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# Asset-Based Financing

## *3 Financing Strategies for your Small Business*

By: Aaron Dyer

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When you were a kid you might have had a hobby or a special collection that was your pride and joy. Perhaps it was a baseball card collection, and every Saturday on allowance day you found yourself at the local sports store salivating over the Mickey Mantle rookie card. You dreamt of that card, but the price tag didn't quite fit in with your financial portfolio that included \$5 for mowing the lawn once a week. In present day, you realize that card could have done more than completed your prized collection, you could have used it as collateral for a loan. Well not really, but you get the point, that collateral for your loan can come in many forms, but it's up to you to research your assets in order to gain the financing you desire.



**Accounts Receivable Financing -** One of the most common methods to achieve financing is known as accounts receivable financing. It involves a secured loan wherein the accounts receivable are used as

collateral in exchange for a cash sum that will be paid within a short term period. Typically this type of financing is used to assist businesses with a short term cash problem. The lender considers the "age" of the accounts, meaning the older the account the lesser the value. For accounts less than thirty days old, a lender will allot about 75 percent of the appraised or face value. The lender will also consider credit and past payment history when deciding on a loan-to-value ratio. As the business collects the receivables, the proceeds are used to repay the loan or line of credit. There is also a monthly interest rate that will be calculated through applying a daily rate to the receivables left standing each day (the less the outstanding receivables, the lower the interest charge).

**Inventory Financing -** Inventory financing is another popular option which involves using the business's current inventory as collateral in exchange for a secured loan. The average lender will allot a percentage of 60 to 80 percent of the value of your inventory. If you are a manufacturer with more raw materials, component pieces, and unfinished products, it is likely you could only receive up to 30 percent. The lender will want collateral that can quickly and easily secure funds in the event that you default on the loan. This type of loan is more ideal for short-term loans and offers

interest rates similar to those found in accounts receivable lending.

**Factoring Financing** - Factoring is the third category of most popular forms of asset-based financing. This is the sale of accounts receivable, or selling your future payment invoices in order to obtain funding now. The factor company will purchase the offered invoices and takes control over collecting on the payments when due. You receive an infusion of cash immediately and don't have to worry if a future account goes delinquent on their payment. The factoring company will use their own resources to gain payment, including customer debt collection fees.

It is not a particularly common method used for the long-term, but can be more suited to growing businesses with short term or temporary cash flow issues. Another mark in the "positive" column is the fact that there is no debt involved in factoring financing. You are selling those invoices and therefore conducting a transaction that is final.

On the other hand, the factoring company will discount the amount you will gain from this sale. Traditional loans will typically be less

expensive than the costs of factoring. The upfront cash price for accounts receivable is typically 70 percent to 90 percent of face value, depending upon the credit history of the customers and the nature of your business. Another issue with utilizing factoring is the possible harm to customer relations. The collection actions taken by the factor company may endanger an ongoing business relationship with one of your customers. A factor company has little interest in preserving your future relationship with the debtor and some companies may be overzealous in collecting receivables.

You can find the plan that would be most suitable to your company, but first take inventory of those assets. Know what you have, appraise its worth, and find that Mickey Mantle equivalent that will be the final piece to this part of your funding puzzle. Beyond that, deciding what method of procuring finances is best for you and your business is of the utmost importance. The fact that you are doing your research and reading this article is a particularly smart step to take. It demonstrates that you are taking a proactive role in your business affairs.

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#### **About the Author:**

Aaron Dyer is President of Dyer Consulting Group, a small business consulting firm that advises business owners on ways to grow their revenues and increase profitability through better strategic planning and financial management. For more information, and also to sign up for Aaron's future articles, visit [www.DyerConsultingGroup.com](http://www.DyerConsultingGroup.com)

