NICHES & ESSENTIAL PRODUCT AREAS

Expanding Your Horizons

Now that you understand the transactional basics of factoring, its time to learn a little about the many specialty *niche* areas of this unique form of commercial finance and also about four additional and important "core" product areas for brokers.

CORE PRODUCT AREAS

The majority of factors are what might be called "plain vanilla". They will look favorably at most standard factoring referrals which do not involve problems of mechanics liens, spoilage, or additional special paperwork that can elevate non-payment risk. They keep it as simple as possible and avoid industries and sectors they are not completely comfortable with.

SPECIALTY TRANSACTIONS

The occasional need to finance hard to fund, non-standard factoring transactions, however, will often attract a small group of very creative, entrepreneurial factors who learn to deal with the additional transactional risks and adversities present. In fact, such specialty factors may actually adjust their business models and marketing efforts towards that particular difficult industry or segment. These “niche” factors play an important industry role and brokers should become knowledgeable regarding their capabilities.

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So among the many industry areas brokers should understand inside and out is the area of niche factoring, or how factors deal with the unusual or exceptional risks associated with a particular industry. If contacted by a small business owner operating in such an industry and seeking your expertise, you will obviously need to have that knowledge at the ready and in your ammo belt.

Another reason to expand your horizons and explore factoring's many specialized areas is that some will offer brokers a significant marketing and operational advantage. In fact, gaining this special knowledge and focusing on a particular industry segment can provide you with a tremendous advantage over your competition. Specializing in construction receivables factoring, for example, can often provide well prepared brokers with such a powerful opportunity that it is literally the only sector where they need focus their marketing efforts.

SPECIALIZING IN CONSTRUCTION RECEIVABLES

In the balance of this chapter, you will be introduced to the most common areas referred to as "niche areas" by factors. Rest assured, there are probably more being created as you read this guide. In each niche area, we will also provide you with the reasons for the difficulty in financing such industries or transactions. Getting to know the following specialized and hard to finance industries will be very helpful to you when you begin marketing your business.

NICHE AREAS OF FACTORING

- **CONSTRUCTION RECEIVABLES**
- **STAFFING & TEMP SERVICES**
- **AGRICULTURAL RECEIVABLES**
- **FEDERAL / STATE GOVERNMENT RECEIVABLES**
- **REAL ESTATE COMMISSIONS**
- **FREIGHT BILL / TRUCKING**
- **THIRD PARTY MEDICAL RECEIVABLES**
- **DIP (DEBTOR-IN-POSSESSION) FINANCING**
- **SPOT FACTORING**
- **MICRO-FACTORING**
- **POULTRY AND MEAT PROCESSING RECEIVABLES**
- **INTERNATIONAL (CROSS-BORDER)**

NOTES

In addition to these specialized niche areas of factoring, we will also introduce you to four "must know" essential CORE product areas for all professional factoring brokers. These are:

ADDITIONALCORE PRODUCT AREAS

- **ASSET-BASED LENDING**
- **PURCHASE ORDER FINANCE**
- **MERCHANT CASH ADVANCE**
- **MICROLOANS**

PRE-SETTLEMENT LEGAL ADVANCES

As we previously mentioned, you may occasionally hear references to certain types of consumer financing transactions referred to as factoring. For example, the financing of true legal receivables, invoices payable by businesses to law firms for services rendered, is a commonly factored transaction. There are other specialized finance companies, however, that provide cash advances to plaintiff parties (individuals) involved in personal injury lawsuit claims. Such advances are strictly based on the merits of the case and the likelihood of an award being granted. These *pre-settlement legal advances* are often referred to as factoring transactions, yet they do not involve an invoice nor or they typically B2B in nature.

STRUCTURED SETTLEMENTS

INHERITANCE ADVANCES

Finance companies specializing in the purchase of the monthly income streams provided by *structured settlements* and annuities are said to "factor" those income streams. Here again, no invoice is involved and the advance is made to an individual and not a business. Even a future inheritance that is tied up in the probate court system can be factored or advanced upon at a discount (called an *inheritance advance*).

