GARRTECH FUNDING - A QUICK WALKTROUGHT OF ALL YOUR INVOICE FINANCING OPTIONS

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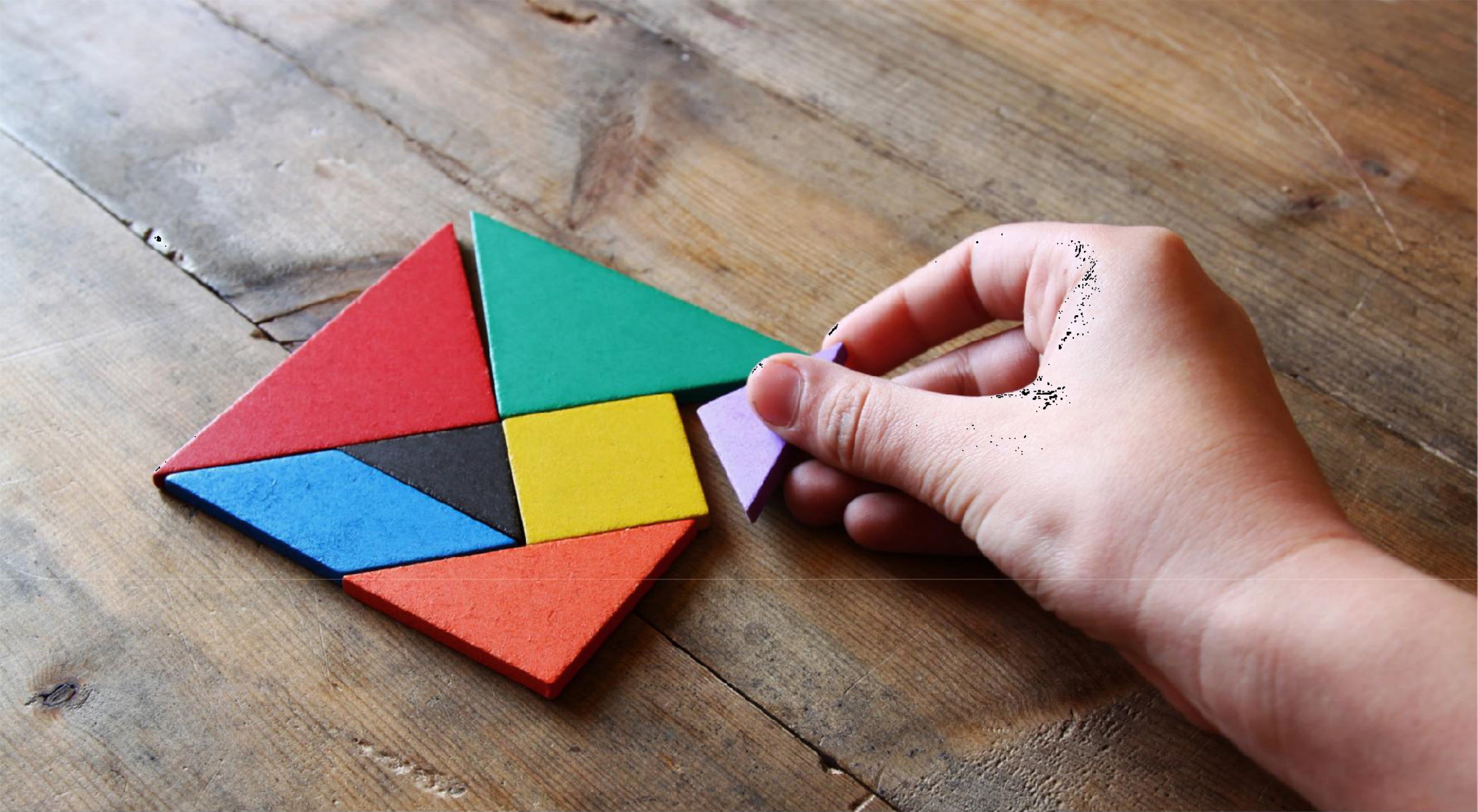

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When you own and operate a small business, your business's cash flow is a top-of-mind priority. Keeping your cash flow strong and resilient is a challenge for any small business. But it's especially frustrating when your customers don't pay your invoices on time, and your finances are suffering because of it.

If your unpaid invoices are creating a dangerous gap in your cash flow, invoice financing is a great option for getting your accounts receivables back on track.

