

# FEDERAL NATIONAL PAYABLES

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## **Factoring or Asset Based Lending? Which is Better for You?**

There are some differences between Asset Based Lending and Factoring that are important under some circumstances. However, they are more similar than they are different and, more often than not, their differences are not of material importance to their customers.

### **What is Asset Based Lending?**

Asset Based Lending is working capital received from a finance company or bank in the form of a loan collateralized by business assets such as Receivables, Inventory or Raw Materials.

### **What is Factoring?**

Factoring is working capital you receive by selling your accounts receivable to a finance company or bank.

### **How are factors and Asset Based Lenders (ABLs) similar and how are they different?**

For the most part, the differences between ABLs and Factors are not important to most borrowers. ABLs and Factors use the same techniques and processes to provide you with financing. Both will provide you with financing based upon your accounts receivable assets. Also, both usually require that payments from your customers be assigned to a lockbox. Finally, both usually require that they be permitted to routinely verify invoices with your customers.

However, there are a few differences that may under some circumstances make a difference.

1. Some people think ABLs are less expensive than factors. This is not true. Finance companies are not regulated by any government authority and are free to structure, quote and charge their fees and interest as their markets permit. Your price is going to be significantly determined by how well you shop and you are just as likely to find a Factor to be as low priced as an ABL.

2. Factors often handle each invoice as a discrete asset whereas many ABLs roll them together in a “borrowing base” concept. Therefore, ABLs may be a better solution for a company with lots of very small invoices and a high turnover in their customer base.
3. Some ABLs offer some lending on inventory or raw materials whereas Factors do not. Though this is increasingly rare and advance percentages are low, this can be valuable to manufacturers or some providers of goods.
4. Technically, an ABL is loaning working capital using accounts receivable as collateral whereas a Factor is providing working capital by purchasing the accounts receivable. As a practical matter, this is only a technical difference and rarely makes any difference to their customers.

Other than these, there are no important, consistent differences between the two specialty finance company types.

To summarize, businesses seeking non-bank financing should not go into their search with any pre-conceived notions about whether a Factor or an ABL would be a better solution. The only way to really know is to shop both and carefully compare formal proposals. If the business has lots of very small invoices and/or a high turnover in a base of numerous customers, an ABL may be a better fit. They may also be better served by an ABL if they are looking to finance inventory or raw material though this service is increasingly difficult to find in material amounts.

### **When should you use a Factor or ABL?**

Specialty finance companies (Factors and asset based lenders) are more expensive than a conventional bank loan but are the place to go when you cannot qualify for enough conventional bank lending. The two operative words here are “enough” and “conventional”. A bank loan for \$100 thousand sounds great until you need \$500 thousand or more. Very often banks cannot increase a facility because you don’t have enough of a track record at higher volumes or because your loan is actually secured by a fairly limited amount of equity in your fixed assets. If the profits from growth would be greater than the additional

cost of a finance company to properly fund the growth, then a finance company makes sense for you.

Traditional bank lending is a wonderful thing. But it is increasingly hard to find it in amounts that make a difference for you and your business. Many banks today offer products that are not “conventional” bank products such as factoring and asset based lending. They can cost as much or more than a good specialty finance company and, because banks have federal regulators looking over their shoulders, their products may be more restrictive than those of a finance company.

***Federal National Payables, Inc.*** has been in business since 1992 and provides accounts receivable finance to more than 100 small and medium sized businesses throughout the country.  
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