WHEN BANKS SAY "NO!"

THE SMALL BUSINESS GUIDE TO...

FACTORING

Published by the IACFB
International Association of Commercial Finance Brokers
11000 Metro Parkway
Suite 22
Ft. Myers, Florida, 33966

Printed in the United States of America

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An Overview of Alternative Commercial Finance Solutions For Modern Day Small Business Entrepreneurs

There have been thousands of articles written about entrepreneurs and their unique characteristics. A common fallacy regarding entrepreneurs is that they are driven to build enormous entrepreneurial empires which is generally not the case. Most true entrepreneurs start their businesses simply to generate a "living" and a steady stream of income. They have had enough of being the "dependent" employee, wanting to achieve something greater and with more reward. They want to be their own person, make their own decisions, and run a business <u>their</u> way.

Many traditional economists view entrepreneurism as a minor contributor to the general economy. This is simply not the case. In fact, most new net jobs in today's "jobless recovery" actually come from startup ventures. It is estimated that as much as 21% of U.S. GDP now is directly contributed by companies which were launched by venture capital and other methods of creative alternative finance. And while many of these companies were technology focused and grew rapidly to enormous size, it is important to not underestimate the economic importance of the true "small" business entrepreneur whose shop may employ just two or three additional people.

Among their many characteristics, entrepreneurs.....

- are risk takers and believe in themselves and their ideas. True entrepreneurs are reluctant to give up on anything and if failure of a venture occurs, they will quickly begin seeking a new, more achievable opportunity.
- are competitive and strive to earn respect from both customers and competitors. They compete not only with others but with themselves and firmly believe they control their own destiny.
- tend to be loners and thinkers and are often attracted to small home-based businesses. They will spend serious amounts of "alone time" thinking out problems and analyzing possible solutions. They are always thinking up new ideas.
- are goal oriented and once a goal is achieved, they may well quickly replace it with an even loftier goal.
- are multi-taskers. Once a new idea is envisioned, they will then quickly develop a sense of urgency towards its implementation and fruition.
- tend to constantly be developing new ideas. In fact, it is most often <u>only their inability to finance</u> their many ideas and projects that truly limits an entrepreneur's potential for success.

ABOUT SMALL BUSINESS

The U.S. Office of Advocacy officially defines a small business as an independent for-profit business with fewer than 500 employees. When attempting to qualify for government contracts, the U.S. Small Business Administration furthers that definition by defining size requirements by business type. The complete listing is available at www.sba.gov.

According to the most recent census data, the U.S. Department of Commerce estimates:

- there are nearly 28 million small businesses in the U.S. of which over 22 million are self-employed with no additional payroll employees.
- over 50% of the working population (120 million) work in a small business of some type.
- small businesses have generated over 65% of all new “net” jobs since 1995.
- approximately 543,000 new businesses begin operation each month.
- 52% of all small businesses are home-based.
- 7 out of 10 new businesses last at least 2 years and over half last at least 5 years.

DEBT vs. EQUITY FINANCING

In order to grow their businesses, it is crucial for all small business entrepreneurs to have access to "ready" capital. Commercial banks and other depository institutions have historically been the largest providers of financing for small business, accounting for approximately 65% of all financing through commercial loans (including those for non-residential mortgages, vehicles, equipment, and leases).

Though a variety of resources for commercial financing are available worldwide, actual providers of business capital can be broken down into two very broad categories. Those that provide *equity* capital through investment alternatives, and those that financing through *debt*.

Equity Financing...can be described as the exchange of money for a percentage of ownership in a business. Equity financing allows a business owner to acquire funds without the expense of a monthly payment (servicing the debt). It typically does not encumber assets such as equipment, inventory, and accounts receivable and is normally accessed through venture capital companies, angel investors, family and friends, etc.

Debt Financing...refers to borrowed money that is paid back over time. Debt financing is flexible and can be for varied periods of time (short term or long term). The lender does not gain any ownership interest and the obligation of the business owner is simply to repay the loan as set forth in the lending agreement.

Debt and equity financing offer significantly different opportunities / responsibilities when raising capital. While one is not universally viewed as better than the other, it is often said the most expensive financing a company can acquire is equity financing.