Well informed freelance brokers should probably be aware of such quasi-factoring products, even if they tend to stretch the boundaries of what is considered to be "true" factoring. They are a type of financing based on discounting, just like factoring, and whose providers are well known to pay attractive fees and commissions for referrals. Such consumer-based, specialized areas of finance are much smaller than the factoring and asset-based finance industries, but doing a little online research and including these products in your knowledge base may well provide you with an occasional opportunity to earn additional fee and commission income.

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FORFAITING & CROSS BORDER SALES

Additional Essential Product Areas

There are many types of business finance included under the heading of *Asset-Based Finance*. You have already been introduced to a very powerful type, that of accounts receivable factoring. There are many others used to finance small and mid-size businesses worldwide. Some, such as *equipment leasing*, you have probably heard of or may have even utilized. Others, such as *forfaiting*, a rather exotic method of financing large, cross-border sales in emerging markets, is unknown to all but a few industry experts.

Before getting totally immersed in factoring's many nook and cranny niche areas, we're going to introduce you to four important and essential CORE products you need to learn about before you ever open your doors as a broker. They are *asset-based lending, purchase order finance, merchant cash advances*, and *micro-lending.* Along with factoring, they make up the primary product areas all factoring brokers must have in their playbook to begin operation. For most freelance consultants, these five areas will account for virtually 100% of the commissions and fees earned year after year.

Asset-Based Lending

Asset-Based Lending is a well-practiced method of business finance and ready source of working capital which is typically used to:

- ⇒ **accelerate cash flow on accounts receivable**
- ⇒ **finance the manufacturing of goods for purchase orders**
- ⇒ **finance business inventory**
- ⇒ **acquire business assets**
- ⇒ **manage turnarounds**

Asset based loans are simply working capital loans secured by lien rights to a collateral, but should be distinguished from more traditional bank loans or what can be termed *financial statement loans*. Here’s the difference:

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- ***Financial Statement Loans:*** are loans which are based on the financial strength, creditworthiness, and balance sheet health of the borrower. They reflect on the borrower's calculated ability to repay the loan from normal operations and cash flow and are often the most difficult types of loans to obtain for young companies.
- ***Asset-Based Loans:*** are loans primarily based on the liquidation value of business assets. Such assets will include accounts receivable, inventory, and occasionally equipment. They are perceived as higher risk loans than financial statement loans but are easier to obtain for younger companies with a limited credit history.

HIGHER RISK FINANCING

So the real difference between asset-based lending and traditional commercial bank lending is simply how the lender views its primary source of security and repayment for the loan. The security for a traditional loan is cash flow and a strong balance sheet. The security for an asset-based loan is accounts receivable, inventory, equipment, and the fair market liquidation value of those assets.

FAIR MARKET LIQUIDATION VALUE

ABL Revolving Lines of Credit

The actual loan structure of a typical asset-based loan also differs significantly from a financial statement loan. A financial statement loan will most often be structured as a *term loan* or *amortized fixed loan* with the loan amount being determined and fixed at the loan's time of creation. Although they often are used to address problems of cash flow, they can be used for almost any purpose including equipment purchases or acquisitions.

An asset-based loan will usually be structured as a *revolving line of credit* with a primary focus of addressing problems of cash flow. The line of credit available to the business owner will have a maximum cap, but will also expand and contract based on the amount of current business accounts receivable outstanding and the amount of inventory on hand.

REVOLVING LINE OF CREDIT

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Asset-Based Loan Collateral

Asset-based loan collateral will normally include the accounts receivable, inventory, and perhaps the equipment of a business. If a business also owns real estate, it is usually financed in a separate long-term amortized transaction and not considered part of the asset-based loan's collateral.

