



DENIM eBook

Why Factoring is Now Better than Line of Credit



A line of credit has traditionally been the most cost-effective financing option for the logistics industry.

Until Now.

Recent rate hikes by the Federal Reserve have made it more challenging for businesses including freight brokers, carriers, and logistics companies to access affordable lines of credit.

In light of these tighter credit conditions, finding alternative financing solutions is crucial to ensure steady cash flow and remain competitive. Freight factoring emerges as a potential option that may offer a more favorable solution in the current interest rate environment.

Line of Credit Drawbacks Today

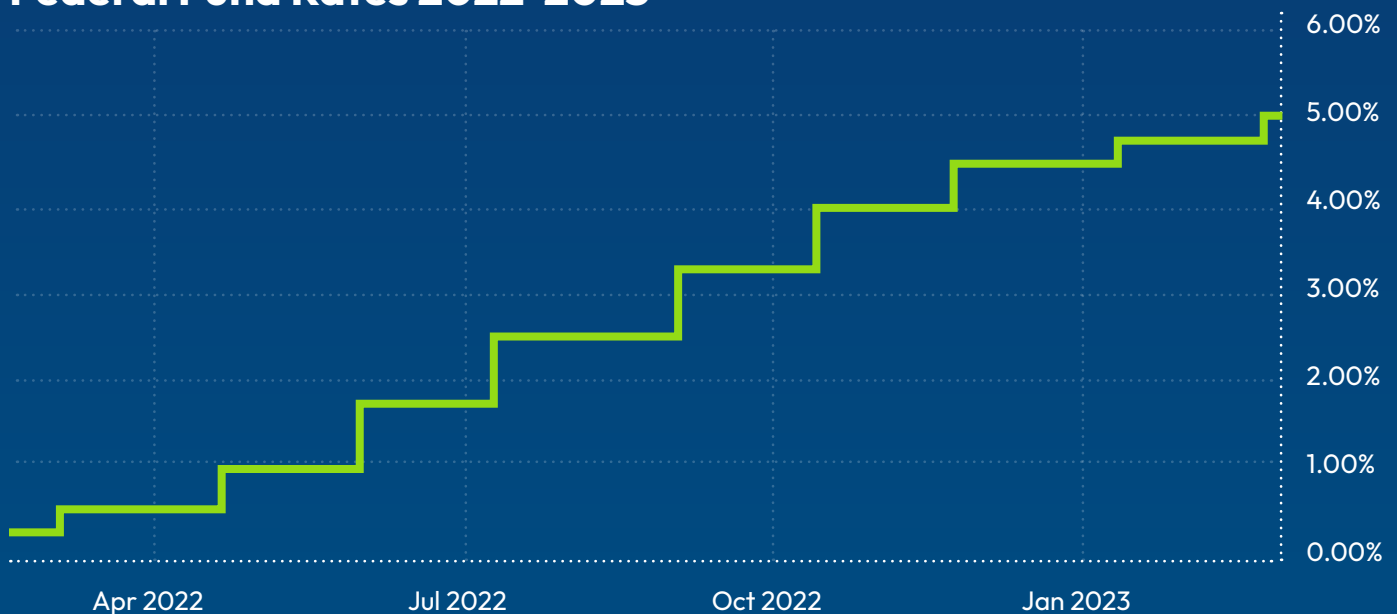
Since March of 2022, the [Federal Reserve](#) has raised the federal fund rates nine times, increasing from 0% to 5%. So what does this mean for you and your financing options?

A lot.

The federal funds rate is the interest rate at which banks lend money to each other overnight. Higher federal funds rates make it more expensive for banks to borrow money from each other. As a result, banks usually pass on this increased cost to their customers by raising interest rates on various loans, including business lines of credit.

There are 3 major impacts that the increasing rates have on businesses applying for a line of credit.

Federal Fund Rates 2022-2023



Source: [TradingEconomics.com](#)

1. Higher borrowing costs

The interest charged on a line of credit will depend on the prime rate and an additional percentage determined by the lender, known as the plus.

