



## ‘Effective’ Rate Trap and How to avoid it! Or, ‘You’re charging me WHAT rate?’

by Kenneth P. Walsleben

Are you presently factoring, or thinking of factoring your receivables? If so, great! I won’t dissuade you. After all, my firm is a factoring firm and I believe whole-heartedly that our services provide many benefits!

Luckily, for you, I’m going to save you money. Lots of it. I want to turn you into a smarter consumer of factoring.

Personally, I prefer smart consumers of our service. Smart consumers usually make good decisions about whom they wish to work with.

Like many financiers, factors quote a ‘rate’, but neglect to detail the true *effective* cost, or rate, of capital.

**Rate** and **effective** rate are 2 different numbers, and total up to 2 different results!

For instance, if you read the fine print for a bank loan or mortgage, you’ll see terms like “rate” and “yield” for the same loan. Often, yield is a higher, but unless there are substantial loan origination points, the difference between “rate” and “yield” remains negligible.

There is sometimes a large difference between the rates you think you’re paying versus what you actually pay — the effective rate.

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**And, funding companies, including many factors, disguise the true cost of your capital.**

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### You’re kidding, right?

**No!** I guarantee that every time a current user of factoring tells me about their “great rate”, I stop them in their tracks when I ask what their true ‘**effective rate**’ is.

Inevitably, my question is met with silence. Sometimes there’s even a slight sucking sound!

The more forthright folks may actually admit they have no idea about what I’m asking, or they’ll flat out concede that they have no idea what the difference is and what they are paying.

If you don’t know the answer either, take heart. You’re not alone.

### You’ve got to be kidding me?

**No!** Here’s the issue: funders of all stripes — not just factors — can dramatically enhance yields, meaning their effective rates — through transactional structuring.

Here are some examples of yield enhancers for factors. Do they look familiar to you?

- term agreements
- minimum monthly fees
- fee periods longer than 10 days,
- minimum fee periods
- volume requirements and associated penalty requirements
- reserve escrow accounts
- fee float days
- credit approval charges
- blanket assignments of all accounts, whether factored or not
- treatment of non-factored invoices
- clever tack-on fees for item processing or electronic transfers
- requirements that all invoices be factored or that all be factored **at once** without the option of aging prior to factoring
- batch accounting rather than individual invoice accounting

This is quite a list that contributes to your ‘EFFECTIVE’ rate.

### You’re not kidding!

**Now you get it!** I bet that if you’re funding your receivables, you’re dealing with at least a few of these items.

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### Wouldn’t it be great if you didn’t have to deal with these buried costs?

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Wouldn’t it be refreshing if your factor confirmed that your stated rate was equal to your effective rate? If you are dealing with any of the items listed above, I can confirm that your actual effective cost of capital is *higher* than you’ve previously thought.

### Can you help me?

**Yes!** If you’d like a list of these potentially hidden yield enhancers, contact me. We can help you to compare. It may prove to be impossible to calculate an exact answer, but we can help you to determine your actual effective costs of capital.

Only then can you properly compare the bids of competing suitors.

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### We try to ensure that our stated rate equals our effective rate.

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I challenge you to ask your present funder about these issues.

See what sounds come over your phone when you ask him/her what the effective rate of their program really is. I’m betting that you too will become a wiser consumer!

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