<u>Self-Employment & the Factoring Industry</u>

by Laurence J. Pino, Esq.

Dedication

This book is dedicated to those insightful individuals who recognize and seek out self-employment as the means to achieving their ultimate career goals. Their individual dreams embody the future of the American enterprise system.

Table of Contents

Introduction

by Laurence J. Pino, Esq.

This is the age of small business. Recent downsizing trends have eliminated all security in the corporate job market. Americans intent on success are looking to self-employment for security, income realization and personal gratification. The motivation for starting a business has always been clear; the obstacle has been what to do.

Almost anyone with vision and a spirit of self-reliance understands the power of self-employment. The difficulty comes in choosing a specific business. The days of apprenticeship or taking over the family store are behind us. Today, people need a new option for setting out on their own. Factoring is the answer to that question.

My own experience in business has shown me firsthand the frustration people feel. Having started more than 45 businesses in the past 20 years, I know that anyone with entrepreneurial drive can take a solid business and make it work; they just need to know what business is right for them.

My personal mission in life is to empower adults to become successful and effective in their lives. I've done this already, through appropriate training programs, for several thousand new entrepreneurs, and I plan to do it for thousands more.

By profession I'm an attorney, but at heart I'm an entrepreneurial educator. At the age of 30, after building my business portfolio to include real estate investments, a chain of nine sporting goods stores, the largest institutional athletic distributionship in the state of Florida, and a multicity commercial law practice, I set out on the financial lecture circuit to teach Americans how to become successful in business. I designed and developed the *Desktop Lawyer,* a set of audiotapes, manuals and software, as a complete compilation of all my legal documents to enable businesspeople and investors to represent themselves in business transactions. It was in meeting so many interesting people, all eager to make their lives and livelihoods better, that I decided to establish and operate the International Factoring Institute as the first institution in the nation focused on teaching adults practical entrepreneurial skills in the factoring field.

When I first became aware of factoring, I was overwhelmed by its elegance and simplicity in meeting such a dire need of small business — effective answers to cash flow problems. In addition to being so potentially lucrative, I also realized how perfect the business was for home-based self-employment opportunities for anyone, anywhere.

With little overhead, no investment and the ability to control one's income, a career in factoring and factoring brokerage is the perfect solution for those searching for a profitable self-employment option. This book is meant to serve as an introduction to the business of factoring. By no means do I expect these pages to hold the answers to all your specific questions about this industry. In the end, there is no substitute for proper training, preparation and knowledge. Once you complete this primer, however, you will have a very clear understanding of what it takes to succeed in the factoring industry. You will also have a solid base of knowledge from which you may decide whether or not to pursue factoring as a self-employment career yourself.

In any event, I know you will enjoy this easy-to-read book, and I look forward to receiving your comments.

Chapter One — The Key to Starting Your Own Business

Begin looking at ways to start your own business in America and you will soon discover that there are only three real options.

#1 Purchase an existing business

It's a nice thought, but even on a small scale you're looking at an upfront investment of between $60,000 and $250,000 — and beware the liabilities. Things are seldom as they appear. Buying a business today means the risk of inheriting unhappy customers, disgruntled employees, undisclosed liabilities and maybe even a lawsuit or two.

#2 Buy a franchise

While it's a legitimate way to get into business, it's also a very expensive way. Upfront costs and franchise fees almost require you to be independently wealthy before you even start the business!

If that's not enough, you can count on ongoing royalties and licensing fees, which actually puts you in the position of paying for your business forever. And the more you make, the higher the royalties and fees.

#3 Start an entirely new business from scratch

Starting your own business gives you the security of knowing what you have and being in control of the money you spend on it. However, starting a traditional business comes with the uncertainties associated with startup situations — like staying in business through the initial pre-revenue and pre-profit stages.

I believe that starting your own business is the only way to secure your future. The key, however, is to get the proper training and to start the right business: a business where you don't have to spend your life savings (or more) to get started, that enables you to profit almost from day one and that allows you to work at home, full- or part-time.

The factoring industry is that type of business. In the following chapters, I will share the specifics that make the factoring business so exciting to so many different people.

Chapter Two — Factoring: A Brief History

Factoring has a history stretching back thousands of years. Supposedly, the Phoenicians used a primitive form of factoring and the Romans were the first to pass on promissory notes at a discount. It is known that pilgrims financed their trips to America through a factor. Funds were advanced for future repayment utilizing collateral to secure the money to pay for passage.

Factoring continued to play a large role in the development of America. The colonies regularly sent raw materials such as timber and furs to a factor in London. For a fee, the factor sold the colonial materials, guaranteed the credit of colonial buyers and collected the debts owed to London merchants who exported refined goods to the colonies. Factors also frequently made advances against the accounts receivable of a client, just as they do today.

After the Industrial Revolution, the factor became more of a banking and credit-servicing agent. He assisted clients in investigating and approving customers, and then purchased his client's accounts receivable without recourse. The factor also advanced cash against the invoices for merchandise.

It's believed the first independent finance company, one not associated with a bank, was established in 1904. These early credit companies established the percentage of receivables they would finance. Those figures of 70 percent to 80 percent are still used today. In addition, they established the account procedures used to track invoices issued and monies received which are also still in use.

Even with this extensive history, factoring is one of the best-kept secrets in American business. This doesn't mean there aren't many factors; indeed, there are several hundred. But it does mean that the potential for growth is unparalleled.

Factoring — A Definition

Factors can quickly provide financial help to companies that are growing but need capital to fuel that growth. Furthermore, they can do it without the traditional restraints of conventional financing. Companies get the money they need quickly, easily and without acquiring more debt.

Simply put, factoring is the process of purchasing accounts receivable, or invoices, from a business at a discount. Factors provide a vital financing service to mostly small and medium-sized companies who are short of working capital. The factor fills the money gap between the time a manufacturer or seller makes a sale and the time the customer pays the bill. For this the factor charges a fee equal to a percentage of the invoices purchased.

Why Companies Factor

The need for cash is common to every business. Business managers know that it takes cash to pay for growth, and a lengthy delay between delivery of goods and collection of the invoice can be crippling. On the other hand, quick payment can mean even faster growth and higher profits. Different companies factor for different reasons. Usually, however, the customer profile is a highly successful, fast-growing business that needs help. A growth-oriented company will increase sales and profits, but not necessarily have immediate cash on hand to pay for the growth. The company has to carry higher accounts receivable and inventory to meet the increasing sales. Factoring rescues these companies by providing them with the liquid assets, or cash, they need to fuel their growth.

Most businesspeople are trained to go to banks when they need money. However, banks have strict criteria when loaning money that makes it very difficult for small, growing companies to secure loans. Banks lend against assets, not sales. If a business generates $1 million in annual sales, it's a valuable operation; but if it only has $50,000 in hard assets, it won't qualify for much of a loan. The assets of the company and its creditworthiness are all checked and rechecked during the due diligence process. And a business must have a solid track record to qualify for a loan — something young, growing companies are not able to provide.

A company with no history, no assets and no credit couldn't hope for a bank loan, but as long as their customers are creditworthy, a factor would love to do business with them. The factor is not extending credit to the client company, but actually purchasing their invoices — invoices which represent cash due from their customers. So the factor is concerned with the creditworthiness of the customer (whom the industry refers to as the account debtor), not the client. The factor's security in the transaction is their control over the collection system and their ability to check credit information about the client's customers.