With these types of small business loans, you have a chance to get paid for your outstanding invoices right away—no need to wait for slow-paying customers.

Interested in invoice financing? Here's a walkthrough of what you need to know about all the options out there.

Option #1: Traditional AR Financing

Although invoice or accounts receivable financing is a term that is used a lot to cover different types of financing involving your outstanding invoices, let's explore how it usually works and why your small business might want it.

What is Accounts Receivable Financing?

Accounts receivable financing, or AR financing is a type of asset-based loan. An asset is simply a thing your business owns—it might be a piece of equipment or machinery, a selection of inventory, or a vehicle. While conventional debt-based business loans use your borrowing and business history to determine what you qualify for, asset-based loans rely on the asset to act as collateral for the loan.

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With invoice financing, your outstanding invoices act as collateral. AR financing companies advance you the money you're owed, so you don't have to wait for your clients to pay you before you can cover your own bills and operating costs.

How Exactly Does Accounts Receivable Financing Work?

With invoice financing, you'll receive around 50 - 90% of the cash for the outstanding invoices you want to finance upfront. You'll receive the remaining 10 - 50%, minus the lender's fees, when your customers pay up. Generally speaking, most AR financing companies will advance you 85%, and hold the remaining 15% in reserve.

In general, that's the structure you can expect when you work with invoice financing companies. But, each company might work slightly differently. For instance, some AR financing companies simply advance you 100% of your outstanding invoices. In return, you pay back the lender weekly, over a set period of time—about 12 weeks—until the advance is cleared.

What Will Accounts Receivable Financing Cost?

When an AR financing company advances you 85% of your outstanding invoices and holds 15% in reserve, that 15% is subject to lender's fees until your customers pay up.

What do those fees look like? Your invoice financing company will charge a processing fee of about 3% of the value of the invoice right off the bat. After that, they'll charge a "factor fee" for each week it takes your customers to pay up. Many lenders will charge 1% each week until payment. Once your customers pay the invoices, you'll get the 15%, minus fees, back.

The processing and factor fees are essentially the price you pay for receiving cash from your invoices now, instead of waiting for your customers to pay later. If you can justify paying the lenders in fees in order to get cash now, then invoice financing might be a good option for you.

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Here's an example of what the costs of invoice financing might look like:

Let's say you have a $100,000 invoice with 30-day terms. An accounts receivable financing company pays you 85% of that amount upfront. You'll see $85,000 in your bank account, and the financing company holds $15,000 in reserve.

The invoice financing company takes a processing fee of 3%, or $3,000, from the value of the invoice. They also charge a factor fee of 1%
each week, and your customer pays 2 weeks later—meaning you'll owe $2,000 in factor fees. After taking the total of $5,000 from the $15,000 reserve, the lender then gives you the $10,000 leftover.

The Advantages to Invoice Financing

There are some good reasons why accounts receivable financing is a popular business financing option, like:

1. Helps out your cash flow

Invoice financing solves a common problem for small businesses: you're waiting for your customers to pay you back, but their delays mean your cash flow is suffering and you might even miss payments on what you owe on your end—threatening the good standing of your credit rating.

With accounts receivable financing, you can stabilize your cash flow to make sure you're covering all your business's costs.

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2. Invoices serve as collateral

Accounts receivable financing companies rely on your invoices as collateral for the loan, so there's no need to put up any other collateral. Another advantage to collateralized invoices? You don't have to worry about a credit check for your business.

Traditional small business loans will rely heavily on your personal and business credit scores. These lenders will want to make sure you're a trustworthy borrower before they lend to your business. With invoice financing, lenders just want to make sure that your invoices make sense for them to finance. This is great news for small businesses who don't qualify for other business loans because their credit rating isn't up to other lenders' standards.

3. No need to wait for customers

When you have outstanding invoices, it may seem like the well-being of your business is in your customer's hand—all you can do is wait for them to pay you back. With accounts receivable financing, you no longer have to wait for the cash to smooth out your business's operations.

The Disadvantages to Invoice Financing

Like any business financing option, there are trade-offs for you to consider. Before you sign on the dotted line, consider this:

1. More expensive than other small business loans

As business loans go, accounts receivable financing is a relatively expensive way to fund your business. Invoice financing companies recognize that most small businesses in a cash flow crisis are eager to solve their problems quickly, therefore giving the lenders the advantage to charge a premium for financing your invoices.

