by selling your current receivables (those that are 60 days or less) at a small discount, and have the cash immediately on hand to hire the staff, and purchase your necessary inventory and equipment. Your ongoing invoices for the new large account will also be factorable, along with any other invoices you generate to other clients each month. Essentially, factoring is like a revolving line of credit that will grow as your sales grow.

Another possibility - you have a large amount owed to you as in accounts receivable, but one company is paying much too slowly, despite the penalties for late payment. You can sell your not-past-due accounts receivable to a factoring company in order to maintain your cash flow, and with penalties for late payment applied to the other company, you will probably break even.

Is factoring right for your company? Traditionally, this is the right solution if you are a young, emerging company with sales, but are not bankable yet, or if you are in hyper-growth mode where a bank loan will not be able to adequately support your accelerated growth rate.



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