The Time Is Now

Factoring continues to fill a niche in American business. In the last four decades, the industry has exploded, filling an ever-widening gap in the financial structure of our economy. The expansion of the industry is due to several trends that have emerged in the recent past.

Traditionally, factoring has been used by large Fortune 500 companies in the garment, transportation and furniture industries. Today, an increasing number of smaller and mid-sized companies in America are turning to factoring as a viable solution to cash flow challenges. This increases the sheer number of businesses available for factoring. In addition, it has only been recently that brokers have become an integral part of the factoring system. Traditionally, large factors used employees and yellow-page advertising to reach potential consumers. With the emergence of factoring brokers, factoring has become more accessible and attractive to more businesses.

In fact, the area of factoring brokerage is becoming the fastest-growing segment of the industry. Simply put, factoring brokers are a group of industry professionals who bring together factors and companies with invoices to sell. Factoring brokers locate companies in need of cash, conduct an evaluation to determine the most appropriate factor, and then place the account for a commission. The rapid growth of the brokerage network has instilled the industry with a shot of vitality. A broker, who acts as a representative of the factor, is able to develop a personal relationship with the client. Independent brokers can provide personalized service impossible for large factoring companies to provide themselves. This personalized service, in addition to the sound financial reasoning behind the principle of factoring, is the impetus for the current factoring boom.

As in any industry, businesses expand their range of services to increase their profit margin. Factors are no different. In today's market there are factors who provide a variety of services in addition to factoring. Some companies furnish collection and sales ledger services, insurance and bad debts, credit approval, accounts receivable bookkeeping, as well as a host of other financial services. The procedures to provide these services are gradually becoming more simplified because factors and factoring brokers are trying to reach more businesses.

This expansion into new areas is just another example of the opportunities factoring offers. The industry built its niche by providing a necessary professional service — purchasing receivables so businesses can maintain positive cash flow. The service continues to be necessary, allowing factoring to remain a growth industry well into the 21st century.

Chapter Three — Factoring — What's It All About?

Factoring is simply the process of buying accounts receivable (invoices) from businesses, collecting the money due under those invoices, and then keeping a portion for a fee. How factors collect their fees differs. They may discount up front the face value of the invoices, or lend against the receivables until they are collected and charge daily interest on the open amount, plus a one-time commission. In either case, the factor buys and owns the receivables outright.

Some businesspeople refer to factoring as accounts receivable financing. This is inaccurate because factoring is not financing. Accounts receivable financing occurs when a company receives funds by pledging its accounts receivable to a lending institution as collateral security for a loan.

No money is borrowed or loaned in factoring. The factor receives a fee equal to a percentage of the amount of the invoices purchased. That percentage is determined by the quality, quantity and average turnover of the accounts.

There are certain restrictions to factoring. The account debtors — *i.e.*, the payors on a company's invoices — must usually be other businesses and not retail consumers. Restaurants, small retailers and other businesses that operate on a strictly cash basis don't need to factor — they have cash on hand and don't generate invoices. Factoring is also not suited for a company with annual sales less than $100,000 unless they plan on factoring to help them grow aggressively and they have a stellar customer list. Even with these restrictions there are millions of companies that could use, even need, factoring in their daily business.

The Process of Factoring

Factors, like other businesses, try to minimize their risks as best they can. Once a company is convinced they need to factor, they are put in contact with a factoring company, who will make sure they meet all of the above criteria. Before buying the invoices, the factor then conducts professional credit checks on all the client's account debtors.

Since this isn't a financing situation, the creditworthiness of the client isn't the issue. In factoring, the issue is the strength of the receivables being sold. In short, factors want to make sure that the client's customers pay.

After the credit checks are complete, the factor takes over the entire collection process, including mailing out the invoices. Since he has protected himself with credit information, the factor has maximized the opportunity to get the money owed. From the client's point of view, the system produces a method that will give them access to all their receivables at once.

Let's use an example to further illustrate the process of factoring.

Sam makes souvenir hats to sell to shops for resale to tourists. He uses his own hard-earned money to purchase caps and to hire other people to embroider the cap's fluorescent design. It's a good idea, but he's got to capitalize on it quickly while the fad is still hot.

Sam fills an order for 2,000 hats from Surf's Up and gives the shop 60 days to pay. In the meantime, he gets another order for 5,000 caps from Barney's Barnacle. While Sam badly wants to fill the order, he hasn't been paid yet for the caps he sold to Surf's Up. Without the money to buy more materials and labor he's stuck on a bad wave without a board. Sam's choices are to either borrow the money, lose the order or factor. Fortunately for him, factoring is the perfect answer to his problem.

If Sam is a small, startup company without any assets, he probably won't be able to receive a loan. This is just as well because most likely it wouldn't come in time to help him. Losing sales opportunities is no way to expand a business, and Sam is too good an entrepreneur to let money go without a fight. So Sam decides to factor his invoices.

Sam has been receiving mail from a factoring broker named Fred. Although he isn't sure exactly what factoring is, he saved Fred's letter because the idea of factoring intrigued him. Now Sam calls Fred, who takes some preliminary information over the phone. Fred comes to Sam's office and fills out a client profile on Sam's business. He gets information on Surf's Up and any other customers that Sam is interested in factoring so that he can run a credit check. After determining that Surf's Up is a creditworthy business, Fred contacts a factor who, after further research into Sam's business and Surf's Up, agrees to purchase Surf's Up's invoice. The factor sets out a deal in the following manner:

- 4 points discount if Surf's Up pays in 30 days
- 1 point for every 10 additional days it takes Surf's Up to pay
- 70 percent advance

This means that on a $10,000 invoice, Sam gets 70 percent as an advance, or $7,000. The other $3,000 is held in reserve. If Surf's Up pays within the first 30 days, the factor will charge $400 (4 points). The remainder of the reserve account, $2,600, will be rebated to Sam once the transaction is completed and the factor has received payment from Surf's Up. The broker's fee on this type of deal is usually between 5 percent and 15 percent of the factor's fee.

One of the real benefits of factoring is that once Sam has an account set up with the factor, the funds for his invoices can be advanced to him within 24 to 48 hours. Factoring his invoice from Surf's Up did cost Sam $400, but he was able to use the advanced funds to fill the order from Barney's Barnacle and make another $20,000!

Of course, it would be very unusual for a business to factor a single invoice as described in the previous example. Most businesses will decide upon a certain amount of cash they need each month, and then factor an equal amount of invoices. This requires multiple credit checks and more due diligence on the part of the factor. But once a client like Sam enters into a factoring agreement with a broker and a factor, that client becomes a steady stream of income for the life of the agreement.

The Different Types of Factoring

As stated earlier, factors receive a percentage of the face amount of the invoices as a fee for their services. That percentage is determined by the quality, quantity and average turnover of the accounts. Part of the percentage also is determined by the risk that the factor is asked to take. The potential factoring client must decide whether it wants credit protection from the factor or not. This is a choice between nonrecourse or recourse factoring.

Nonrecourse Factoring

Nonrecourse means that if the client's customer does not pay the factor within a specified period of time, the client is not responsible for indemnifying the factor. An exception to the factor assuming this risk, however, occurs when the debtor doesn't pay because of defective goods or services.