The prime rate is the interest rate commercial banks charge their most creditworthy customers. It is a benchmark for various types of loans. And the prime rate is influenced by, you guessed it, the federal funding rate.

Banks have been increasing prime rates as the Federal Reserve has increased their funding rates. Currently, the [prime rate is 8%](#), up from 3.5% in April of 2022. Any new lines of credits opened today would be paying 128% more interest than a year ago.

The plus percentage added to the prime rate is determined by the lender and is based on your creditworthiness, business financials, collateral etc.

In our current high-interest rate environment, you face higher borrowing costs, affecting your cash flow and overall financial health.



How Company Profiles Determine Prime Plus Rates

CHARACTERISTICS	Been 'Round the Block' Freight Brokerage	New Kidz Freight Brokerage
COMPANY SIZE	50 Employees	5 Employees
YEARS IN BUSINESS	15 Years	2 years
ANNUAL REVENUE	\$20 million	\$500,000
REPUTATION	Strong, well-established	Building, limited track record
CARRIER / SHIPPER NETWORK	Extensive	Limited
CREDIT SCORE	750 (high)	620 (fair)
LENDER'S RISK PERCEPTION	Low	High
PRIME RATE	8%	8%
PLUS PERCENTAGE	1%	6%
TOTAL INTEREST*	9%	14%

* Based on a hypothetical scenario

2. Tighter credit conditions

Banks have become more cautious with their lending practices in response to a higher federal funds rate, making it more challenging for businesses to obtain a line of credit and secure favorable terms.

Due to increased risk perception, lenders are reducing the amount of credit they are willing to extend. The Federal Reserve Bank of Dallas surveyed 71 banks late last month, and [found a significant drop in lending](#). A smaller credit limit makes scaling your brokerage difficult.

Since banks are lending less money in this economy, they are imposing tighter requirements. You can expect requests for higher credit scores, robust financials, more collateral, and lower loan-to-value (LTV) ratios.

Even if your brokerage qualifies for a line of credit, you will still face stricter contract terms and conditions. Lenders may offer variable rates, shorter loan terms, impose additional fees or penalties. They may also include more restrictive covenants in loan agreements to manage the increased risks associated with high borrowing costs and protect their interests.

3. Variable interest rates

Variable interest rates appeal to borrowers when market interest rates are declining (like in 2020-2021). However, borrowers may face higher payments if market interest rates rise, making it more expensive to repay the loan.

Banks are more likely to offer variable rates in this market because the Fed will likely continue to increase rates until inflation stabilizes.

The variable interest rate is adjusted at regular intervals, such as monthly, quarterly, or annually. The loan agreement specifies the adjustment period and determines how frequently the interest rate can change.

Lines of credit with variable interest rates can involve more uncertainty than fixed-rate loans or financing options like factoring.

Factoring is Recession Resistant

In today's uncertain financial climate, factoring has become a more attractive and stable option for businesses seeking financing.

Factoring involves selling your accounts receivable to a factoring company in exchange for immediate cash. Funds are accessible without incurring debt, making it a more attractive option in a down economy.

Unlike lines of credit, agreed upon factoring rates do not change based on market conditions. For example, a 3% factoring fee will remain the same regardless of whether the federal interest rates increase or decrease. Factoring rates are typically volume or time based and can vary between companies. But they remain consistent once established.

Factoring also provides several benefits, including quick access to cash, simplified approval processes, and no need for collateral, making it an accessible financing option in various market situations. Additionally, factoring companies offer support for your back-office operations in several ways.

5 Benefits Only Factoring Offers

- 1 Improved cash flow:** Access funds within 24-48 hours vs. waiting 30+ days
- 2 Protect your business:** Free credit checks on customers to avoid risky deals.
- 3 Automated invoicing and collections:** Save hours with smart automation to send documents.
- 4 Freight Payment Management:** Schedule carrier payments, including QuickPay
- 5 Scalability:** Factoring services grow with your business, allowing you to access more funds as your revenue increases.

