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The Factoring Factor

Factoring can be an important tool for maintaining cash flow, especially for new small businesses, but it's important for owners to do their homework before signing any agreement, says Robyn Barrett, owner of Scottsdale-based Factors Southwest.

"A company can be doing business with very good, grade-A clients, but the company needs to make payroll every week, while the clients may not pay for 30 days or more," Barrett says. "Well, most small businesses can't wait 30 days for payment" because they need cash to pay their expenses.

When a company needs cash quickly, it can sell its outstanding invoices to a factor. The factor will take a percentage from the invoices as a fee. Barrett says it's customarily about 3% of the face value of each invoice per month as long as the invoice remains outstanding.

The advantages of factoring are that the cash is quickly available and there is no upper limit. "We can continue to advance on invoices ... we're limited only by the amount you can sell," she says. Bank loans are for set amounts, and even a revolving credit line has a maximum limit. If you max out the credit line or need to seek a new loan, "it's hard to get a bank to move as quickly as you need to," she says.

The disadvantages include losing control of the collection process. Although the factor is not your company's collection agent, once it buys an invoice, it has the right to collect on it. An overly aggressive factor can alienate your good clients, Barrett points out.

Some factors also charge extra fees, and others won't factor below a minimum dollar amount, she says. "Make sure you understand every single fee you're going to be charged and read your documents," Barrett says. "Everything has to be outlined in your documents; there should be no surprises."

More importantly, she says, shop around for a factor that you and your customers will get along with. "Call different factors, get competitive bids, and see who you like."—SC

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