Before a factor purchases invoices from a client, he:

- Will have completed the required due diligence. That means approving the client as well as viewing and approving the creditworthiness of the client's customers under the invoices.
- May charge the client a small upfront application fee.
- May set a limit for each customer beyond which the client may not extend credit.

As long as the value of goods and/or services supplied by the client to the customer does not exceed that limit, the factor will usually approve the debt, purchase the invoices and protect the client against any loss from the customer's inability to pay. As stated earlier, the factor will be entitled to full recourse against the client if the customer fails to pay for any other reason. An example of this might be a case where there's a dispute over the quality of the goods or services or the quantity ordered and delivered.

You can best relate to nonrecourse factoring by thinking about your credit cards. Let's say you buy furniture and you charge it on your MasterCard. The furniture store is actually selling the receivable, created by your purchase, to MasterCard at a discount. You will pay your bill to MasterCard, who has already paid a percentage of the face amount of the invoice to the furniture store.

If you can't pay MasterCard, the furniture store isn't out anything at all. At that point it's up to MasterCard to pursue collection of your debt. Therefore, the prime concern of MasterCard (the factor) is your (the customer's) ability to pay, not the financial ability of the store.

Nonrecourse factoring is the fastest-growing type of factoring. As you would expect, it is more expensive to the client than recourse factoring.

Recourse Factoring

With recourse factoring, if a customer doesn't pay an invoice within a certain time frame, no matter what the reason, the factor has the right to go back to its client for payment. The factor gives no protection to the client against a customer's failure to pay sums outstanding. The credit risk remains with the client. If the factor has advanced monies against the invoice or invoices, the factor is entitled to demand to be paid by the client.

With recourse factoring, the factor is concerned not only with the customer's status, but with that of the client as well. Because of the factor's reduced risk of loss, recourse factoring is less expensive for the client, costing from 4 percent to 8 percent of the face value of the invoices.

The Hybrid

Risk-sharing factoring combines nonrecourse and recourse factoring. In that situation, the factor agrees to nonrecourse up to a preset limit for a particular customer. The client, however, is allowed to exceed that credit limit with the customer as long as the client is willing to take the risk of default on the balance above the limit.

Chapter Four — A Future for You in Factoring

Where Factoring Is Going

The factoring we know today was born in the garment district of New York. It didn't take long for the factor to reach beyond the textile industry and add such services as bookkeeping, collection and financial consulting. Today, factoring is spilling over into new industries and creating innovative ways of assisting entrepreneurs. The industry also is building new opportunities for generating additional wealth.

As a constantly evolving industry, the business of factoring not only keeps up with the marketplace, but actively assists its growth. When mass-production methods made it possible to flood the marketplace with goods, installment sales were created to increase sales on larger items. This development made it possible for consumers to buy a product and pay for it while they enjoyed its use. Just as quickly, factors jumped on this lucrative bandwagon. They began advancing cash to clients against installment sale contracts for automobiles, appliances and a host of other goods.

Today, factors continue to expand into numerous new markets, from manufacturing to industrial to commercial. Factors are involved with companies making everything from sporting goods, plastics and building materials to toys, accessories and communications equipment. You name it, a factor is involved in it.

The current trend toward international trade will create an even greater demand for factoring, at home and abroad. Increasing worldwide demand will eventually mean more companies producing more goods to satisfy an ever-increasing demand. Whenever countries develop their industrial sector, no matter where they are, the need for factors and their services escalates.

Factors Meet Needs

By playing a significant role in the expansion of many small and medium-sized companies, factoring will continue to make an important contribution to the growth of American business. In this role, the factor has two advantages over other financial service companies — the ability to provide personal service and a loyal customer base.

Personal Service. Whether alone or with a small professional staff, a factor maintains constant contact with his client and with the client's customers. This arrangement promotes and maintains a sense of goodwill far superior to normal seller/client relationships. The ever-expanding network of brokers enables a factor to provide that personalized service virtually anywhere his clients do business.

Advantages of Factors Over Other Financial Service Companies

- Personal Service
- Loyal Customers

Customer Base. Once clients come into the factoring market, the personal service and ease of the relationship keep them there. In many instances, there simply is no better source of working capital for those companies with suitable sales ledgers. The stable and loyal customer base gives the factoring industry a platform to launch into new areas of growth.

It's true that national and state-chartered banks are entering into factoring. On paper, banks have a built-in advantage because of their great access to new business, but they usually lack the training and experience of traditional factors. More importantly, factors have the flexibility to make quick decisions and act on those decisions without delay. Traditional banks and financial bureaucracies are simply unable to compete. I fully expect far greater demand for factoring as a clearly superior alternative to traditional financing in both good times and bad.

Chapter Five — How You Can Prosper in the Factoring Business — Brokering vs. Factoring

As you have probably noticed, factoring offers significant advantages over other businesses. Whether you work as a broker or a factor, there is little overhead involved in starting your business. Both brokering and factoring offer you the opportunity to work out of your home. The main difference between the two is that a factor must have a ready pool of cash to factor a deal. A broker needs nothing to get started but good training and the commitment to hard work.

Brokering = Flexibility

As mentioned earlier, brokers are the people who connect clients with factors. In many ways, the broker's job is much simpler than the factor's. Brokering doesn't involve significant startup costs, financial risk, collections or much paperwork. As a broker, once you ensure that the client's package is in order, including a complete application and invoices in proper form, and it is received by the factor, much of your work is done.

What brokers concentrate most of their efforts on is screening potential clients. By either speaking on the phone or visiting a business, you will qualify a potential client in advance to make sure factoring is right for them and they are right for factoring. If all checks out and the client does enter into a factoring relationship, you receive a commission. Commission is usually paid on a monthly basis after the factor receives payment on the factored invoices.

As I stated, the risks involved for brokers are small. The due diligence that factors complete is extensive and does a good job of reducing the likelihood of nonpayment. Through hard work, vision and persistence, brokering can provide any entrepreneur with an opportunity to reach whatever professional goal they set for themselves.

Factoring: Higher Risks, Higher Rewards

Working as a factor involves significantly higher financial rewards than brokering, but it also has higher risk. Factors who don't complete their due diligence on a conscientious basis invite serious problems. Taking care of those problems before they occur requires legwork.

As part of their due diligence, factors must regularly check the receivers of the potential client's invoices. The company must be verified as legitimate before the transaction can be closed. Many factoring companies request a letter of acceptance from the customer to have written proof of receipt of the goods.

Factors also must know something of bankruptcy laws, setoff, liens and any other possible conflicts that can arise over goods and materials. Knowledge of these areas, combined with the use of well-prepared forms and contracts, can often prevent potential problems.

Another way to avoid potential problems is to not purchase invoices that have already been mailed to the client's customers. While large factors often do purchase these invoices, it's best for the small factor to avoid them because of the risks associated with not notifying the customer up front that the invoice belongs to you. When the client is paid directly, the check must be sent to the factor, but this can cause unnecessary delays, complications and possible fraud.

Accounts are paid at the end of the month. Factors calculate how much of the reserve account is due to the client and how much commission is due to any participating broker. Payment then follows, usually between the fifth and 10th of the following month. If you choose to be a factor you can use your money to purchase new invoices at least every 60 days, six times a year. In addition, you also get to use the money from reserve accounts, which further boosts your earnings.