ACCESSING TRADITIONAL BANK FINANCING

A common source of frustration to virtually all small business entrepreneurs is their inability to access meaningful credit through the traditional banking system as they attempt to grow their business ventures. Banks and ordinary lenders are severely regulated and covenant restricted when attempting to provide truly accessible financing and small business loans to startup entrepreneurs. Banks, in general, have difficulty providing financing for risk oriented entrepreneurs in the first three years of their operation without the availability and pledge of non-business related collateral such as a home or other real estate.

For most small business entrepreneurs, it is when their business is initially successful through its start up and into its first stage operation that the entrepreneur is confronted with his/her first cash flow problems. It is at this stage that the initial cash grub stake from savings, credit cards, and friends and family is "burned through" and the need for immediate additional financing becomes necessary.

BUSINESS FINANCING ALTERNATIVES for ENTREPRENEURS

Worldwide, there are literally dozens of unique financial product areas that join to make up the entirety of what is termed the *alternative commercial finance community* with some being more favorable than others in particular economies and geographic regions. For their ability to provide ready access of capital to entrepreneurs and to generally meet the working capital and cash flow problems of start up and early stage small business, several product types clearly stand out among the rest. These areas include:

- ACCOUNTS RECEIVABLE FACTORING...one of the oldest known forms of commercial finance, factoring is also characterized by its simplicity. It directly addresses those cash flow problems associated with the accounts receivable of a business, slow paying customers upon those accounts, and the granting of terms of payment to customers in order to become more competitive in the marketplace and secure more business.

- ASSET-BASED LENDING...similar to factoring in some ways, asset-based lending solutions can be employed in a multitude of industries where financing of accounts receivable, inventories and equipment is essential for growth.

- PURCHASE ORDER FINANCE...simply put, purchase order finance involves the process of providing capital to business owners needing to purchase or to actually manufacture goods to fill large orders to creditworthy buyers <u>prior</u> to shipment. It is often necessary to facilitate handling transactions involving major retailers and especially when contract manufacturing overseas.

- MERCHANT CASH ADVANCE...a relatively new area of small business finance but with broad availability, MCAs provide cash advances on future anticipated credit card and / or daily cash receipts of retailers. True Merchant Cash Advances require no personal guarantees and can be used for growth and general business expansion.

Overall, today's *alternative commercial finance industry* is enormous with asset-based lending transactions alone accounting for over $545 billion in terms of outstanding loans annually. *Factoring*, known affectionately as the industry's "crown jewel", has grown to an annual volume of roughly $135 billion domestically. But as far as factoring is concerned, that is only the tip of the iceberg. Recent statistics compiled by the international factoring organization, *Factors Chain International*, quotes total global factoring now reaching an epic annual volume of nearly $1.3 trillion.

ACCESSING ALTERNATIVE COMMERCIAL FINANCE SERVICES

While many of the product areas, associated with the *alternative commercial finance* industry are well established throughout the world, some are relatively new. Factoring, for example, is historically ancient with traces of this financing found to be nearly 4,000 years old. The area of merchant cash advances, however, is relatively new and becoming a powerful financial tool for modern retailers.

What has changed markedly in the past 10-15 years is the broad access to knowledge of *alternative commercial finance* products. This has occurred primarily due to two major influences:

- **The Internet**....without question, the information superhighway now offers and imparts a broad array of knowledge to those who know where to look.

- **Industry Brokers**....a unique vocation practiced by a select group of individuals that share their industry knowledge and business financing abilities with small business owners and entrepreneurs. Such consultants are rapidly becoming more valuable due to the rapid expansion of *alternative commercial finance* providers in today’s challenging bank-impaired economy.

Accounts Receivable Factoring: How Factoring Can Help You Grow Your Small Business

In simple terms, *factoring* or *accounts receivable factoring* is the sale of the accounts receivable of a business at a discount to a finance company known as a *factor*. Factoring is commonly employed by, and directly addresses the cash flow problems of, businesses that grant extended *terms of payment* to their customers for goods or services purchased, allowing those customers to delay payment upon invoices for 30, 45, 60 days or longer. Factoring is probably the oldest form of commercial finance known to man and is utilized as a business finance strategy in almost every corner of the globe.

It is important to keep in mind as you develop your knowledge of this powerful financial tool, factoring differs dramatically from most other forms of commercial finance in that true factoring is <u>never in the form of a loan</u>. Factors actually <u>purchase</u> the accounts receivable of a business with each account representing a separate transaction. This is a trait that gives factors powerful financing advantage over more traditional commercial lenders. Factors, for example, can comfortably provide financing for businesses with little or no credit, even those operating in a Chapter 11 bankruptcy, an area where banks seldom participate.

