
Cash Flow Solutions for Small Business - Spot Factoring

The catalyst for business growth is money. However; even the most efficiently run business will occasionally experience intermittent shortages of working capital. The dilemma facing an expanding business is that it requires new cash injection to fuel the growth engine - prior to receiving the profits generated by that growth. Who provides the small business owner with the growth capital? Often it is parents, family, and friends, so called "*love money*", and without this love money small business owners face a formidable challenge raising additional financing.

The concept of a trade credit transaction has existed since the origin of economic exchange. Factoring services can be traced historically to Roman times. This involved the sale of goods or service by a merchant for an amount to be paid at a specific time. If the merchant required cash before receipt of the customer's payment, he sold the customer's promise to pay, at a discount to an investor. This secondary transaction is a form of what has become known as factoring.

The concept of factoring is not new and is widely practiced. The Asset Based Lending industry in the United States is a \$500 billion a year business, in terms of aggregate loans outstanding (based on data for the year ended 2006). According to the Commercial Finance Association (CFA), the US trade association, in 2006, the asset based lending industry grew 16.5 per cent. Factors Chain International now has 179 factoring companies in 54 countries and has become the world's leading factoring network with a yearly volume of factored trade receivables in excess of EUR 371 (586USD) billion. Worldwide volumes exceed \$1.08 Trillion USD. In Canada, we have been slow to adopt this alternative method of financing with National volumes of approx. only \$3.9 Billion (2006). Most Canadian business owners are not aware that the growth of their business can be assisted by selling specific accounts receivable for cash on an individual invoice basis.

As entrepreneurial business owners, we are often asked to pledge the family home as collateral to secure conventional bank financing. But what happens if this is not an option or the spouse is not agreeable to risking the family home for the business? The business must then look inward at its own assets. (*Imagine how a firm's cash position could change - if it were able to convert all or part of its accounts receivable into cash.*)

However; as ideal as it would be, these asset-based loans can be difficult to obtain from conventional sources. Generally, an accounts receivable portfolio of less than \$150,000 is unacceptable to conventional lenders because of the high administrative cost, time, and effort required to manage a "*marginied*" account. It is most often offered only supplemental to an existing line of credit secured with hard assets (home equity, term deposits, liquid investments).

Non-marginied small lines of credit take just as much time to set-up and administer as larger lines of credit for the Commercial Account Manager but the return is substantially less to the Bank. Additionally some banks are not interested in financing a business directly unless they have been operating profitably for at least two years. Most financial institutions would prefer a simple collateral mortgage on the business owner's home, an annual review and or a business Visa credit card account. In either case the amount offered by conventional lenders at this level is based for the most part on the credit scores and personal assets of the business owners.

Factoring or accounts receivable financing is based mainly on the credit-worthiness of the business' customers not the owners.

Cash flow problems are simply a timing issue. If receivable turnover can be improved this can go a long way to resolving many cash flow problems. One solution could be to shorten credit terms from net 30 to net 15 days or increase collection activities. Unfortunately, when dealing with many larger corporations or government institutions, expediting an outstanding A/R is not a practical or easy process. Unless your product / service is very unique and in high demand it is the customers who dictate the credit terms to a new business wishing to sell its product to them. Lengthy payment terms result in new business opportunities and consequent profits foregone or delayed until payments are received. Meanwhile the growth within the business has exacerbated cash flow pressures.

For example, let us suppose that you have just landed a deal that you have been working on for some time. The customer is a large, reputable, credit worthy company, or perhaps a crown corporation / government contract that takes credit terms of 30-90 days or more to process your payment. Ultimate payment and credit worthiness is not a question, simply when will you be paid. Do you put a customer such as this on credit-hold because they haven't paid by due date? Of course not! Spot factoring of this invoice or other quality A/R upon completion or delivery can provide immediate accelerated cash flow to pay employees, buy additional inventory, take supplier discounts, or similar value enhancing business activities.

Spot factoring allows a business to finance specific operations without the need for additional collateral as security. You don't have to put the house on the line to finance the growth of your business! Used even more effectively, spot factoring allows a business to grow and become more profitable when the additional cash flow is used to invest in activities that create new sales.

How many independent small businesses are able to take advantage of early payment terms (30 Net 10) supplier discounts? The cash flow provided by spot factoring can be used to maximize supplier discounts and improve your company's credit rating. In the long run you are in a better position to obtain larger credit lines and more generous trade credit terms from your suppliers, and unknowingly to them, your suppliers have indirectly subsidized the cost incurred to do so!

By selling individual invoices, spot factoring provides greater flexibility without the ongoing obligation to sell all invoices for a contractual period as required by conventional full service factors. It is designed to provide short-term cash flow solutions to match the short-term needs of rapidly expanding new businesses. Business owners retain control over their business and their customer relationships. The owner determines which, when and how often they wish to sell specific A/R to meet their specific needs.

Companies that are experiencing flat growth due to limitations of their existing financing can use this service to move their business forward. Companies often become more bankable, develop stronger balance sheets and grow to a size where long-term lenders may now consider a conventional accounts receivable margining program or an increase in any existing conventional financing.

Spot factoring does not conflict with prior secured parties. Funding to established clients usually occurs the same or next day. It provides the flexibility in a financing program that business owner's demand. Businesses are able to produce greater revenues during their most active or seasonal peak periods. With spot factoring a start-up can develop into a successful small business or an existing small business can have the financing in place to grow larger, profitably.

Is cash flow stopping you from growing your business? Consider leveraging your assets through the power of Factoring.