Being a Factor Is Like Any Other Business

As in any other industry, becoming a factor means covering the startup costs of your new business. Possible sources could be family or arranging a revolving line of credit with a bank, using the purchased accounts receivable as collateral. Ironically, factoring companies often find it easier to obtain credit on accounts receivable than do the clients who sold the invoices.

If you plan to operate as a factor from the start, it's a good idea to maintain 20 percent to 30 percent of your available cash as a cushion, using the other 70 percent to 80 percent for factoring. If you don't have the funds to invest in the business and have little borrowing power, it would be best to begin doing business as a broker until your financial position improves. That's a perfectly good way to enter the world of factoring — learn the ropes and then progress to the next level with the added advantage of experience and a ready pool of earned cash.

Chapter Six — Financial Transactions Require Numbers

Whether you are a broker or a factor, factoring offers the kind of returns that few, if any, businesses can match. To fully understand why everyone is excited about this business, you need to take a closer look at the numbers yourself. Numerically speaking, factoring is really simple. If you've ever taken a high school math class, the calculations in factoring will be a piece of cake for you.

So far in this book, we haven't played with many figures. We've just said that a factor buys invoices for a fraction of their face value. That fraction is based on the various risks taken by the factor and the amount of time until the invoice is paid. There's no doubt that the factor is making a good return. The question is how much and how it is determined. As you review these basic economic concepts you will see how profits are generated in the factoring industry.

There are two terms you need to understand before we go any further:

Discount — the amount of the invoice that the factor keeps as a fee for his factoring service. A typical discount is in the range of 3 percent to 6 percent per month outstanding on most invoices. For customers who factor a large amount of invoices, the percentage of discount may be less.

Rate of Return — the percentage of the original investment the investor will receive for the use of his money. For example, a $1,000 investment with a 10 percent annual rate of return will yield $100 for one year.

Returns for the Factor

The basic concept of investing is using your money to make more money. Most people think of this as saving money in some sort of interest-bearing account or buying a financial instrument such as a stock, bond or other security. When a factor "invests" his money in invoices, he is buying the assets of another company. When he does this, he receives a rate of return far superior to that of a traditional investment vehicle. Let's look at an example.

Suppose you had $100,000 to invest. Let's say you put that money into some type of security, say a corporate bond, that paid 10 percent as an annual rate of return. If you let that money sit for a year, at the end of the year, you would have $110,000. That is a profit of $10,000 and a good rate of return.

Now let's take the position of a factor with a client that is factoring $100,000 per month of their receivables. Let's assume the invoices pay off in 30 days and you are charging them a 5 percent fee for your factoring service. If you factor this account for one year, you will have $160,000 at the end of the year. That shows a $60,000 profit and an even better rate of return.

Now that you have seen the figures for one year, take a look at what these different rates of return mean on a long-term basis. In the following example, we have $100,000 invested in a security instrument that pays 10% annually and we let the earnings compound over the five-year period. In other words, we leave our profit in the account every year to continue earning interest. We also have a factoring account doing $100,000 per month in volume and not compounding every year, which means we are taking the profits out every year and not reinvesting them.

Year	Traditional Investment (10%)	Factoring
1	$100,000	$160,000
2	$121,000	$220,000
3	$133,100	$280,000
4	$146,410	$340,000
5	$151,051	$400,000

Obviously, a factoring transaction requires overhead expenses not required with a traditional type of investment. However, these numbers still graphically illustrate the huge potential for making a profit in the factoring business. Just imagine what those figures look like on a 10-, 15- and even 20-year basis.

Returns for the Client

As you can see from the previous section, factoring can provide a tremendous return for a factor. Now let's see how the factor's clients also benefit from factoring.

Company XYZ has been in business for three years and has sales in the range of $1 million per year. They have just been given the opportunity to expand into a new marketplace and they need a large amount of capital to make this expansion successful. Moving into this new market would double their annual sales volume.

Unfortunately, XYZ's bank says that they have reached their credit limit and cannot get another loan. The factor has offered to buy their invoices for a flat fee of 5 percent. XYZ company wants to factor their accounts receivable but they are not sure about the cost of factoring.

For $1 million of sales, the company spends 10 percent of that for the raw materials to produce the goods. Their fixed operating costs are $150,000 and their variable operating costs are 20 percent of sales.

As a factor, you show them their sample balance sheets with and without factoring.

	Without Factoring	With Factoring
Sales	$1,000,000	$2,000,000
Cost of Goods Sold (10%)	100,000	200,000
Fixed Costs	150,000	150,000
Variable Costs	200,000	400,000
Factoring Fee	0	100,000
Net Profit	$550,000	$1,150,000

While this is a very simplistic view of corporate financial operations, it is a perfect example of how factoring can greatly increase a company's capability for expansion and profitability.

Returns for the Broker

Brokering can provide any entrepreneur with the opportunity to reach whatever professional or financial goals they set for themselves. There is a great potential in brokering accounts receivable.

The financial risks involved for brokers are small. The business requires minimal startup costs and little overhead. The due diligence that factors complete is extensive and does a good job of reducing the likelihood of nonpayment.

A broker's commission is usually paid on a monthly basis after the factor receives payment on the factored invoices. Some factoring companies pay a commission on the face amount of the invoices collected, ranging from 0.5 percent to 1 percent. Others pay a percentage of their fee, usually from 5 percent to 10 percent.

As a broker, the only time you wouldn't receive a commission is if the factor isn't paid and the reserve account isn't sufficient to obtain payment, or the factor has no right to payment under the factoring agreement. However, if the client's reserve can be charged, you would still receive payment even if the client didn't pay the factor.

Chapter Seven — Good Marketing = Success

The success of your factoring business hinges on one little word: marketing. The single most important thing you can do to create success is to let people know what you do.

In the factoring business, marketing very nearly equates to educating. Most businessmen have never heard of factoring, so there is a definite curiosity value in just mentioning what you do. Use this to your advantage. Talk about factoring to everyone you know and take their blank stare as an invitation to explain what factoring can do for them.

Good Prospects

First, we need to identify whom you want to market to. Good prospects for a factoring broker are any business that provides goods or services to another business. Prime client candidates are small to medium-sized companies who are:

- growth-oriented
- looking to expand
- lacking adequate bank funding
- having trouble making payroll
- having tax problems
- in need of additional working capital
- working through a bankruptcy
- lacking a net worth
- just plain young

The only types of businesses that do not make good candidates for factoring are cash-and-carry outlets such as grocery stores. Excellent prospects can be found in the manufacturing, printing, temporary help, medical, construction, telephone or cable, textile and sporting goods industries.

Marketing Strategies

There are many marketing strategies that can work for you. A good rule of thumb to follow is to play to your strength. If you hate speaking in public, direct mail may work better for you. If you dislike paperwork, get out and network in person. Formal advertising is a great tool, but it's got to be backed up with plenty of word-of-mouth, lots of phone calls and volumes of letters to prospective customers. Marketing strategies you may consider include:

Professional Networking. The best way to locate factoring clients is by building a network of professionals who encounter businesses that fall into the categories of prime factoring candidates. Groups of professionals you might want to cultivate include bankers, CPAs and purchasing agents.

Bankers are in an ideal position to refer business to factors. Most businesses that factor have already been turned down for a bank loan. There is no competition involved because banks do not have factoring divisions for small and medium-sized companies. CPAs have firsthand information that enables them to know which of their clients are most likely to need your services. And purchasing agents can locate excellent leads for you — especially agents of cities, school boards, counties, and state and federal government offices. Those government contracts are where the money is!