OTHER PEOPLE'S CREDIT

Everyone in businesses is familiar with the adage "Other People's Money" (OPM) and the idea of leveraging investment by using money other than your own. Factors, and those that employ the power of factoring, take this concept one step further and also employ "Other People's Credit" or OPC.

When a business owner applies to a bank for a loan, the bank not only has to approve the size of the loan against collateral but will also analyze the credit of the business owner. In other words, they will analyze the borrower's ability to repay the loan. If the owner has only been in business a short time without sufficient time to build a credit history, this can be problematic and usually results in a turn down.

Factors are different. In fact, dramatically different. Because factors are repaid for their advances of cash by the customers of a business and not the business itself, a factor will judge the viability of the factoring arrangement by the credit of customers (OPC) or those the business sells products and services to, and not the credit (or lack thereof) of the business itself and its owners.

Because factors focus on "Other People's Credit" (OPC), factoring is the financing mechanism of choice for millions of businesses worldwide operating in their earliest stages and without a credit history. Additionally, unlike banks which typically require hard assets such as real estate to approve a loan, factors only require accounts receivable to advance funds. This makes factoring the perfect cash flow solution for service oriented businesses such as those providing janitorial services, staffing services, guard services, which have little or no hard collateral for a loan.

For entrepreneurs in the early stages of developing their businesses, factoring represents one of the most powerful financial tools easily accessed worldwide. Factoring...

- is available to businesses in the earliest "start up" stage of their existence.
- requires little or no credit history for either the business or its owner.
- provides a financing facility that automatically increases as the business grows.
- provides substantial operational support in addition to providing capital.
- allows other business assets to be financed separately from accounts receivable.

THE BASICS OF A MODERN FACTORING TRANSACTION

In a typical factoring transaction, a business owner (known as the client) will enter into a relationship with a commercial financing source (the factor) to which it periodically sells its invoices payable by its customers. In most modern factoring transactions, the invoices are purchased by the factor with an *initial advance* of cash (usually 75%-85% of the invoice face value). The initial advance provides working capital for the business while the invoices are outstanding. By periodically purchasing a business's invoices, the factor provides immediate working capital for normal operations including timely payment of its bills due to suppliers and its periodic payroll obligations.

When payments upon purchased invoices are ultimately received from the customers in say 30-60 days, the factor repays itself for the earlier 75%-85% advance, and then rebates the balance of the customer payment (15%-25%) to the seller. Before doing so, however, the factor will pay itself a fee for services known as the "factoring fee".

In a factoring arrangement, each and every invoice represents a separate transaction and is accounted for as such. Clients receive daily reports of collections and weekly aging reports for accounting. The factor performs all necessary collections on past due accounts, sends monthly statements of account to customers, and generally performs all back office functions other than payables, alleviating a great deal of back office work for clients and becoming a "back office partner".

In most modern factoring arrangements, clients will sell their invoices to the factor on at least a weekly basis but sometimes as often as daily. With a factoring arrangement in place, the customers of the seller still get to enjoy their 30, 45 or even 60 day credit terms while the factor, not the seller, patiently waits for the agreed upon payment.

PRIMARY REASONS FOR A BUSINESS TO UTILIZE A FACTOR

There are dozens of reasons that business owners may employ factoring as their chosen method of finance. Most commonly, however, are issues associated with payroll where the first signs of a cash flow problem typically surface. As more and more sales are achieved (with more and more invoices remaining unpaid for 30 days and longer), cash flow problems become more critical. Payroll increases along with accounts receivable and sooner or later, a business can simply run out of cash. As is easily understood, cash advances on invoice payments as a result of factoring provide a ready solution to problems of working capital and cash flow associated with payroll. Factoring basically puts a business on a C.O.D. basis and waiting desperately for customer checks to turn up in the mail is a thing of the past.

Though the circumstances that can trigger the critical need for a factoring arrangement can vary considerably, the common thread is always a need to speed up the payment from invoiced sales so the cash can be used for some immediate purpose. Such needs typically include:

- Making and meeting timely payroll
- paying suppliers for parts, raw material, or merchandise early to obtain volume discounts
- paying overdue federal or state tax obligations
- purchasing new or used machinery and equipment
- funding retirement plans and investment programs
- providing funds for acquisitions or business expansion
- increasing sales and marketing operations for business growth
- buying out business partners

The list of reasons for establishing a factoring arrangement goes on and on. In most cases, the need for factoring is the result of the inability of a business to access bank lines of credit, a trait that is of even greater importance in today's credit impaired markets. It is no surprise that factoring is enjoying an ever increasing awareness by business owners today as more traditional methods of business finance continue to dry up or prove difficult to obtain.

