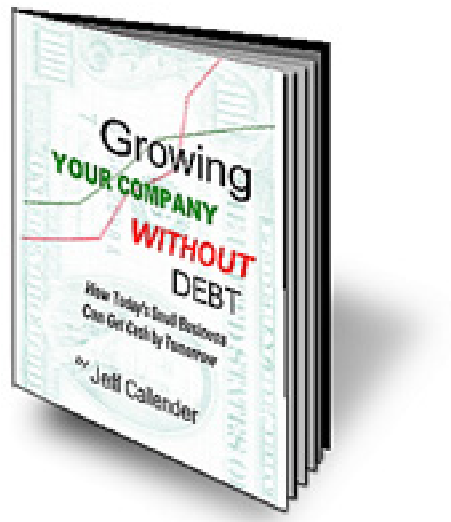

Growing Your Company Without Debt

How Today's Small Business Can Get Cash by Tomorrow

By Jeff Callender

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Important Notice

This publication is for educational purposes only and is not intended to give legal or tax advice. If such service is needed, the reader should seek professional advice from a competent attorney or accountant.

The author assumes no responsibility for any financial losses a reader may experience as a result of any business transaction.

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Introduction

The purpose of this booklet is to familiarize small business owners with a kind of financing that is unfamiliar to many people. It will explain, in a simple yet comprehensive way, how to improve your company's cash flow. You may then decide if using such a financing approach is a sound business decision for your particular situation and needs.

The Life Blood of Every Business: CASH

If we were in a room full of small business owners and asked them all, “What is the one thing your business needs the most in order to survive and grow?” we would probably get a variety of answers: “a needed product or service,” “a solid base of loyal customers,” “a well-prepared business plan to chart your course,” “a good location,” or “effective marketing.” All true answers. But in addition to these, there is one need central to every business – that is the need for available CASH.

Cash to business is like fuel to a car. You need to have enough in the tank to start the engine and you need to maintain enough in the tank to keep it running. Now the car (your business) will take you where you want to go. If you run out of gas – cash on hand – at any point along the way, well…we all know what will happen.

Where can a business owner obtain the cash he or she needs? Banks, venture capital, private funds of the owner, friends, and relatives are the most common places in turn. However, banks usually want a minimum of two or three years' worth of business financials before they'll give a loan. Venture capitalists want part ownership of the business. Not being in business long enough or not being profitable enough to satisfy the banks; and not wanting to give up any ownership; and with private resources already tapped, the business owner may be stuck. "Where can I find that cash to grow my company? I have a good business with loyal customers, I'm profitable or would be with enough cash to fuel the engine; I just need to get over this hump of not enough cash flow. What can I do?"

The answer to this question may be right under your nose and you don't even know it. If you have accounts receivable with good, solid customers who pay your invoices in a dependable manner, you have something with intrinsic value that other business owners are interested in buying. The cash that can be obtained for your good receivables can be exactly what you need to get over a cash flow crisis. By selling something you own – your receivables – you're not generating any debt that must be paid back; and you're improving your credit stature because you're converting assets to cash. That cash can enable you to save further by getting volume purchase discounts, discounts for cash, create market opportunities, or hire needed staff. And most of all, you can start new and expanded production without waiting for earlier invoices (sales) to be paid.

Setting accounts receivable at a discount is a means of financing called "factoring." It's been around for centuries and is a billion-dollar industry for large businesses today. And it is growing rapidly in popularity with small- and medium-sized companies. Factoring not only has saved countless businesses from going under, it has provided many more exactly what they need to grow: cash to fuel the engine.

Factoring Defined

Now let's get a clear definition of this alternative means of financing called "factoring." Factoring, by definition, is the purchase of accounts receivable at a discount, in exchange for immediate cash. When a business sells a product or service to a customer, that business provides an invoice which states what has been sold in the amount the customer has agreed to pay. It is essentially an IOU from the customer to the business. Sometimes these invoices are paid immediately; sometimes they are paid over the course of 15, 30, 60, or 90 days, or even longer. Quite often, the larger the customer (and invoice) the slower they are to pay.

The receivable or an invoice which has not been paid yet has real value. It is a debt that your customer has agreed to pay in the near future. Factors are businesses who will pay cash now for the right to receive future payments on your invoices.

Just about any type of business has the potential to benefit from factoring, not just small struggling operations. Eighty percent of the businesses that factor today do so because they are growing, not because they are in trouble. Factoring is especially appealing to young and rapidly growing companies. Since the process shortens their business cycle of receiving payments on receivables, these businesses can grow even faster. The inability to make more products to sell, while waiting for invoices to be paid, is largely eliminated.

Just think for a moment about how much money is tied up in 60 days' worth of receivables, and then think about what you could do with that cash if you had it on hand. You can't pay the power bill or this week's payroll with a customer's invoice, but you can sell that invoice for the cash to meet those obligations.

Be clear that factoring is not a lending process. It is the discounted purchasing of an asset. A loan places a debt on a business' balance sheet and it costs interest. By contrast, factoring puts money in the bank without creating any obligation to pay. Thus a business' balance sheet is strengthened by having more cash on hand and fewer receivables. Loans are largely dependent on the borrower's financial soundness; with factoring, it is the soundness of their customers, not their own company, that matters – a real plus for new businesses without an established track record.