Don't be afraid to pay referral fees to those who generate leads for you, at least when it is ethical. In the long run, it is more than worth the cost.

When approaching another professional about factoring, never assume that he understands factoring concepts well. One good way to educate without offending is to preface your remarks with, "As I'm sure you already know…"

Yellow Pages. This is a good place to advertise your services. Check your local directory. You can place your ad under "Factors" or "Commercial Finance." In a big city, your ad will be next to your competitors'. Make sure that yours stands out with a stronger message and clearer presentation. In a small city, the only other factor listings may be 800 numbers, which gives you the distinct advantage of being the only local provider of your services. Make sure you point that out in your ad.

Business or Trade Journals. There are several advantages to advertising in these papers rather than your local daily. First of all, you can target your message to a distinct market — one in which you may have specific expertise. Second, the cost is much lower than purchasing ad space in a daily newspaper.

Business Cards. This is the least expensive and most effective advertisement you have if you use it well. Avoid the mistake of cards that look fancy or are printed on dayglow orange stock. A business card should protect the image of a professional and instantly deliver the message of what you do for a living. Once you have your cards, use them! Hand them out freely at social functions; leave them in restaurants and on bulletin boards. The more people who know what you do, the more business you will ultimately have.

Group Meetings. Every community has weekly meetings of the Rotary Club, Lions Club, Jaycees, etc. Here is an ideal opportunity to get your message across to more than one person at a time. You will have a captive audience of businesspeople who are interested in what you have to say. And you'll probably be the first factoring broker who has ever been presented to these people.

Program chairpersons of these organizations struggle to come up with speakers every week. They will be more than happy to put you on the speaker schedule once they learn that you have something of unique interest to present to their membership.

Public Relations. PR is a much more cost-effective marketing tool than advertising, simply because it has few hard costs associated with it. You don't need to hire a PR firm to get your message out to your public. A little common sense and a good working knowledge of the English language are all that you need.

Try booking yourself on TV and radio talk shows as a guest. Producers are constantly looking for interesting guests and topics. Send a press release to your local newspaper, announcing the fact that you've opened a business. Keep it short and to-the-point, and describe what factoring is and how it works. Volunteer to write a small-business column for a local community weekly.

Direct Mail. Establish lists by looking through the yellow pages or purchase lists from a direct mail shop. Lists become more effective if you target them to focus on the market you want to reach. You can target your lists geographically (businesses within a 50-mile radius from your home) or by industry (medical, manufacturing, etc.)

The secret to a successful direct mail campaign is to be noticed. Experiment with post card mailings; letters; invitation-sized, handwritten notes — anything that will distinguish you from the rest of the mail your prospects receive each day. Put together a plan of action for your mailings with a series of four to six pieces to be sent to each group of names over a predetermined time period. Each time you mail, you'll see an increase in your response because you have become more familiar.

Telephone. Many people have a subconscious fear of using the phone and dislike the idea of picking up the phone to make a contact call. But used effectively, the phone can be your most valuable marketing tool. Again, depending on your preference, you can make cold calls directly from the phone book, or target your phone campaign by obtaining lists from office building directories, industrial parks, etc.

Remember, no matter what method or combination of methods you choose, the goal is to get your message across. Identify your market and then inform them. It's an ongoing process that will never stop in a successful business.

Chapter Eight — Why Factoring Is Easy to Sell

Obtaining credit in general, and business credit in particular, has become increasingly complicated and difficult. In fact, for many businesses, it has become downright impossible. Lending standards and requirements are now more stringent than ever and personal guarantees are almost always required. Traditional lending sources are often unable or unwilling to provide all of the financial assistance needed by a business. That's where factoring comes in. Factoring can sometimes solve problems for a business that has nowhere else to turn.

To find out if factoring can help a prospective client, ask these three simple questions:

1. Do you have a profitable business that is sometimes short of cash?
2. Could better cash flow help you take advantage of discounts or generate more sales?
3. Is your business growing, or could it grow with improved cash flow?

If your prospects answer "yes" to any of these questions, and he or she probably will, then factoring can help.

Relief

Factoring can provide much-needed relief by increasing a business' cash flow. In that way, the business receives funds that can increase sales and profits, pay bills, or buy needed inventory and supplies. Factoring can sometimes mean the difference between shutting the doors or remaining open for business. Using factoring can increase production and sales to the greatest extent possible without increasing overhead, so factoring can actually increase the profit margin for a business.

Alternative Financing

The smaller the business is and the less time it has been in operation, the more difficult it is to obtain a loan. Many small and medium-sized businesses have no hope of obtaining credit even though they have a promising future and are dealing with creditworthy customers. Factoring is an alternative source of cash which allows these companies to stay in business, increase sales and, consequently, increase profits. As a factoring broker, you are not interested in the client's credit. It is the customer's credit that counts. So no matter how long a business has been around, if their customers have good credit, you can factor them.

Factoring vs. Bank Financing

Traditional financing can provide money for expansion of a business. However, a bank's limitations can make it unsuitable for the needs of a business that is growing rapidly because at some point the banker will deny the request for a higher credit limit. Banks qualify clients for loans based on the assets and credit history of the business. Factors, on the other hand, qualify clients based on their current sales and the ability of their customers to pay.

In addition, bank loans are normally short-term and become payable in less than a year. Each time the business needs an extension, it must go through the original loan procedure again. With factoring, a business can factor any amount it chooses — all of its invoices or a portion of them. And the business can increase the amount of cash it receives by simply factoring more invoices. It is easier to adjust the cash flow of a rapidly growing company through factoring as opposed to traditional bank financing. Factoring is flexible and immediate.

Factoring requires no collateral, lien or security interest. That is why it is so attractive to new businesses. New businesses usually can't meet the loan requirements set by banks simply because they are new businesses. Factors can help new businesses because factoring is not a loan. It is the selling of invoices. A business does not incur debt by factoring — it is selling its invoices at a discount in exchange for cash. Additionally, factoring requires no penalties or lump sum payments to terminate the factoring relationship. That is the opposite of most other forms of financing.

Factors vs. Banks

- Banks qualify clients for loans based on the assets and credit history of the business. Factors, on the other hand, qualify clients based on their current sales and the ability of their customers to pay.
- Bank loans are normally short-term.
- With factoring, a business can factor any amount it chooses.
- It is easier to adjust the cash flow of a rapidly growing company through factoring as opposed to traditional bank financing.
- Factoring is flexible and immediate.
- Factoring requires no collateral, lien or security interest.
- A business does not incur debt by factoring.
- Factoring requires no penalties or lump sum payments to terminate the factoring relationship.

Factoring vs. Venture Capital

Another way to infuse a business with cash is to locate venture capital. A venture capitalist puts money into a business and receives a percentage of the business in return. So along with that capital comes partial control: The business is now subject to the wishes and whims of an additional owner who will receive a portion of the profits. Some companies might find such investment to be a desirable alternative, but most would gladly turn to factoring rather than take on a partner. With factoring, the business receives the cash it needs to continue growing without giving up a share of the business and its profits to an outsider.