So, the processing and factor fees associated with invoice financing tend to be higher than fees attached to other business loans. You should also watch out for hidden fees—like application fees or credit check fees—attached to your invoice financing offer. In the end, when you add up everything you'll pay your lender, you won't be receiving the full value of what your customers owed you.

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2. Fees based on the time for invoice to be paid off

On one hand, invoice financing takes away the stress of waiting for your customers to pay you back. On the other hand, though, you're still incurring losses from your slow-paying customers. Each week it takes the customer to pay your invoice, you lose a percentage of the value of the invoice in factor fees.

The longer it takes your customer to pay back the invoice, the less money you'll get back from the lender in the end.

What’s the Difference Between Invoice Financing and Invoice Factoring?

Invoice financing and invoice factoring are terms that are often used interchangeably. But, they’re actually different forms of financing.

What is Invoice Factoring?

Go back to those outstanding invoices that we keep talking about. Your unpaid invoices represent potential income—for both you and invoice factoring companies.

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Invoice factoring companies are interested in buying your outstanding invoices. Whereas invoice financing companies advance you cash by taking your invoices as collateral, invoice factoring companies buy your invoices and take over collection from your customers, for a fee.

How Exactly Does Invoice Factoring Work?

When you go to an invoice factoring company to take your outstanding invoices off your hand, the company typically advances you about 85% of the value of the invoices, holding 15% in reserve.

In exchange for collecting payments on your behalf, the invoice factoring company will charge a premium—in the form of processing and factor fees. Just like invoice financing companies, invoice factoring companies will generally charge a 3% processing fee and a 1% factor fee for each week it takes your customer to pay up.

Once your customers have paid the invoices in full, you’ll get the remaining balance back, minus the lender’s fees.

The Perks to Invoice Factoring

Invoice factoring will generally have the same advantages as AR financing, but, there's one more to consider:

With invoice factoring, you're hiring a **third-party company** to take over the burden of collecting from your customers. For busy business owners, this is a major convenience.

The Downsides to Invoice Factoring

Again, the disadvantages for invoice financing will also hold true for invoice factoring. But, add these two to the list:

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You lose direct control:

When you work with an invoice factoring company, you're inviting a third-party into the relationship between you and the customer. So, your customers will be very aware of the fact that you've entered into the factoring agreement. This might signal to your customers that your business is in trouble—scaring off existing and future customers.

Customer's bad credit affects you, too:

With invoice factoring, lenders will care more about the creditworthiness of your customers. If your customers have a history of late or missed payments, you might not be approved for the financing you need.

Option #2: Invoice-Backed Line of Credit Loans

There's another invoice financing option that can get you cash right away for your outstanding invoices—an invoice-backed line of credit.

How Do Invoice-Backed Line of Credit Loans Work?

With a line of credit, you get a pool of funds that you can tap into whenever your business needs access to capital, and you'll only pay on the cash you take out. For an invoice-backed line of credit, your outstanding invoices act as collateral for the line of credit loan.

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With invoice-backed line of credit loans, you submit your eligible accounts receivable and A/R aging, which the lender then uses to figure out your line of credit maximum. Just as with AR financing, you can expect to receive about 80 - 85% of your invoices.

When your customers start paying back the invoices, the funds go directly into a bank account managed by the lender—paying off your invoice-backed line of credit debts. If you haven't drawn any funds from your line of credit, then your customers' payments are redirected to your business.

Which Invoice Financing Option Is Right For You?

Now that you know a few of the invoice financing options out there, you might be wondering which one is right for you.

While getting paid for your invoices is attractive to a lot of cash-strapped small business owners, not every company will benefit from the various invoice financing options.

Generally speaking, invoice financing works best for small businesses that deal with corporations or companies with 15 - 90 day payment cycles. Businesses who invoice other businesses—instead of individuals—are better candidates for invoice financing, too.

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When you get down to the different types of invoice financing however, you should think about which option will fit your business's structure and finances.

Does your business depend on customer loyalty and maintaining a relationship with your customer? Then maybe invoice factoring isn't for you. Do you need flexibility in your cash flow, having the finances available to you whenever you need them? Taking out an invoice-backed line of credit might make sense. As always, compare the costs to each invoice financing option, and then decide which fits your business best.

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Invoice financing can be a great option for solving your business's cash flow problems, but it's important to know the difference between invoice financing options.

Once you have the facts on each option and each invoice financing company out there, you can be confident you're making the best financing decision for your small business.