THE INITIAL BORROWING BASE

The maximum amount of an asset based loan will be determined by a formula. The results of the loan formula will determine the loan's *initial borrowing base*. A typical asset-based loan formula might be calculated on:

- ⇒ **ACCOUNTS RECEIVABLE**: 80% of the face value of eligible accounts receivable (just like factoring)
- ⇒ **INVENTORY:** 50% - 70% of the estimated liquidation value of inventory
- ⇒ **EQUIPMENT:** 50% - 70% of the liquidation value of the equipment

A/R Assignment & Collection Schedules

To help determine the available credit line, an asset-based borrower will prepare two (2) *schedules* each week and forward them to the asset-based lender. These are the:

- ⇒ **ACCOUNTS ASSIGNMENT SCHEDULE:** lists all new accounts receivable billings for the week in numerical order. New accounts considered eligible will increase the borrowing base.
- ⇒ **ACCOUNTS COLLECTION SCHEDULE:** documents all collections upon outstanding accounts and will reduce the borrowing base.

THE BORROWING BASE CERTIFICATE

Based on these two reports, the asset-based lender will prepare a *Borrowing Base Certificate* which calculates the new maximum amount of credit available to the borrower under the revolving line.

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Asset-based lending is most often structured on a *non-notification* basis or in other words, customers of the borrower are unaware of the financing in place. Payments received each week, however, are either directly remitted to or forwarded to a special depository account known as the *cash collateral account* which is often a lockbox at a local bank. Cash deposits made to this account act to reduce the loan balance in the revolving line. They also reduce the interest being charged and increase the borrowing base.

CASH COLLATERAL ACCOUNT

Verification of Invoices

As in factoring, asset-based lenders will periodically verify invoices and their amounts to detect if fraud is present. This can be done by mailing monthly statements of account to the borrower's customers or through direct customer contact. The primary function of the verification process is to detect fraudulent invoices which may have been submitted to artificially increase the borrowing base. Such periodic verifications usually involve just a sampling of the borrower's customers, but if fraud is suspected or detected, will involve all.

PROCESS TO DETECT FRAUD

Field Examinations

Another characteristic of asset-based lending facilities is periodic on-site *field examinations* which will:

- ⇒ **validate the borrower's reporting and accounting**
- ⇒ **substantiate the value and condition of collateral including inventory**
- ⇒ **disclose issues which may materially affect the loan's overall condition**
- ⇒ **detect a deteriorating situation**

Such field examinations are a necessity and tend to be more frequent in large loans with a substantial inventory component. While borrower fraud involving accounts receivable is relatively easy to detect, inventory is another matter. In desperate times, inventory has a nasty habit of "growing legs" and walking out the door.

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Purchase Order Finance

Purchase order finance is an ancillary product and financing tool provided by many factors as well as many stand alone providers. It is an important form of alternative commercial finance often associated only with import-export trade, although it is perfectly suited for strictly domestic transactions as well.

When submitting their first deals, many new brokers are not aware of the difference between factoring (invoice finance), purchase order finance, and contract finance. All brokers need to learn that…

- **FACTORING:** is the purchase of invoices where the goods or services represented on the invoice have already been delivered or services performed.
- **PURCHASE ORDER FINANCE:** is a method of financing the actual manufacture of goods so they may be delivered in accordance to a valid purchase order. Purchase order finance is readily available to most businesses involved in offshore contract manufacturing where a large order for goods is received from a quality, creditworthy customer.
- **CONTRACT FINANCE:** Not to be confused with contract manufacturing, this refers to the financing of a contract (typically service related) where some form of *mobilization funds* are needed to begin the performance of services as set forth in the contract.

THE BIGGEST MISTAKE MADE BY NEW INDUSTRY BROKERS

THE BIGGEST MISTAKE MADE BY NEW INDUSTRY BROKERS

Without question, the biggest mistake made by new brokers is referring clients to a factor who have just been awarded a <u>service contract</u> and are seeking mobilization funds. This is contract finance. The work has not been performed, and no invoice is involved. It is not factoring nor is it purchase order finance. There is no collateral and it will always be turned down.

NOTES

Purchase order finance commonly involves the need for financing the manufacture of goods when a large order is received which is in excess of the amount of inventory on hand and/or the available capital to make the goods.