Benefits of Factoring

- Elimination of bad debt
- Invoice processing
- Meet increasing demand
- Take advantage of early payment discounts
- Take advantage of volume discounts
- Stop offering early payment discounts to customers
- No loss of equity
- Don't incur any debt
- Factoring helps clients build credit

- Factoring is easy and fast
- Leverage off your customers' credit
- No personal guarantees
- Detailed management reports
- Invoices are paid faster
- Concentrate on marketing and expanding the business
- No geographical limits
- Early detection of customer service problems
- Credit screening
- Credit monitoring

Selling Advantages

Factoring can be a valuable tool for expanding businesses. It can provide more cash than may be available from other sources. It furnishes a continuous cash flow without the requirement of periodic payments or interim payoffs. Factoring offers increased access to cash as receivables increase, cuts down on the red tape and paperwork required by traditional financing, and is more flexible. All without requiring that a business owner lose any equity in his business.

Still, some business owners may have reservations about factoring. Prospects who are unfamiliar with factoring tend to compare its cost with the cost of a bank loan. In doing so, they are considering only one of the benefits of factoring — the "use of money." A more realistic assessment of factoring can only be made after analyzing the "true cost." In order to measure the true cost of factoring for a particular client, we must look at all the benefits of factoring and how they can impact a business.

Elimination of Bad Debt. A nonrecourse factor will assume the risk of bad debt, thus eliminating this expense for the client's income statement.

Professional collections. A good factor will handle collections more professionally and productively than the client.

Invoice processing. Factors handle much of the work associated with processing invoices, including mailing, posting invoices, depositing checks, entering payments and producing regular reports. A client can greatly reduce his current overhead costs by having a factor handle this aspect of his business.

Offer credit terms to customers. With factoring, the client can offer credit terms to his customers without negatively impacting his cash flow. The client can expand his business by making it easier for his customers to buy from him.

Meet increasing demand. Factoring is the only source of financing that grows with the client's sales. As sales increase, more money becomes immediately available to the client. This allows him to constantly meet increasing demand.

Take advantage of early payment discounts. Factoring may allow clients to take advantage of early payment terms offered by their suppliers. If a client can save 2 percent of his raw materials cost because he has the cash to pay the bills within 10 days, this can significantly reduce the true cost of factoring.

Take advantage of volume discounts. If clients can buy in greater volume from suppliers because of improved cash flow, they will likely save even more money, another positive impact on the bottom line.

Stop offering early payment discounts to customers. Many companies offer discounts to customers as incentive to pay the invoices early. Since companies that factor receive their money immediately, they can consider eliminating early payment discounts to their customers. Factoring will save the client every dollar in discounts his customers were taking.

No loss of equity. Clients do not give up any equity in the company, as is usually required with venture capital, or take on any partners with factoring.

Don't incur any debt. Factoring is not a loan, and therefore the client is not incurring any debt. This keeps his balance sheet looking clean, thereby making it easier for him to obtain other types of financing or to ultimately sell his company.

Factoring helps clients build credit. Once clients begin factoring and they have adequate cash flow, they can begin to pay their bills on time and start establishing or improving their credit. This improves their chances of getting credit terms from suppliers and improves their ability to get conventional financing in the future.

Factoring is easy and fast. The application required to establish a factoring relationship is much simpler than any other form of financing. Clients are not required to turn over tax returns, personal financial statements, business plans, projections, etc. Financing usually occurs within a week or so of receipt of contracts. How many banks do you know that can operate that quickly?

Leverage off your customers' credit. A company does not need to be creditworthy to factor. They don't need to be profitable or in business for at least three years, or meet any of the other assorted credit criteria required by banks and other commercial lenders. A company that has creditworthy customers can get financing through a factor.

No personal guarantees. The principals of the company do not have to personally guarantee the repayment of the funding. They usually have to guarantee against fraud or disputes, but not against customers' ability to pay. Banks, on the other hand, not only require personal guarantees, they may also require liens on personal assets such as residences.

Detailed management reports. The factor provides detailed management reports to its clients, which enable them to better run their business and manage their cash flow.

Invoices are paid faster. Many people don't realize that some debtors pay factored invoices faster than nonfactored invoices. The reason is that factors generally report payment experiences to Dun & Bradstreet or other credit agencies while the clients tend to be more lax about this procedure. A debtor who is aware of this knows that he may impair his credit rating by paying a factor slowly.

Concentrate on marketing and expanding the business. The business owner often spends more than half his time on collections, administration, bookkeeping, fending off suppliers, searching for capital, etc. Factoring frees him up to concentrate on marketing, sales and expanding his business.

No geographical limits. A factor can work with a client in any part of the country and that client can have customers spread out all over the world.

Early detection of customer service problems. This benefit is not widely recognized but is very important. Because factors verify invoices with customers, they discover customer service problems much more quickly than a client would on his own. A nonfactoring client is not likely to find out about a customer service problem until the invoice goes unpaid and is past due. At this time, it may be too late to salvage the account and the client has probably lost a customer.

Credit screening. A factor will provide credit information on new customers for a client, which enables him to make better credit decisions.

Credit monitoring. A factor provides ongoing credit monitoring of existing customers to make sure there is no significant diminution in their credit status.

Addressing Client Concerns

Even once all the benefits of factoring are known, some clients may feel concern that their customers will think they are in financial trouble when they discover that they will now be paying a third party. One way around this is to compare the factor/customer relationship to that of a mortgage company/homeowner. Most everyone is familiar with the way mortgages are bought and sold. It does not affect the homeowner when a mortgage is sold — the homeowner simply sends his check to someone else. Factoring can be presented in much the same manner, with no negative connotations. And in any event, it should also be noted that the largest companies in America routinely factor, because it's just plain smart.

Some clients may worry about how factoring will affect their company's financial statement. The truth is that factoring will improve the company's current ratio. The payable shown on the financial statement will be smaller because a source of money has been made available to pay debts as they mature. With that increased cash, trade liabilities will be lower too. There are no special tax considerations to factoring and a client's loans are not affected except that the collateral available for new loans is reduced by the amount of receivables sold.

Selling Your Services as a Broker

What if a client asks why they should work through you, a broker? Why not go directly to a large factoring company?

The biggest advantage to using a professional factoring broker is service. The kind of personalized service you can provide gives you the decisive edge and can be the reason for your future success. You can accommodate a client by making decisions on the spot. You can provide funding within a short time once a client is signed up.

Another advantage is your flexibility. Large factoring firms operate under rules, just as any corporation must. You have the freedom to bend or break your rules and to make up new rules as you go. As a result, you may be able to assist clients in unconventional ways.

Your status as a free agent means that you can review the various factoring companies and choose the one that can best meet your client's needs. Your proximity to the client means that you can physically be there to assist with the approval process and you can personally monitor the first few transactions to be sure that things run smoothly.

Once a client is sold on the benefits of factoring, it should be simple to sell that client on the benefits of factoring with you. If you believe in yourself and the services you offer, you will present yourself in a positive, professional manner that inspires confidence.

Chapter Nine — Client Evaluation

After your first contact with a prospect, you will most likely meet face to face to discuss whether the prospect should continue with the factoring process. During this important meeting, it is important to gather the right kind of information to make informed decisions from this point on.

There is nothing as beneficial as meeting the prospective client in his place of business. This allows you to get a personal feel for the business and its possibilities as your factoring client. Your mission during this meeting is to collect the type of information a factor would want to know to evaluate the client. This meeting will allow you to gather the first wave of information that a factor will need.