Regardless of the reasons for its need and the end use of the funds received, factoring always accomplishes its objective simply by speeding up the payment of cash from invoiced sales or services through purchase of invoices and immediate advances of cash for those purchases. And most importantly, all factoring facilities (arrangements) grow as the as the client's business and customer base grows. So long as the client continues to sell goods and provide services to creditworthy customers, the factoring facility automatically increases in size along with the business.

CHARACTERISTICS OF A FACTORING CLIENT

Business-to-Business Invoiced Sales

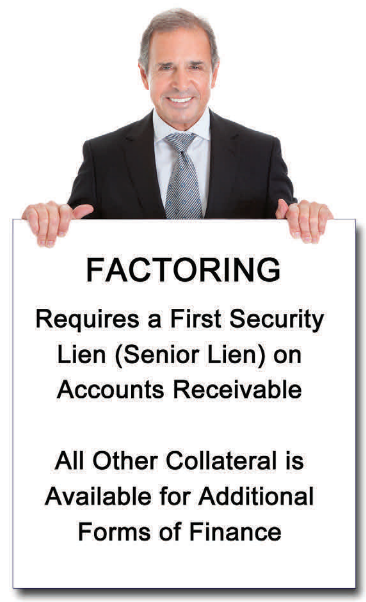
As a method of providing commercial finance, factoring only involves the purchase of invoices due for payment for goods delivered and for services performed on a business-to-business basis. Because of its commercial nature, the invoices that factors purchase from one business, must be payable by another business and not by a consumer. Factors are not lenders and do not loan money regardless of collateral. They also do not purchase delinquent debt. Factors simply purchase normal commercial trade invoices as they are created for goods and services which have actually been delivered or performed.

Ability to Verify Invoiced Amounts Due

Unlike banks that may lend against hard assets such as real estate and equipment, factors purchase a piece of paper (an invoice) that evidences the obligation of one company to pay another for work performed or goods sold and delivered. Such invoices clearly must be *verifiable.* If the factor calls the customer that owes the invoice balance, that customer will verify that the amount owed is correct. The customer will also verify that the terms of payment (generally 60 days or less) granted by the seller are as agreed upon and will be adhered to with timely payment.

Unencumbered Invoices for Purchase

Invoices purchased by a factor must be unencumbered. This means that the business owner selling the invoices cannot have a pre-existing loan from a bank or other lender that claims the invoices (accounts) as collateral for that loan. If such a pre-existing loan exists, the prior lender will be required to *subordinate* the collateral position in invoices (accounts) so that the factor can obtain a "senior" security position to proceed with financing. An alternative is, of course, that a portion of the first cash advance made from factoring is used to completely pay off any existing bank loan and thus eliminate the bank's collateral security position in the invoices entirely.



Assignable Invoices

Factors require the ability to "notice" the account debtors of a client with a *notification of assignment* and to redirect payments from the client's address to that of the factor or to the factor's lockbox. While this is not an issue in most cases, some debtors, such as the Federal government or some municipal governments occasionally refuse to pay a factor directly and will not recognize such notification, thus adding a level of risk that may be unacceptable to a factor.

Acceptable Profit Margins From Sales

Factors will look at the profit margin of a prospective client to make certain that enough profit exists to absorb the overall costs of factoring. Companies with15% profit margins or higher can easily absorb the fees of a factor. Companies with less may find factoring too expensive. In most cases, a large portion of the factoring fees charged or even the entire fee can be passed along to the client's customers through creative terms of payment formulas.

Factoring fees have dropped markedly over the last 20 years. Today, the costs for financing invoices for 30 days is about the same as if the customer purchased the goods or services with a standard credit card. Even invoices outstanding for 60 days and longer often accrue fees of only 5% or less. Basically, if a business accepts credit cards for its sales, it can most often absorb the modest costs of factoring.