Factoring VS. Line of Credit

This table provides a high-level comparison between factoring and lines of credit for your business. While factoring offers faster access to funds and additional support services, lines of credit may provide more flexibility in terms of fund usage.

Key Considerations for Freight Brokers	Factoring	Line of Credit
Eligibility	Easier eligibility. Most freight brokers qualify with a passing background check and proof of revenue.	Stricter eligibility criteria based on credit score, financial health, and collateral.
Application Process	Applications include simple documentation including driver's license, articles of incorporation, voided check with business bank, and operating agreement.	More rigorous, extensive documentation required including on all financial statements, tax returns, business plans and on-site collateral inspection.
Collateral Requirement	None, invoices serve as collateral.	May require collateral such as real estate or other assets like trucks.
Difficulty to Secure	Easy to secure.	More difficult depending on creditworthiness and collateral.
Time for Approval	Faster, often within 24-48 hours	Slower. May take weeks or even months.
Flexibility	Funding is only providing for accounts receivables	Funding can be used for any business-related expense.
Rates	Varies, but usually a percentage of invoice value (e.g., 1-5%)	Varies, often prime rate plus a margin annualized (e.g., 4-12%).
Invoicing and Collections Support	Provided by a factoring company.	Not provided by lender; Broker is responsible for invoicing and collections.
Scalability	Grows with your business and revenue.	Depends on the lender's willingness to increase the credit limit.

Breaking Down the Costs

Eliminating all other considerations, let's take a look at the cost of factoring compared to interest on a line of credit.

Let's assume a freight brokerage is moving a \$5,000 load with net-30 day payment and the carrier agrees to do it for \$4,500.

SCENARIO 1: Factoring at a 1% rate

If the factoring company charges a 1% factoring fee on the invoice total. We can calculate the factoring fee for this load as follows:

$$\text{Factoring fee} = \$5,000 * 0.1$$

$$\text{Factoring fee} = \$50$$

With factoring the freight broker would receive
 $\$5,000 - \$4,500 - \$50 \text{ (factoring fee)} = \450

SCENARIO 2: Line of Credit at 13%

(8% prime rate + 5%)

If the freight broker uses a line of credit with an interest rate of 13% to pay the carrier, the interest cost is calculated as follows:

$$\text{Interest cost} = \text{Principal amount} *$$

(Interest rate per year / 365 days) * Number of days

$$\text{Interest cost} = \$4,500 * (13\% / 365) * 30$$

$$\text{Interest cost} \approx \$47.88 \text{ (approximately)}$$

The interest cost for the freight broker using a line of credit at 13% to pay the carrier \$4,500 for 30 days would be approximately \$47.88.

With the line of credit, the freight broker would receive:

$$\$5,000 - \$4,500 - \$47.88 \text{ (interest cost)} \approx \$452.12$$

While the costs are within a few dollars of being the same, the major value add for brokers using factoring now over a line of credit is **access to smart freight payment features through their factoring provider**. Big banks do not have freight and logistics specialization and will never provide niche services like invoicing, collections, reporting, and carrier document collection. Factoring will always remain accessible regardless of credit score and the ideal route for freight companies to receive fast, reliable financing.

CONCLUSION:

Grow Your Freight Brokerage with Denim

In the current economic climate, freight factoring and a line of credit have comparable borrowing costs. However, factoring is a more favorable and accessible financing solution.

Factoring offers several advantages, including faster approval times, more accessible eligibility criteria, and immediate access to cash upon selling invoices. Factoring companies also provide valuable services like invoicing and collections support, credit checks, and freight payment management.

Most importantly, factoring fees are not directly tied to interest rates. Factoring fees are predictable costs regardless of economic uncertainty.

Securing a line of credit in a high-interest-rate environment can be more challenging due to stricter lending standards, reduced credit availability, and potentially unfavorable contract terms, such as variable interest rates.

Don't let rising federal interest rates derail your freight brokerage's success. [Schedule a demo](#) with Denim today and seize the opportunity for reliable funding to scale your brokerage.



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