To summarize thus far, firms frequently want to sell their invoices:

- for instant cash
- to meet payroll or tax obligations
- to fund marketing efforts
- to provide working capital
- to replenish inventory
- to have cash for growth
- to have cash for volume purchases at a discount
- and for numerous other reasons, which no doubt you can name.

How Factoring Works

Let's walk through a simple factoring transaction so you have a feel for how factoring might work for your business. Let's say you have established a relationship with a factor, agreed to advances and discounts, and now have an invoice you wish to submit.

For round numbers, let's say you have a $10,000 invoice (although it could be for $1,000, $100,000, or $1,000,000; the principle is the same). You know this is a good customer and it will take 30 days for him to pay. Rather than waiting that length of time, you factor the invoice and receive a 70% advance, or $7,000 in cash the next day from the factor through a bank wire, direct deposit or check. The invoice is mailed and 30 days later, the customer pays the factor the full amount of the invoice, $10,000. With that $10,000, the factor reimburses himself the $7,000 that was advanced, keeps his discount of perhaps five percent or $500, and pays you back the balance, $2,500. In essence this is what happens with just about all factoring transactions. You’ve paid $500 to have $7,000 today plus get the residual $2,500 in a month. Meanwhile what has the $7,000 in hand enabled you to do? Buy inventory to make more sales, have cash on hand to take advantage of discounts, provided working capital to pay your own bills, meet payroll, pay taxes, or whatever your business might need at the time. You’ve accessed instant cash for an otherwise unperforming asset – your receivables. You haven’t generated any debt for this cash, the discount you pay is paid after you receive the cash, and the cash on hand should enable you to bring in more business that may more than pay the discount. Best of all, you are not being a free banker for your customers!

You’re probably beginning to see how your business can grow from factoring your receivables.

Can You Qualify?

What types of businesses can benefit from factoring, and what does it take to qualify? The list is virtually as long as the index to the Yellow Pages. However, the rule of thumb is simple: if you sell products or services to credit worthy companies and usually wait to be paid, you may benefit form factoring. Examples of credit worthy companies include companies well-rated with Dun & Bradstreet or other credit reporting agencies; federal, state or local governments; universities and hospitals, and large, not-for-profit organizations.

You will need to submit invoices the factor can verify. That is, the factor needs to establish that the work has been performed or the product has been delivered and that the customer is satisfied and will say so, indicating the invoice is valid. Usually invoices need to be current and have not already been sent to the customer. Occasionally a factor will consider some recently outstanding invoices, but will usually prefer to purchase new invoices that have not yet been delivered.

You must own the invoices you intend to sell. They may not be pledged or encumbered in any way, or have any liens placed on them.

If you meet the above criteria, you may well qualify to factor your accounts receivable.

Other Services Factors Offer

Realize that factors offer many services in addition to upfront cash for their clients. Factors can quickly and inexpensively run credit checks on prospective customers, saving a small business the potential disaster of unknowingly taking on a new customer who might never pay his bills. Many factors take on a business' billing responsibilities or even the whole Accounts Receivable department. This enables the owners of both small-ad medium-sized businesses to concentrate on their management and growth.

Factors commonly verify invoices before making advances, thus providing a built-in means of quality control. This sometimes helps to speed up a customer's payments because factors normally report payment histories to credit agencies, many customers tend to pay factors more quickly than vendors.

Some businesses offer discount terms to companies which pay quickly. If you offer 2% net 10 (2% discount if a customer pays in ten days), you’re already discounting for quicker cash. Factoring can make such discounts unnecessary; and while costing little more, offers you, the client, many more benefits.

As you can see, factors provide a great deal more than simply improved cash flow. They bring services and expertise from which nearly any business can benefit.

What It Takes to Begin

What does it take to begin? A factor will have an application form for you to fill out, which will usually be far simpler than those of banks and other lending institutions. When this is completed it usually takes a week, maybe two, for the factor to accept you as a new client and advance the first funds. Even better, once your application is accepted you will not need to reapply every time you want to factor more invoices.

After this early setup stage is completed, the process becomes smooth and advances are done quickly. You’ll simply submit the invoices with a one-page summary provided by the factor, the factor will verify them with your customer, and the advance will be forthcoming usually within 24 to 48 hours after verification.

Telling Your Customers

Your factor will work with you to inform your customers you are using the factor's services, and will maintain customer relationships in the manner you wish. A frequent surprise too many business owners is how familiar other businesses already are with factoring.

Virtually all large customers, especially national chains and government agencies, deal with companies who factor all the time and some even have their own department handling factored accounts. Smaller customers who are unfamiliar with factoring may be a bit curious about it, but their relationship with you is essentially unaffected.

Further Benefits of Factoring

Selling accounts receivable puts you in control of your business like no other form of financing. You control the discount by specifying when the advance is to be made. You can space the advances to create a steady flow of cash. If you don’t need cash now, you can wait to receive the advance and save on the discount (waiting on an advance creates a line of credit).

Wheat’s more, no debt is created, you have no loans to pay off, you create and keep a cleaner financial statement, our access to cash grows with your business sales, and there is no need to re-apply. Finally, you can stop factoring at any time.

Conclusion

As you can see, factoring can be a tremendous asset to companies who need to improve their cash flow. If you would like to explore further if factoring can help your business, contact the person who provided you this booklet.

Thank you for your interest, and best wishes for the success of your business!