Federal Tax Liens

Prospective factoring clients must have their payroll and corporate taxes current and cannot have a *federal tax lien* for delinquency in place. Federal tax liens are "super liens" and can "prime" or jump in front of the factor’s senior position in the payments from invoices. During the underwriting process and periodically thereafter, factors will check for tax lien filings and if found, immediate suspension of the factoring arrangement is likely. <u>It is important to note however, factoring can be an exceptional financial tool in dealing with tax liens, freeing up cash from invoices which can be used to satisfy liens In some cases</u>. Additionally, factors may often be granted a *subordination* from the I.R.S. regarding their lien filing, thus allowing the factor to proceed with the important factoring arrangement, maintaining the profitability of the business, and also assisting the IRS by making timely pre-arranged payments to the to satisfy the tax delinquency over time.

Continuing Need /Ongoing Basis

As a prospective client for factoring, the business should exhibit a need for the service on an ongoing basis. Those entrepreneurs that only need additional working capital on an occasional or one time basis (known as spot factoring) will find it much more difficult to interest a factor in accepting the arrangement. Should the factor accept such a client, the factoring fees charged are usually a bit higher

CASE STUDIES

One of the best methods of fully understanding factoring and its unique ability to provide working and growth capital solutions to small business owners is through real life examples or “Case Studies”.

Case Study: James Manufacturing, Inc.

James manufacturing is a small manufacturer of boat trailer products such as trailer frames and axles in S.W. Florida. Bill James, its owner, was awarded a contract to supply the Florida Fish and Wildlife Conservation Commission with 72 new trailers to replace old units that were rusty, corroded, and failing. Each trailer was $2,900 for a total value of $208,800. James had 20 trailers in inventory for immediate delivery and the contract called for all trailers to be delivered within 60 days.

James Manufacturing had little excess capital. The problem it would now face is that the state pays slowly and Bill James would not receive payment for the 20 trailers he could immediately deliver for nearly 45 days...cash he needed to order bulk steel and hardware to build the remaining 52 trailers and to be able to deliver them by the 60 day deadline.

James went to a local community bank to explain his problem and to request a short term loan. The loan officer explained that what he really needed was factoring, a method of financing his accounts receivable. Through factoring, James could receive an advance of $46,500 (80%) based on the $58,000 invoice generated as a result of the immediate delivery of the 20 finished trailers in inventory. The $46,500 was enough to buy the bulk steel and hardware to complete the additional 52 trailers in time to meet the required delivery date. Even more importantly, the community bank had a factoring department and James was introduced to the bank's factoring officer where an account was immediately established to provide the necessary working capital to meet the order.

The factoring arrangement also opened Bill's eyes regarding other state contracting opportunities he had been passing up due to long wait time for payment. With the new ability to immediately turn his invoices into cash, dealing with the slow paying state was no longer a problem for James Manufacturing.

Case Study: John's Security Guard Service, Inc.

John provides 24 hour security guard service to gated communities. He has slowly built his company up over 5 years and enjoys an excellent reputation for service. The property management companies responsible for payments to John's for its services are notoriously slow payers, however, and the further growth of John's Guard Service has been severely limited due to weekly payroll requirements and cash flow constraints. John has attempted to secure financing for his company at a local community bank but has been turned down on two separate occasions due to a slightly tarnished credit history and lack of any meaningful "hard asset" collateral.

Because of its excellent reputation, John's Guard Service has been offered a contract to provide security guards to new 12 gated communities in his local area that, if accepted, would double the size of his company overnight. Unfortunately, the large management company offering the business to John also has a reputation for 60 day payment for services. John calculates the number of guards needed to cover all entrances at the 12 properties to be 15 and the communities require 24 hour guard protection for a total of 45 guard shifts daily. With a weekly salary of $550 per guard shift based on a 7 day work week, John's weekly payroll requirement for the new contract will be nearly $25,000. This means that because of the management company's 60 day payment history on its invoices, John will have to bankroll his company for 9 weeks at $25,000 per week or a total of nearly $225,000 to accept the new contract and before he sees his first invoice payment. John has only $37,000 in his business checking account and feels he must unfortunately decline the new business offer.

John, however, remembered that he recently received a brochure through the mail that explained the benefits of something called factoring and its powerful financing capabilities. He contacted the commercial finance consultant that mailed it to him and explained the hopelessness of the new offer. The consultant explained to John that factoring would provide him with the capabilities to say "yes" to the new contract and the broker immediately arranged a conference call with a factor specializing in service sector financing such as what John required.

John was quickly provided with a factoring arrangement to purchase accounts with a discount rate of 2.5%% for 30 days. This means that John's fee rate will be approximately 5% on his invoices but with nearly a 30% profit margin, it will still allow him to record a gross profit of approximately $6,250 per week from the new contract or over $325,000 per year from an offer he was about to turn down.