FINANCES THE PRODUCTION OF GOODS

Basically, a purchase order is a contract that guarantees payment for goods delivered if the goods arrive to specification and by a particular date. Purchase order finance is a method of financing the production of those goods so the order can be met. Once the order is shipped and delivered, it can then be invoiced and if required, that invoice can be factored. The criteria necessary for purchase order finance is as follows:

CRITERIA REQUIRED

⇒ **A Valid Order:** There must be a valid order from a creditworthy customer. The ability of the customer to pay for the goods once delivered is critical in a purchase order transaction.

⇒ **Performance Capability:** The client must have a track record and performance history showing its ability to make the goods (or have the goods made through contract manufacturing) and meet specifications and deadlines as set forth in the purchase order.

⇒ **Inability to Modify:** The purchase order must be "firm" in that it's price and quantities cannot be adjusted or modified. Additionally, the order must warrant that if the goods are delivered according to specification and deadline, they will be paid for unconditionally.

LETTER OF CREDIT IS POSTED

In most instances, a purchase order finance provider will post a *letter of credit* (in an amount necessary to manufacture the goods) with a bank acceptable to the manufacturer. Once the goods are made to specification, samples accepted by the customer, and the order shipped, the letter of credit is "triggered" and the product manufacturer is paid. The goods are then delivered directly to the customer. The customer will be billed for the delivered goods and the invoice factored if necessary to "take out" the purchase order finance provider. In some cases, the purchase order finance provider and the factor are one in the same company and the two separate financings are seamlessly blended.

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A Double Commission Opportunity

DOUBLE COMMISSIONS

For industry brokers, *purchase order finance* often provides an opportunity to earn "double commissions". This is because the vast majority of purchase order financings require the purchase order finance provider to be paid off (taken out) as soon as the goods are shipped to or received by the customer.

Purchase order finance usually involves large, out-of-the norm orders and most often, the client utilizing purchase order finance does not have the ready cash to pay the purchase order finance provider off when the goods are delivered. Most will not have the funds until the customer actually pays the invoice for the shipment. A factor is, therefor, required to advance against the invoice and subsequently pay off the purchase order finance provider using a portion of the funds from the initial advance.

PACIFIC RIM MANUFACTURERS

It is very common to find the need for purchase order funding in the small manufacturing sector and especially when a domestic manufacturer is actually contract manufacturing with a factory located offshore in the Pacific Rim. Such offshore production facilities will almost always require the posting of a letter of credit to produce the goods. Letters of credit are complex trade documents best drawn up by experts such as companies specializing in purchase order finance.

LIFE-OF-ACCOUNT COMMISSIONS

When selecting a funding source for any deal involving purchase order finance and factoring, search your lender database for a factor that provides both rather than two separate entities. This will insure that you become the *broker of record* for both transactions. Additionally, make certain the financing source for the purchase order finance pays life-of-account commissions for referrals. While almost all do, there are a select few that only pay the purchase order referral fee for the first year or so.

Referral commissions paid to brokers for purchase order finance are very similar to factoring with the referring broker usually earning 10% - 15% of the fees earned. Most often, the referring broker will earn both a percentage of the purchase order finance fees as well as a percentage of the factoring fees.

Merchant Cash Advance

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Like several other financing types presented in this section, MCAs or *Merchant Cash Advances* and their related *ACH Advances* are not true factoring transactions. Their popularity with seasoned factoring brokers and their small business clients is such that you need to become familiar with this particular product segment of the asset-based finance industry.

SHORT TERM LUMP SUM ADVANCE

Originally, MCAs were structured as a short term lump sum advance to a business in return for an agreed upon percentage of the business's future credit card receipts. The MCA provider would partner with the credit card service provider of a business to effect a daily or weekly withdrawal for repayment of the advance. In some cases, the MCA provider would require that it actually become the credit card processor. Advance repayments were setup to be of short term duration, usually 18 months or less.

PURCHASE AND SALE TRANSACTIONS

Much like factoring, MCAs are not loans but purchase and sale discount transactions, thus allowing the MCA to charge higher than normal fee rates and not be in violation of state *usury laws.* In a typical MCA transaction, a business owner might sell $20,000 of its future credit card sales for a discounted price of $15,000 in immediate cash. The entire $20,000 is then collected over an 8 to 10 month period.

