Isaacs Advisory

Financing Advisory Services

Factoring:
What is it and how does it work?

This is the first of two articles on factor financing. The second article will focus on the common terms and conditions of factoring.

Your customers take 60, 90 or even 120 days to pay—but you need the money now. Rent, payroll and government remittances are all due. Enter factor financing, or invoice discounting as it may also be called.

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When you invoice your customers, Factor Co. will give you the money immediately. You generally pay Factor Co. interest from the date you get the fi nancing to the date that Factor Co. receives payment from your customers.

This type of financing is typically suited to start up or early-stage businesses, those experiencing rapid growth, those companies hitting a bump in the road, or those in distress. Or, it may be as simple as traditional bank financing is not available.

Factor Co. is really not relying on you to pay back the loan, they are relying on your customers. Factor Co. makes the decision to advance you the money based primarily on the credit worthiness of your customers, and less on you.

Historically, factoring was done on a notifi cation basis i.e. a factor financing company would contact your customers to notify them payment of the invoice needed to be remitted to them, not you. Many business owners prefer not to involve customers in this process so notification became an impediment to a factoring solution. In response, some factors now offer non-notification basis factor solutions where you continue to receive the payments directly from your customers but the payments are deposited in a restricted bank account. However, not all businesses qualify for this option as it requires a more complex set up and is more risky for the factor as they do not control the receipt of funds.

Even though interest rates may vary from 1.5% to more than 4% per month, and the factors will require a lien or charge over the invoices they finance, there are still many reasons to choose factor financing:

- **Customer credit checks and collection** – Factors can perform credit checks and manage the collection of payments from customers so you don't have to. This can save you time and money and off set some of the interest costs.
- **Same or next day financing** – Providing you with immediate access to cash.
- More customized service levels – Factor solutions typically have less red tape so factors are generally more responsive and quicker in getting things done.
- **Stable source of financing** - Factors tend to work with you through the ups and downs whereas traditional lenders tend to want to curtail lending when things are not going well.
- **Quick approvals** – Factor companies can typically give a fairly quick "Yes" or "No."
- **Other financing options** – Some factors can provide additional financing (beyond factoring customer invoices) secured by other assets such as equipment, real estate and inventory.

While banks do not typically offer this type of solution, there are a wide range of factoring companies in Canada and their terms, conditions and service levels can vary significantly.

A Google search of "factoring financing in Canada" yielded 1.6 million hits with approximately 25 factor financing companies appearing on the first 3 pages.

Recently, the National Post wrote that compared with the United States and the United Kingdom, factoring is underdeveloped in Canada, at about US$4-billion worth, versus US$300-billion and US$600-billion, respectively. As such there has been an influx of new entrants into the factor financing marketplace over the last number of years in Canada.

There are a wide range of terms and conditions that one needs to be aware of when deciding if this solution is a viable option for your business and the requirements for these and factor rates vary widely amongst the various factoring companies. In addition to notification or non-notification options, there are items to consider such as: recourse or non-recourse, minimum income levels, set-up fees, locked in terms and early exit penalties.