General questions you might want to ask include:

- *the size of the company and how long it has been in business*
- *the name of the company, its principals and any home offices it might report to*
- *the number of customers it has as well as the number and dollar amount of invoices it generates*
- *whether the company needs working capital, bad debt coverage and/or administrative help.*

It is important to listen well to the answers the client gives. The more you know about the client, the better you can sell your services. During this stage you may ask the client to sign a client agreement. This ensures that once the client makes the decision to pursue factoring, he must do so with you — not directly with the factor and not with another broker.

Another reason to carefully observe and listen at this point is so that you can sell this client to a factor. The more you know about the prospect, the better you can present it to a factor. If a prospect is interested after this meeting, your next step is to submit the information to a factor who will evaluate the client and make an offer on a deal.

Chapter Ten — Choosing a Factor and Completing the Application

There are hundreds of factors to whom you may broker clients. When considering any factor, you need to gather as much information as possible. Some factors specialize in certain types of clients. Others have minimum and maximum monthly limits that they will work with. When choosing a factor, you need to be sure that the services they offer meet your client's needs. As a broker, you also need to understand the factor's commission structure. Once your prospect is accepted by a factor, the bulk of your work is done. However, for as long as the relationship between the client and the factor lasts, you will continue to receive commissions. And you should work at maintaining the relationship with your client to ensure that they continue to realize the value of your brokering services.

The following are some of the types of questions you should ask factors:

Broker Commissions. How are brokerage commissions calculated and when are they paid? Does the factor have a standard broker agreement that they use? Most factors who pay brokerage fees will pay a broker 0.5 percent to 1 percent of the face value of invoices factored or 5 percent to 15 percent of their factoring fee. However, factoring fees vary widely and change rapidly. With most factors, your commission as a broker will come from the factor's charge to the client. (With some, however, you must add your commission to the fee charged by the factor, which means that the client is actually paying your fee.)

Client Requirements. Each factoring company has set requirements when considering clients. You should obtain a list of these requirements from each factor you are considering. Some large factors have been in business for years and handle more than $400 million annually. They can easily handle most any dollar volume of business that a prospect might have. Smaller factors may want only clients with annual sales to be factored between $75,000 and $250,000. Some factors work only with clients in a particular industry such as manufacturing or medical.

Factoring Arrangements. Does the factor offer recourse, nonrecourse or both?

Factoring Rates. What are the factor's charges for recourse and nonrecourse factoring? Are these rates firm or negotiable? A factor should be able to give you a range of fees and explain the variables that will affect their final fee decision.

Advances. What percentage of the face amount of invoices does the factor advance with recourse and nonrecourse factoring? Again, the factor should be able to give you a range and explain the variables.

Customer Credit Limit. Does the factor normally impose a limit on sales to the client's customers? If so, will there be any additional cost to the client for obtaining the factor's permission to go beyond that limit?

Response Time. How long does it take the factor to process an application? Once a client is approved and invoices are submitted, how long will it take the factor to process the invoices and remit the client's advance? Time may be the single most important variable to your client. Generally, clients who need to factor need the cash ASAP.

Age of Invoices Preferred. Will the factor purchase invoices that have already been mailed to the client's customers?

Application Fee. Does the factor charge an upfront fee for processing a prospect's application? If so, how much is the fee, and will it be applied to the client's account once accepted?

Ask Factors about:

- Broker Commissions
- Client Requirements
- Factoring Arrangements
- Factoring Rates
- Advances
- Customer Credit Limit
- Response Time
- Age of Invoices Preferred
- Application Fee

Completing the Application

Every factor has an application package which must be completed by the prospective client. Here is where you can make your brokering services indispensable. The more you understand about your client's business, the better able you are to assist in the application process. Each and every item of information requested by the factor must be complete and accurate or approval will be delayed. A good broker will make sure that his client's applications are completely filled out to specifications. In addition to completing the application, a client may be required to submit a small upfront fee for processing and provide specific documents such as a current financial statement, an aging of current customers and a customer list showing current credit limits. A factor also may request the company's Articles of Incorporation and Bylaws, Partnership Agreement, Fictitious Name Filing and proof of insurance.

As the broker, you should monitor and assist, if necessary, with the collecting of information and the return of the application to the factor. You can help to ensure that your client does not slip through the cracks. Remember, your client is factoring because he needs money now. Delays in processing can make the factoring agreement less valuable to your client.

Chapter Eleven — Checking Out a Prospect

Although the research involved in checking out a client and a client's customers is the responsibility of the factor, as a broker you should understand the procedure so you can assist if called upon.

Once your client has submitted an application, the factor will review the information to determine:

1) the business's ability to be a profitable factoring client

2) the client's customers' ability to pay (credit record).

Checking Out the Client

During this time, the factor will be verifying that the prospect is in fact operating his business, that he is providing quality merchandise or services and that he has been operating long enough to determine that the business is viable. If the prospect is a corporation, the factor will check corporate records to verify the names and addresses of the officers, directors and registered agent, how long the corporation has been in business and that the corporation is active and in good standing.

If the prospect is a partnership, the factor will review the partnership agreement to see if there is a managing partner who is authorized to enter into a factoring relationship. In reviewing the prospect's Financial Statement and Accounts payable Aging, the factor can verify that the company pays its employees, its payroll taxes and its bills, and that the company is operating in a thoroughly professional manner.

The factor will check with the Department of State UCC Bureau or the county records department where the client has his business to see if any statements under the Uniform Commercial Code have been filed against your prospect and his assets. A UCC-1 filing would indicate that a prior lender has attached the client's account receivable as security for a loan. In this case, in order for receivables to be factored, the UCC-1 would have to be lifted.

At this point, you may wonder why it is necessary to be concerned with the client at all. After all, isn't it the client's customers we should be concerned with? Even if a client's customers are strong and pay on time, if the picture of a client's operations show that he doesn't pay his employees or his payroll taxes on time, that he owes large amounts of unpaid bills, that he experiences numerous returns or complaints, then you need to question whether his customers will remain customers for long. And without customers, there are no invoices for you to factor.

Checking Out the Client's Customers

From the aging report provided by your prospect, a factor can see the names of all your prospect's customers, including how your client's customers pay. This information is relevant to the actual pricing of the factoring relationship and the way in which the transaction between the factor and the client will be set up. Therefore, the aging report is good, solid information that, as a broker, you would want to obtain for the factor.

Especially in the case of nonrecourse factoring, a factor's main concern is whether the customer has a good credit payment history. Credit reports can be ordered from any one of many credit bureaus.

Following the review of all matters, if the factor decides to enter into an agreement with the client, you will most likely assist the client in the execution of the final documents.

Chapter Twelve — After the Deal Is Completed

After a factor approves a client, the broker goes into maintenance mode. Stay in touch with your clients on a regular basis, send a card or note periodically, take your clients to lunch. You want the factoring relationship to last a long time and close contact with your client will help.

Companies often continue to factor once they realize the difference the increased cash flow makes to their business. It becomes difficult to make do with less cash, and oftentimes, as the business grows, they will require more. Be poised to assist with adding new customer invoices whenever needed. This includes new credit checks and verification of payment history. The more the client factors, the more you get paid — as either the factor or broker!

Use your newfound familiarity with an industry to open doors with other clients in the same industry. Once you recognize the factoring potential in a particular industry, it is easier to present factoring to other businesses.