NO PERSONAL GUARANTEES

The term merchant cash advance has now grown to include a host of small business financing alternatives, many of which are not directly associated with credit cards, but simply daily sales deposits. Although overall costs of MCAs are considered high, there is also considerable risk to the MCA provider in such transactions. Since MCAs are not loans, there are usually no personal guarantees required from a business owner in such financings. If the business receiving the MCA cash advance becomes insolvent prior to repaying the advance, the MCA provider must absorb the loss.

NOTES

The volume of MCAs provided to small business is growing rapidly with well over $3 billion in financings currently being provided annually. One reason for their popularity is that MCAs have a flexible repayment schedule which can be advantageous to small business owners and especially those engaged in highly seasonal sales. Since most MCA repayments are based on sales revenue and not a fixed monthly repayment like a bank loan, the repayments for the advance are less when business is slow and higher when sales are robust.

PRIMARY SOURCE OF REVENUE

MCAs are a significant source of revenue for today's brokers and although not true factoring, have now become so popular that all consultants should align themselves with several competitive MCA product providers.

Microloan Programs

Microloans have become an important financing product for budding entrepreneurs worldwide and a product factoring brokers definitely need to become familiar with.

These small loans of $500 to $50,000 are shunned by most local banks as being difficult to manage and unprofitable. For factoring brokers, this product provides the perfect opportunity to build solid relationships with loan officers who will gladly refer microloan applications your way. In fact, the product area of micro-lending should be considered "key" when it comes to building solid relationships with loan officers, attorneys, accounting professionals, and other local professionals.

USE FOR ALMOST ANY PURPOSE

Microloans can be used for almost any business purpose including working capital, equipment, inventory, marketing, fixtures, etc. Loan interest rates, of course, are higher than normal commercial bank loans with 10-13 percent being the norm, but are still considerably less than trying to finance a business with credit cards.

There are many providers of microloans nationwide and they can vary greatly from community to community, so you will need to do some online research to locate all of your local resources. Many non-profits, *Small Business Development Corporations* (SBDCs) and *Economic Development Corporations* (EDCs) offering microloans are actually SBA intermediaries, so the place to start learning about micro-lending and the application process is the *U.S. Small Business Administration* at www.sba.gov. The SBA's website explains their popular program in detail and also provides a state-by-state reference list of authorized intermediaries to assist you with finding networking opportunities. Visit www.sba.gov.

NOTES

VISIT WWW.SBA.GOV

Getting immersed in your community's microloan programs should be a networking priority as you open your doors. Most providers of microloans require applicants to attend entrepreneur training classes and this is where some of your earliest small group speaking opportunities may well present themselves.

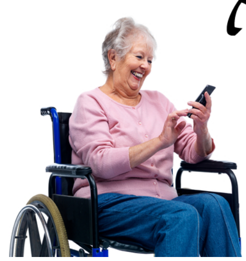
A NETWORKING PRIORITY

Factoring goes hand-in-hand with small business microloans if the applicant's business is based on B2B sales. In fact, factoring is often presented as an early stage cash flow tool in a start up's business plan, so there is great benefit to booking yourself as a guest speaker at any training classes if possible. Referral accounts from such workshops are initially small with minimal commissions, but they often will grow and multiply exponentially over time.

CAN GROW EXPONENTIALLY

The Bottom Line

Though you may fully intend to focus 100% of your time on the factoring product when you open your doors, you will likely come across many small business owners in need of asset-based lending, purchase order finance, merchant cash advances, or a simple microloan. Developing a working knowledge of these additional essential product areas is absolutely necessary if you are going to be able to effectively network with your local bank lending officers, accounting professionals, and others. Spend the required time exploring lender websites and advance your level of knowledge on all four.



