

Will Factoring Give Your Business More Cash?

By Graham Couper-Smith

Will Factoring give your business more cash? What are the benefits? What are the pitfalls? What is factoring? If you're asking these questions you should read this:

Factoring is a way to get your accounts receivables paid to you as soon as you invoice, not at the end of whatever payment term you offer your supplier (Drum roll sounds). The Factor (the lender) pays you the amount you are owed, less a small percentage (essentially an interest charge) called a discount.

Many fast growing businesses hear about factoring and see it as the Holy Grail of cash flow that removes the working capital (cash) blockage which is cramping their style and potentially slowing their business' growth rate.

The reason growing business' often experience working capital pressure is because the amount they earn from work done, or services performed, or merchandise sold, does not get paid immediately. This money sits out in the businesses accounts receivable as an asset, but the business can't spend it until it actually gets paid.

The trouble is, many of the bills incurred by the growing business have to be paid now, not in 30 or 60 days or whatever.

So the business takes on another client. (Great. More profit, right?) But, the business then has to pay the overheads associated with that client while waiting for their money. This means that if the business takes on the new client it needs to have enough cash available to pay those overheads.

If the working capital is insufficient, something has to give, and normally the business starts to pay suppliers late, potentially damaging supplier relationships.

Factoring allows the business to collect the money much sooner and the business can therefore grow more quickly than when restrained by a shortage of cash.

Sounds fantastic, right?

There are some pitfalls:

Factoring can be dangerous to your business health if the client doesn't pay. You see, before you had factoring, you couldn't spend that money until the client paid you, but with factoring, you can. As the business is growing rapidly the money paid to you for the client invoice isn't just sitting in the bank. When the factor explains that the client didn't pay, you have to repay the factor (slow drum roll now), but the money isn't there!

This issue has sunk businesses. Does it mean you should abandon the Holy Grail entirely? Not necessarily, but be careful, and have your eyes wide open. Do smart risk management things like get deposits and arrange progress draws for large jobs. Don't move to the next stage until the factor advises the first progress payment has been made etc.

Combined with good, cautious invoice management, factoring can help smooth your income and make you more money, but caution is the word.

Graham Couper-Smith

Co-author of 'Recession Proof Yourself'

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