For example, the printing industry is notoriously rich with factoring opportunities. Printers need good cash flow to purchase supplies in large amounts, such as ink, paper and equipment. Printing customers are invoiced after receiving their product. The lapse between delivery and payment can make it difficult for printers to purchase the supplies needed for the next jobs. Factoring can be a lifesaver for printers who struggle to maintain inventory and have a high volume of business. Once you factor a printing business, you can approach other printers with confidence and a degree of understanding of the way their business operates. Your knowledge will create new clients in the same industry.

A happy factoring client is the best advertisement you can have. Clients usually offer referrals among their own industry or group of acquaintances once they see how beneficial factoring is to their own business. If you are good at what you do, the referrals will follow. A strong professional reputation is your biggest asset.

Chapter Thirteen — Your Business: Day One

Starting your home-based factoring business is a relatively simple task. When it comes right down to it, all you require is a space in which to work and access to a fax, copy machine, word processor or computer. There is very little overhead involved and the operating expenses are limited. Your most regular expenses besides office supplies will be postage and occasional overnight delivery charges. You need no employees to get started, which means no government reporting and no payroll. Startup costs are minimal. Factoring is an ideal home-based business.

The legalities of owning your own factoring business are simple as well. You can operate your business as a sole proprietor under your own name or a fictitious name. To operate under a fictitious name, you need to file an affidavit with your county recorder's office, run an advertisement in a local newspaper, or do whatever your state requires under its fictitious name statute. The only license you may need to obtain is an occupational license at the city or county level. There are no government regulatory agencies in the factoring business with whom you need to file. And sales tax does not have to be collected or paid on the purchase or brokering of accounts receivable.

So the physical aspects of starting your factoring business are a simple matter. The intellectual and emotional aspects may require more thought. If you are a self-motivated worker, if you have the ability and the desire to be your own boss, set your own hours, and organize and execute a successful marketing campaign, then factoring may be the perfect choice for you. If you enjoy helping businesses find creative solutions to challenges, you will find the factoring business a rewarding and enriching experience. And if you are committed to getting the proper training in the industry, you will have all the tools you need to be successful as a factor or factoring broker.

In a survey by the Private Companies Practice Section of the AICPA, small-business owners ranked uneven cash flow as their single greatest financial obstacle — an obstacle that factoring can help overcome. As a factoring broker, you hold the key that many small businesses need to unlock their full potential. The market for your factoring business is there — all you have to do is tap into it!

So what are you waiting for?

Chapter Fourteen — Getting Trained

This primer has provided you with the basic principles of the factoring industry. In carefully reading each chapter, you have touched on the fundamentals of virtually every aspect of this business. How you choose to use this knowledge is now entirely up to you. Hopefully, you will use the information covered throughout this book to determine what role you want to play in the factoring industry.

Unfortunately, I could not use this format to present all of the information needed to prepare you for self-employment in this field. I know that without being able to walk you through every necessary calculation and document, without having an opportunity to introduce you to key industry contacts and provide all the training that goes into certification in this field, you would just end up wasting a lot of time, spinning your wheels to get started.

Thorough training is available to help teach you the business, fill in the gaps, and fully explain the legal and marketing aspects that have only been touched on in this book. You can apply the basics taught in this book and build on them in training to become a factoring expert. Gaining professional training on how to run your own factoring business can be financially and personally rewarding.

The International Factoring Institute (IFI) leads the industry in training adults to become factoring brokers. In fact, some have estimated that IFI has trained approximately 80 percent of the trained factoring brokers in the country. If you are interested in becoming a Certified Factoring Specialist and gaining the tools necessary to excel in this industry, I encourage you to contact an IFI Student Counselor to receive more information on training in this exciting industry.

Good luck!

Glossary of Terms

Account: A compilation of all claims and invoices against a particular debtor for merchandise sold or for services rendered in the ordinary course of business.

Accounts Payable: Amounts owing on open account to creditors for goods and services.

Account Receivable: A claim against a debtor for merchandise sold or for services rendered in the ordinary course of business. The debt appears on the books of the seller as a receivable and on the books of the purchaser as a payable.

Accounts Receivable Aging: A schedule showing how long accounts receivable from each customer have been outstanding. It indicates the receivables that are not past due and the amounts past due by, for example, 30 days, 60 days and so forth.

Accounts Receivable Financing: Obtaining a loan by pledging accounts receivable to a bank or other lending institution as collateral security for the loan.

Accrual Accounting: Whereby income and expense items are recognized as they are earned or incurred even though they may not have been received or actually paid in cash. The opposite of cash basis accounting.

Articles of Incorporation: A document filed with a U.S. state by founders of a corporation. After approving the articles, the state issues a Certificate of Incorporation; the two documents become the Charter of Incorporation.

Authorized Signatory: The person who is empowered to execute and bind a document on behalf of a corporation, partnership or other entity.

Bill of Sale: A document used to transfer the title of certain goods from seller to buyer.

Broker: The individual, such as you, who finds a client in need of factoring and refers that client to a factor for a fee.

Cash Flow: Cash received in relation to cash paid out.

Confidential Factoring: This is a factoring arrangement whereby the client continues to receive payments from his customers and the fact that the invoices have been sold to the factor is not disclosed. The relationship between the factor and the client is not disclosed to the client's customers.

Factor: The entity that purchases accounts receivable from a client at a discount from the face value.

Maturity Factoring: Maturity factoring is generally a type of nonrecourse factoring. Maturity factoring is useful to companies with extensive and complicated sales ledgers. By factoring all of their invoices in this manner, these companies receive better management of their accounts receivable by the factor than they could provide for themselves. The factor takes an assignment of all of the client's book debts and administers the client's sales ledger. When monies are collected, they are sent to the client, less the factor's fee.

Nonrecourse Factoring: The factor assumes the risk of the debtor not being financially able to pay for goods or services provided. The factor does not, however, assume the credit risk where the debtor doesn't pay because of defective goods or services.

Recourse Factoring: With this type of factoring, if a customer doesn't pay an invoice within a certain period of time — no matter what the reason — the factor has the right to go back to its client for payment. The factor does not give any protection to the client against a customer's failure to pay sums outstanding. Although the invoice is assigned to the factor, the credit risk remains with the client. If for any reason the customer does not pay the factor, the debt will be reassigned to the client. If the factor has advanced monies against the invoices, the factor is entitled to demand to be repaid by the client.

"Risk Sharing" Factoring: A hybrid form of factoring which combines nonrecourse and recourse factoring is sometimes referred to as risk sharing factoring. In that situation, the factor agrees to nonrecourse up to a preset limit for a particular customer, but allows the client to exceed that credit limit with the customer as long as the client is willing to take the risk of default on the balance above the limit. This type of factoring occurs rarely but can be viable when coupled with two conditions: (1) reduced prepayments to the client and (2) an agreement whereby the factor retains the right to approve invoices on an individual basis.

UCC-2: A document commonly used in the state of California which is also filed with the secretary of state. The state of California does not have a UCC-3 document; it is called a UCC-2.

1098 Form: A form issued by either a financial institution, governmental unit, cooperative housing corporation or an individual. The 1098 form shows the amount of interest paid to that institution or individual during the calendar year. Any interest (including certain points) must be disclosed on the 1098 form if the interest amount paid totals at least $600. A good example of when a 1098 form is issued is when an individual who has a mortgage on his home pays at least $600 in mortgage interest to his lending institution.

Index