

A Guide to Factoring



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The biggest issue most businesses face today is not being able to get cash in quick enough to pay the bills.

There are two main options – **Invoice Discounting or Invoice Factoring.**

Invoice discounting and Factoring, both provide finance against unpaid invoices.

An invoice discounting service enables you continue to administer the sales ledger, and the service is usually provided in a confidential manner. Factoring provides the additional advantage of a full sales ledger and collections service under which the “factor” takes on the responsibility of collection of your ledger.

In this guide we will concentrate on looking at the benefits of Invoice Factoring.

Factoring provides an immediate injection of cash to your business by allowing you to raise funding against 90% of your unpaid and future invoices. Factoring not only provides a working capital facility that grows with your business but can also provides a credit control function.

A factoring facility provided by the most appropriate finance company will leave you free to unlock the true potential of your business rather than spend your time juggling bills and chasing customers for outstanding invoices.

However choose the wrong finance company and it could have disastrous consequences on your business.

How Factoring Works

- Factoring is very straight forward
- You deliver goods or services to your client
- You notify the factoring company of the work performed and your invoice is raised
- The factoring company advances you the pre-agreed percentage value (typically 70-90%) of the invoice the next day
- The factoring company collects outstanding debt, deducts its charges and then pays you the balance of the invoice value.
- Funding is usually provided up to a maximum period of 90days



How Much Will it Cost?

There are **two** headline charges associated with factoring facilities and a number of secondary costs which should be studied in the small print.

Firstly, the interest element for the actual amount of money borrowed. This is calculated as a percentage over Bank Base Rate or LIBOR typically at **2-4%**.

Beware certain finance companies will charge a minimum base rate several percentage points higher than actual Base or LIBOR. LIBOR and Bank Base Rate are not always the same.

Bank owned factoring companies tend to link their funding to Bank Base Rate whereas an independent factoring company will link to FHBR.

The second element is the cost of providing and administering the factoring facility, and also for the provision of the credit control. This charge is usually a percentage of the annual turnover and can be anything from **0.5% to 4%** depending on your circumstances.

A refactoring charge is also applied by many factoring companies. After an initial period of say 60 days the value of any unpaid invoices are refactored for a further period of 30 days at a percentage of the amount outstanding. This could be as much as **1 or 2 %**

Disbursement costs are the amount factoring company's charge for doing one off task such as sending payment of direct transfer or sending you a letter. This should again be checked in the small print

Am I eligible for a factoring facility?

Any business providing goods or services to other businesses on credit may be eligible to apply for a factoring facility.

You can be a limited company, sole trader, or partnership.

From a cost effectiveness point of view turnover should be more than £70,000 however there is no upper maximum.

Factoring is available for new start business.

It is now possible to factor foreign invoices.



Businesses that have previously been declined by a high street bank may be eligible for funding via a more flexible independent factoring company.

Specialist factoring packages are available for businesses involved in the construction industry or undertake work via contracts.

How do I choose a factoring Company?

There are 3 types of factoring companies

1. High street bank based factoring companies controlled by their parent bank
2. Independently owned factoring companies that do not obtain their funding from the banks.
3. Bank owned factoring companies whilst owned by a bank have their own autonomy and trade independently of their parent bank.

NB. The most important aspect of a factoring company is the ability of the finance company to provide the right level of funding against your unpaid invoices and the ability for that same finance company to provide a credit control service in a timely, professional and courteously.

Factoring is a value added service and you should not choose your factoring company based on cost alone. Traditionally independent factoring companies have been better at providing credit control than the bank controlled factoring companies. An independent has developed as a stand alone business with factoring as its core product and therefore must deliver an excellent service.

We would recommend obtaining quotes from two or three companies.

The factoring company which will best suit your business depends on a number of differing factors.

Geographic location as independents can be regionalised rather than nationalised

Turnover. Different factoring companies are better than others in a certain turnover level. There are also a number of independent factoring companies specialising in funding to the smaller business



Length of time trading.

Credit rating. Banks will only fund businesses with reasonable credit

Number and quality of invoices

Concentration levels. If you have only one or two customers this may exclude you from certain funders but not others.

Any foreign invoices? Certain factoring companies have an international presence and these are not necessarily the bank owned factoring companies.

Is part of your business contractual? There are only two factoring companies that can provide a facility

Do you need credit insurance? Banks and independents provide very different types of credit insurance

Do you need an overpayment? Certain factoring companies can provide a top up via an EFG loan

Do you have any other borrowing facilities with your bank? There is an argument for and against using a bank in this instance. Too many eggs in one basket or does having one funder provide economies of scale and more flexibility.

Summary

A good independent factoring broker will be able to discuss your own unique requirements and put you in touch with the most suitable factoring providers.

Always see two and a maximum of three, any more and the factoring companies wont take you seriously.

Make sure you understand the charging structure and remember the headline rates do not always show the full picture.

Make sure you are comfortable with the individuals involved in the business.

Make sure you know the credit limits of your top ten customers. Don't be afraid to ask questions and arrange a visit to their premises.