McGargle's

Non-Emergency

MEDICAL TRANSPORT SERVICE

In December of 2013, Elmo McGargle founded *McGargle's Non-Emergency Plus, Inc.,* a medical transport company focused on assisting disabled veterans and senior citizens in need of non-emergency medical transportation (NEMT). McGargle, a disabled veteran himself, financed the company with $5,000 in savings and a $20,000 SBA microloan arranged with the help of local factoring broker, Jon Pendersmite. McGargle used the SBA loan to purchase two used commercial vans which he reconditioned and modified with lifts for wheelchair transport. He also became an approved provider of NEMT through his state's Medicaid office

Partially due to his disabled veteran status, McGargle landed a contract with local county government which had started several programs to assist returning disabled veterans in re-entering community life. One of the programs provided vets with transport to and from the local VA hospital and doctor's offices free of charge. The county was reimbursed for the majority of charges through Medicaid, but due the lengthy time to complete the required paperwork, could only pay McGargle for his transport billings on a net 45 day basis.

The county's new *Disabled Vet Program* soon provided a majority of McGargle's transport business, accounting for nearly 70% of his monthly billings. In fact, he was starting to shop for an additional van and driver to meet the increasing demand. But, McGargle was beginning to see a cash flow problem rear its ugly head due to the 45 days the county needed to pay his billings. McGargle had weekly payroll for his 6 drivers, a monthly SBA loan payment, increasing fuel costs, and also a growing monthly insurance bill to meet state insurance requirements. He realized he needed some type of interim financing program to meet his current cash outflow needs while waiting for county checks to come in. In short, he needed factoring.

Elmo quickly turned to his old friend Jon Pendersmite for assistance. Pendersmite quickly recognized exactly what would be needed, helped Elmo complete a Company Profile factoring application, and then arranged for a conference call with a factor he had been working with for several years. McGargle was billing about $40,000 each month to the county but due to the 45 day payment terms, had outstanding balances of roughly $60,000 each month. During the conference call the factor immediately recognized the opportunity to establish a relationship and forwarded contracts via overnight courier. But there was a small problem. The SBA loan.

When perfecting its loan with a UCC-1 filing, the SBA lender had secured the loan with "all assets" of the debtor. This naturally included accounts receivable and the factor would need to speak with the lender to explore its ability to get a subordination on the accounts receivable. Fortunately, this proved to be no problem since the loan was over 50% paid off and the vehicles would provide more than enough collateral to secure the balance of the loan. **FACTORING COMMISSION EARNINGS: $300 - $400 per month.**

Moneywhistle's
BIG LOADS

FREIGHT BROKERAGE SERVICE

Polly Sprinklemyer opened *Sprinklemyer and Associates*, a business finance consulting firm in 2011. She began by working only part-time at her new consulting business but by her second year, had begun earning enough commissions from factoring referrals to leave her full time job as a receptionist and focus solely on her growing freelance business finance consulting practice.

Polly had spent most of her spare time during the first two years networking and building relationships with CPA's and loan officers. Most she had met at after hours meetups hosted by her local Chamber of Commerce, but she also belonged to a women's civic organization where she had met several good sources of referral. One very important source was Janelle Kneemann, a "special assets officer" at one of the area's larger banks.

Polly learned that special assets officers were put in charge of loan accounts which were "out of formula" and deemed no longer desirable at the bank. This meant Janelle was in charge of finding new homes for loans the bank no longer wanted...a perfect match for Polly and her factoring business.

One day while having lunch with Janelle, Polly was asked to explain a little more about factoring. She gladly did so and Janelle asked Polly if she could come back to the bank with her after lunch to discuss a possible referral.

Janelle's bank had a problem client, *Moneywhistle's Big Loads*, a large freight brokerage operation which was slightly out of formula. Additionally, although the bank already had a $3.5 million credit facility provided to *Big Loads*, they needed more money. Over $500,000 more to be exact, and the bank was not willing to extend additional credit.

At first this looked like an easy factoring arrangement but there was only $3.3 million in accounts receivable and at an 80% advance, there would not be enough to take out the bank's loan. Polly did notice something on the bank's worksheet, however. Some of the customers of *Big Loads* were in Canada and the Canadian receivables, being foreign, were considered ineligible and not included in the loan's credit line formula. The total Canadian receivables were over $600,000. Since the bank was not using these as collateral, they would not have any problem subordinating those invoices to a factor.