Case Study: Betty's Building Maintenance Service

Betty's Building Maintenance Service, provides exterior building maintenance including pressure washing and window cleaning. As a minority (woman-owned) business enterprise, Betty receives many opportunities to compete for local community, city and municipal county contracts but has declined these opportunities in the past as the contracts are relatively large and both the county and city take 45 days to make payment for services performed. Unfortunately, Betty's company has few hard assets to be used as collateral and she cannot secure any form of business loan from her local bank.

Betty remembered meeting a gentleman named Bill at a local Chamber of Commerce meeting who had talked briefly about something called factoring which seemed to be a solution for just this kind of problem. Betty contacted Bill, a commercial finance consultant, who subsequently explained to her the benefits of factoring and showed her how selling her invoices to a factor immediately after her cleaning services were performed would allow her to accept the lucrative contracts offered by the city and county without worries of making payroll and payments to vendors for her supplies.

Bill immediately introduced Betty to a factor's business development officer through a conference call and Betty was very quickly forwarded a proposal for a factoring arrangement whereby Betty would be charged a flat rate of 5% of the invoice face amount for the first 45 days and 1% for each fifteen days thereafter on all invoices factored. Betty's profit margin of 25% easily absorbed the factor's fee and left her with a 20% margin on prospective work she was currently turning away due to the 45 day payment terms. And, she also reasoned that her minority business standing would possibly allow her to build in a slightly higher profit margin for her bids for the city and county's work.

Betty executed her factoring contract and established her client relationship with the factor. She immediately began to bid on the city and county jobs that she had been turning down for years and was awarded a $25,000 monthly contract to provide maintenance on five local county buildings and also won the bid for maintenance on the City Hall for over $100,000 per year. With her factoring agreement in place and with no more payroll worries, Betty is now positioned to grow her business at an exponential rate limited only by her ability to market, train employees, and contract with major customers. For service companies like Betty’s, factoring is most often the financing mechanism of choice.

Case Study: James & Sons Parking Lot Maintenance

Eric James, owner of James & Sons provides parking lot maintenance services including weekly cleaning, curb stone repair / repositioning, and landscape maintenance to small shopping centers and other commercial accounts. When providing services to shopping centers, James and Sons is usually paid by the tenant who's store the particular area of the parking lot serves.

James was contacted by a new management company that serviced the city's largest retail shopping mall. He was offered a contract to service the entire parking lot of the mall, billing the tenants separately for the service. The total contract value was for nearly $30,000 per month and with a profit margin of nearly 50%, the additional business would result in a handsome profit for the company.

James had always been reluctant to accept contracts from major malls since mall "anchor tenants" tend to be very large retailers that are notoriously slow at paying their invoices. Even with a 50% margin, payroll for employees for such jobs would be substantial. With major anchor tenants taking up to 60 days to pay invoices, James felt he could face serious cash flow problems if he accepted such contracts.

Eric James remembered receiving some information in the mail from a loan consultant regarding "invoice financing" which he had saved. He called the consultant who explained the process of factoring and how for a fee of between 4 and 5% for 60 days, James could receive advance payment upon the invoices sufficient to make payroll while he was waiting for invoices to be paid.

James agreed that factoring would allow him to accept the lucrative contract and a conference call was set up by the loan consultant with a factor who told James they could indeed solve his cash flow problem by establishing a factoring facility for his company.

With the establishment of the new factoring relationship, James called the management company and agreed to the contract. More importantly, now that James had the ability to finance his receivables, he began an active marketing program to the other larger retail centers that he had avoided prospecting for so many years.

Accessing Accounts Receivable Factoring: Working With a Commercial Finance Consultant

As previously mentioned, one of the reasons for the rapid growth of accounts receivable factoring and alternative commercial finance in general is the expansive amount of information now available on the internet. The other is the on going development of the community of professional commercial finance consultants.

ESTABLISHING A FACTORING ARRANGEMENT

Establishing a factoring arrangement is a relatively simple process and often, a small business can be receiving its first advance of funds with 3-5 business days. To begin, a prospective client need only complete a short "Company Profile" which tells the factor a little about the prospect's business and what it does. If a business owner is going directly to a factor, it will likely take a bit of research to make certain the factor is one that finances that particular type of business. While factoring was once the "darling" of the garment and textile industry, it is now a powerful source of finance for hundreds of industries with many factors, such as freight bill factors specializing in just one or two primary areas. One of the best methods of finding the right factor for your any business is to enlist the services of a commercial finance consultant.

