Factoring: Alternative Financing for Medical Transcription Services

by Philip Cohen

When an Arizona medical transcription service owner (MTSO) signed three new clients, things got a little hectic at the office. She was ecstatic about the new business and the growth opportunities it provided, but in order to meet these new demands, she would have to increase the size of her dictation system, have interfaces built, and recruit, hire, and train new employees. She was going to incur meaningful start-up costs and her on-going expenses (mainly payroll and taxes) were going to increase tremendously. Meanwhile, it would be many weeks before her new clients would pay her for her work.

The president was now faced with a dilemma despite her anticipated business growth. Instead of immediately launching into her new contracts, she would first need to spend the next couple of weeks looking for capital. This way she would be completely prepared to meet the demands of her new clients. Having already exhausted her ability to borrow from the bank, she instead went to an accounts receivable factor for the money she desired. With the ability to use the receivables from her new clients as collateral, she would be able to quickly secure the cash needed to meet the expectations of these new clients.

But what exactly can a factoring company do for a medical transcription service? And how common, and more importantly, is it wise to do business with this kind of finance provider?

The business of factoring has literally existed for thousands of years. Whenever someone owed money, there has always been an outside party willing to take a piece of the future income in exchange for providing the instant cash relief to the owed party. The most recognizable modern example of factoring is the credit card. In this case, the host bank pays a merchant immediately, before its customer pays the bill. The bank takes a percentage of the customer's payments in return for the advancement of funds.

Factoring works similarly to the use of the credit card. The factor provides capital in one of two ways: either by purchasing the asset value of a receivable (non-recourse) or by making a loan with the invoices as collateral (full-recourse). When the factoring company buys the value of the receivables, the factor takes the credit risk that the invoice will be paid. The client still retains the performance warranty on the work done for a customer.

Before the factor decides to purchase the accounts receivable, the factor performs a thorough credit check on the customer. If a factor makes a loan against an invoice, which usually occurs when the customer credit is not favorable, its client will continue to assume its own credit risk and will also be liable for any nonpayments.

When a prospect applies for a loan from a bank without having an adequate credit record or a profitable business history, it is not uncommon for the bank to recommend a factor since the prospect is not in the position to pursue conventional financing. The factoring firm can help provide the financial discipline that a prospect needs as well as the opportunity to secure short-term working capital. Banks often see factoring as an interim solution to inadequate credit, until the client is in a better position to secure a bank loan.

A good factor wants to see its client eventually move to a conventional banking relationship and avoids companies that would depend on the factor forever. Any company that cannot establish an exemplary credit history can eventually become a bad risk for any financial partner. Factors are as unlikely as any financial institution to invest money, and even time, into a risky company.

There is often a misconception that the only time to use a factor is when the company is going out of business, when, in fact, the complete opposite is true.

Factors will research a prospective company thoroughly before deciding to accept it or not. Since the factor will operate as a de facto partner or investor by assuming the risk of the company's receivables, it is in the interest of the factor to take on clients that are growing, solvent, and ambitious. A factoring company's ideal partnership would be with a new or reorganized company looking at a bright future ahead. Factors want to work with companies that are in the growth mode.

Until recently, working with a factor was thought to be a sign that the company was hitting rock-bottom due to financial troubles and viewed as the last line in a shaky financial defense for a business. This perception of factoring persisted largely because of the unregulated status of the factoring industry. Now, factors are shaking off that bad reputation because the shady players are being sorted out through a combination of competition and sound operating procedures. Factors watch each other closely and constantly interact, often providing assistance to one another as banks do, which in turn means better service to their clients.

Although accounts receivable factoring companies take on businesses that are unable to turn to banks, they will not take on every single company that asks for assistance. In order to establish the most effective business relationship with their clients, factors become experts in their clients' business and industry—for example, dealing only with medical or only construction receivables.

It is vital that you work with a factor who has a thorough understanding of you and your medical transcription business plan. Since most factors are discriminating about their clientele, a smart MTSO should be wary of any factor that gives the impression that they are willing to do business with just about everyone.

It is rather rare to find two different factoring companies that operate exactly alike. Each factor has its own methods for running the business, sorting out credit issues, notifying a client's customers, and verifying that the invoices are real and collectible. Generally, the factor discounts the full face value of an invoice by a certain percentage. Rates are most times determined by the risk and the volume of the invoices. Low volume, measured in dollars per month financed, is usually more expensive. If a client guarantees that it will need factoring for a specific amount of time or money, the rate can also be lowered for the client. Some factors may provide annual APR rates, which are tied to the amount of financing outstanding, while other factors will simply discount invoiced amounts.

There are definitely unique benefits to factoring, and even the hardcore skeptics will admit to the benefits. The first of which is *equity* which remains unchanged on the company balance sheet even when deals with a factor are struck. As opposed to a conventional bank loan or credit line, the factoring relationship does not appear as a liability on the business' books.

Also with a factoring company, it takes only a few days from the time you start the application process to the time you receive capital. For companies battling a cash flow crunch (such as a growing medical transcription service), the immediacy of potential capital is often the dealmaker.

High-growth companies benefit from the factor's flexibility. Rather than operating with a fixed line of credit, a factoring firm's credit line can be expected to grow as their clients' billings increase.

The World Wide Web makes it even more convenient for factoring companies to effectively provide account information to their clients. Some factors offer online services that enable their clients to view their key factoring reports over the Internet. With the use of this service, clients are able to check the status of their accounts at any time from any computer that has Internet access. This makes it easier for clients to keep a detailed tracking of their accounts receivable, giving them the freedom to focus their attention on growing their businesses.

Factors that offer an online service must ensure that the factoring reports can only be accessed with the highest level of security, manageability, and privacy for their clients. Factoring companies must also update client reports on a regular basis so that clients are able to view their most recent account data. The online reporting can help factoring companies serve their clients more efficiently by making their financial information conveniently available on a daily basis. This quick and easy access to factoring reports can help answer any questions that clients may have about their accounts receivables.

Just like the MTSO in this article, when established companies experience cash flow problems due to some new, large accounts, factoring can be the best solution to solve their problems. Rather than going through a total re-application of its bank line, a company can use a factor for short-term working capital until the new accounts become self-financing. The company may be surprised at how quick and painless the whole process can be by using a factor.

The flexibility that a factor can offer is one of the highest regarded aspects of the factoring business. Compared with the usually rigid practices of both your neighborhood and downtown bank, a factor can be just the fresh opportunity a medical transcription business needs to boom.

1 Professional Development
CE credit approved

Philip Cohen is the President of PRN Funding, LLC, an accounts receivable factoring company that provides growth capital to small and midsized businesses that service the healthcare industry. Prior to founding PRN Funding, Cohen served as the Senior Vice President/General Manager of The MRC Group, where he was responsible for corporate development initiatives as well as the company's speech recognition product line.
Web site: **http://www.prnfunding.com/**
E-mail: **pcohen@prnfunding.com/**