Guide: Debt factoring and invoice financing

Small business operators that trade with customers on a credit basis may consider several ways to obtain upfront financing to help cope with unpaid invoices:

- debt factoring, also known as invoice factoring
- invoice financing, also known as accounts receivable financing
- invoice discounting

They are all ways to monetise your unpaid invoices and obtain upfront working capital immediately. All provide greater flexibility than a business loan for a static amount, but they tend to be expensive.

Companies operating in this industry may offer one, some or all the above services. Consider consulting a finance broker to identify a service which best suits your business.

Debt factoring

With debt factoring, the factor purchases a business' debtors' invoices for a fee:

- you received cash for a high percentage of your debtors' invoices (typically up to 85%–90% of the invoice value), virtually simultaneously with the sale
- your customers will be notified since the factor will be collecting payment
- the factor will collect the full amount of the invoice from the customer
- once the customer has paid the invoice, the factor will pay the remaining balance to you, less the agreed-upon factoring fee

In contrast to invoice financing, invoice factoring involves actually selling your invoices to the factoring company.

Invoice financing

With invoice financing, you use your invoices as collateral for a line of credit:

- you can usually get up to 85% of your invoice upfront from the lender
- you may choose whether to disclose you are using this finance option to customers
- you are responsible for collecting the invoice payments
- once your customer pays the invoice, you pay the lender back

Companies may offer selective invoice financing and/or larger full ledger invoice financing.

Invoice discounting

With invoice discounting, having agreed terms and fees, the discounting company advances a percentage of the invoice face value to you upfront (typically 70%–85%) and the financing provides essential cash to bridge the gap while customers pay:

- the discounter does not provide any credit control service and you maintain control over your own sales ledger, payment chasing and client relationships
- your customer does not need to know of the third party involvement

Undisclosed factoring

Normally, if you use a factoring company, statements will be forwarded to your debtor in the name of the factoring company. If you do not wish to disclose that a factor is being used, "undisclosed factoring" is an option where the business' customers are not aware that the debtors have been factored.

The factor buys the goods that have been sold (instead of the debt) and, as an undisclosed principal, appoints the original seller to act as an agent to recover the debt.

Invoices, statements, etc, do not mention the name of the factoring company in any way.

Undisclosed factoring can cost more, and the factoring company may require more strenuous credit checks on your business. There is not the usual requirement for customers to be notified about the assignment of the receivables to the factoring company and for customers to consent to that assignment.

Implementation

If you go ahead with debt factoring, implement it carefully. Tell your customers you plan to use the services of a factoring company, and why. Unless you explain otherwise, they might see the move as an indication that your business is in trouble and start to source alternative suppliers.

Factorer requirements

Many factoring and invoice financing companies have restrictions on the size of the business they are prepared to deal with and most demand annual credit sales of at least $300,000 before they will consider making factoring available. Check the marketplace for the type of deals that can be negotiated.

The factoring company will also ask to see annual financial statements together with periodic financial statements, your business plan, and possibly a cash flow forecast for the coming year. They will require permission to conduct an audit on your debtors' affairs to determine they are credit worthy.

Many small businesses have found that the inconvenience of the factoring company controls, and the fees, are acceptable because of the benefits of substantially improved cash flow from their credit sales.

NZ factoring companies

The next section summarises terms, requirements, and factoring costs for 2 New Zealand factoring companies, as examples.

Factoring Companies

Factoring Company	Services	Advance Rate	Guidelines to Qualify	Administration Fee	Interest Charge	Security Required and Terms and Conditions
Scotpac Business Finance Ltd	• Full service factoring • Confidential factoring service	Up to 85% of the approved debtors	• Invoices should be for goods/services which have been fully delivered/completed when the invoice was raised • It must be business to business not business to consumers	• Calculated on face value of each invoice — ranges from 0.2% to 2.5% • OR they can fix a monthly charge	• Charged on funds drawn down from your facility • Charged at banks' prime lending rate plus a margin, which is flexible from a negative margin for the right deal to their highest margin of	• No residential property security • Shareholders/Directors guarantee required

					+2%	
	• Co-operation factoring service		• No dispute exists with invoice Invoices older than 90 days (from the end of the month in which they were raised) are not eligible for funding	• Dependent on level of turnover, number of debtors and debt turnaround	• Accrued daily and charged monthly in arrears	
	• Invoice finance		• If one debtor forms a major part of debtors' ledger, there may be a reduction in funds available			• A Factoring Agreement will need to be signed for a period, usually 12 months, with an agreed specified notice period. The notice period is flexible and can be negotiated
	• Selective invoice finance					
	• Can be as actively involved in the collection process as you wish or completely dormant, depending on requirements and the facility you have opted for					
[Lock Finance]()	• Full service factoring	Up to 80% of the value of the sales ledger immediately. Other facilities by arrangement.	• Companies that show growth potential, strong core business and a stable, secure market	• Calculated as a percentage of the face value of all invoices (incl GST) presented	• Calculated on net daily outstanding balance	• First or second debenture/mortgage over Company
	• Co-operation factoring		• Minimum turnover of $300,000	• Generally ranges from 0.3% to 2.5% plus GST	• Charged at base interest rate (determined by S H Lock) plus a margin — ranging from 1% to 4%	• First ranking over debtors
	• Export		• Invoices 90	• One off		• A Debt

	factoring • Debtor administration only • Purchase order finance • Trade finance • Inventory finance • Working capital advances		days past are not eligible for finance • No dispute exists with the invoice • Invoices should be for goods/services which have been fully delivered/completed when the invoice was raised • If one debtor is major part of debtors' ledger — there may be a reduction in funds available	application fee may be applicable for creation of the facility		Factoring Agreement is required. No specified term but a one-month notice period is required.

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