Commercial Finance Consultants (CFCs) are highly trained professionals who assist small business owners in sourcing business finance alternatives when traditional bank financing is not an option. While some are primarily CPAs or accounting professionals, most true Commercial Finance Consultants are independent service providers specializing on a full time basis in alternative commercial finance solutions.

Though well practiced throughout Europe, brokers who have the expertise to afford such specialized services in the U.S. are truly rare and while utilizing the services of a broker in Europe is the norm, accessing this service domestically can be difficult. There is no college education, for example, which will prepare an individual for a career in this unique field. It is an simply an area where experience counts a great deal.

Typically, Commercial Finance Consultants are always compensated by the lender for developing business. Double dipping (charging the client as well as receiving compensation from the lender) is universally frowned upon in the industry and very few CFCs charge any type of up front fee for their services. This means that a business owner seeking professional assistance in sourcing the "right" lender will be able to utilize the services of such savvy brokers at no cost.

Whether using the services of a CFC / Broker or not, once a Company Profile is received a member of the factor's underwriting staff will typically be in contact within a few hours. Underwriters will initially be interested in two areas:

- CUSTOMERS: Are the customers of the prospective client creditworthy or diverse enough to provide a suitable and acceptable level of risk for financing?
- EXISITING LIENS: Are there any existing lenders which may have a lien on the accounts receivable, thus prohibiting the factor from perfecting a senior secured position?

If these two primary requirements are satisfactorily met and the industry is one where the factor has a level of comfort, a *Master Purchase and Sale Factoring Agreement* will be quickly created. This agreement or contract sets forth all of the details of the factoring arrangement including all fees, advance rates and other requirements and must be executed and returned prior to the first funding.

Once received, customers whose invoices are approved for purchase will receive a notification of assignment which directs all future payment upon invoices to be made to the factor's address or the factor's lockbox (usually a bank). The above typically takes less than 5 days to put in place at which time funding can commence.

DAY TO DAY OPERATIONS

Once established, factoring is a very simple process and typically works like this:

- Periodically each week, the client will present invoices to the factor for purchase. These will be faxed or email to the factor's operations area. Most factors require original invoices to be sent within 48 hours of faxed or email copies.
- Once invoices are received and a funding request made, the factor will create an advance schedule or a list of the invoices to be purchased, evidencing the advance rate upon those invoices, and also any adjustments made for wire fees or chargebacks.
- Verification of invoiced amounts and the delivery of goods is performed as required prior to actual disbursement of funds.
- Disbursement of funds is made by wire transfer directly into the client's business checking account.
- Original invoices are mailed to the client's customers with the factors *notification of assignment* attached.
- As collections are received, clients will receive periodic collection reports from the factor documenting check numbers, amounts paid, etc. Many factors have accessible account information available 24 hours a day.
- Once collections are received, balances (the amount of a customer check less the initial advance and fees) owed to the client are made available in the form of a reserve distribution or simply rebate.

FACTORING FEES

Fees for factoring services are actually quite modest on a comparative basis. Although invoice size and the volume of monthly factoring will have an effect on the rate charged, typically a thirty day discount rate is under 3% for an average client with average size invoices. This is not much different than the discount which would be charged if the customer paid their bill with a typical credit card and probably less than that charged by a premium card. And while invoices outstanding for longer than 30 days will increase the overall fee rate, factoring is still a very affordable method of finance for virtually all small businesses operating on a B2B basis.

Prospective factoring clients can always receive a fee estimate by requesting a consultation with a factor's underwriter. Typically after such a call, the underwriter will provide a one or two page *Terms Sheet* which will outline the factoring arrangement and document all fees and charges.

IS FACTORING RIGHT FOR YOUR SMALL BUSINESS?

Factoring is well known worldwide as one of the most powerful (and accessible) forms of commercial finance for small, early stage businesses. In fact, the world's central banks now reference factoring as an "essential" form of small business finance for the world's growing number of entrepreneurs.

Is factoring the right for your small business? You can find out more by downloading a *Company Profile* from our website. After completion, simply fax or email the profile to our offices with a request to speak with one of our account executives. We will review your profile and contact you to set up a conference call with an appropriate lender to discuss the benefits and merits of establishing a financing / factoring facility for your business.