Polly quickly set up a conference call with a factor that financed in Canada and an account was set up for *Moneywhistle's Big Loads*. The factor provided temporary financing on the accounts for over 9 months while a new asset-based lender was put in place by Polly. Monthly factoring fees were about $20,000 per month. **FACTORING COMMISSION EARNINGS: $3,000 - $3,500 per month. ABL PLACEMENT FEE $22,500.**

NOTES

Factoring Construction Receivables

The factoring of construction related receivables is certainly one of the more difficult niche areas of factoring from the transactional standpoint, but one all brokers should become very well acquainted with. Why you say? Because the need for financing in this segment is so great that some brokers can actually focus 100% of their marketing efforts on construction factoring and make an exceptional living. To do so, however, you need to become an expert in all aspects of this important niche area.

SOME FOCUS 100% OFTHEIR MARKETING EFFORTS

First, you need to know that construction factoring provides services to several different categories of prospective clients. And when factors finance in this sector, one size does not fit all. From a product knowledge standpoint, there is quite a bit for brokers to learn.

THREE TYPES OF CLIENTS

When focusing your marketing efforts in the construction sector, you will have three possible types of clients or prospect groups for your marketing campaigns . They are:

- **SUB-CONTRACTORS:** Those actually performing the work on a jobsite and being paid for that work by a General Contractor
- **GENERAL CONTRACTORS:** Seeking to get advances on progress payments made to them by project owners or banks
- **SUPPLIERS:** Businesses that supply materials to the jobsite. This is everything from lumber and trusses to bulk hardware.

Of the three groups, sub-contractors will be your largest market and the easiest to actually interact with. The second most promising group will be suppliers. The general contractors themselves are the smallest group and by far the most difficult to finance. In fact, few factoring brokers working this sector actually market to general contractors.

Factoring Sub-Contractors

NOTES

The factoring of sub-contractor receivables is the most common in this niche. Here, the invoices being factored are those payable by a general contractor to the sub-contractor for its work on the job. What makes this area difficult? Here are a few risks not typically associated with "plain vanilla" factoring.

10% HOLDBACK FOR RETAINAGE

- **RETAINAGE:** Most sub-contractor invoice payments are subject to something called *retainage*. Retainage (usually 10% of the invoice face amount) is a holdback the general contractor retains for (sometimes up to a year) to offset poor craftsmanship that may show up well after the sub-contractor has left the jobsite. Because of retainage, all sub-contractor invoices factored are subject to having additional reserve held of 10%. A normal 80% initial advance becomes a 70% or even 65% advance.

- **SETOFFS:** General contractors most often enjoy something called *rights to setoff*. This means that an invoice payment for a current job performed may be reduced or "setoff" by a chargeback on a job performed months prior.

- **VERIFICATION:** While the verification process is usually very straightforward in most everyday factoring transaction, it can be problematic in construction. This is because the invoice verifier, in the normal chain of command in a construction deal, is the project manager who will typically be on the jobsite and difficult to access.

CONDITIONAL MECHANIC'S LIEN RELEASE

- **CONDITIONAL LIEN RELEASE:** Prior to paying an invoice, the general contractor will require a conditional *mechanic's lien release* which protects it from the sub-contractor filing a lien against the job after being paid. This creates some additional paperwork for factors and it can also create a logistical problem since the general contractor will not pay without the release and the release must often be signed in person at the general contractor's offices.

NOTES

Dealing With the Sub-Contractor's General

In most cases, factors will not enter into a sub-contractor factoring arrangement unless the general contractor has exceptionally strong credit. Additionally, most will only finance those involved with commercial building construction and not residential housing. You should understand, when you submit a sub-contractor construction financing deal to a factor, there will be several difficulties the factor will need to overcome for the deal to get done. These include:

WAIVER OF SETOFF

- **WAIVER OF SETOFF:** The general contractor will have to sign a *waiver of setoff.* This will insure that the invoices purchased by the factor will not be reduced in payment due to a poor past performance of the sub-contractor.

- **NOTIFICATION:** The general contractor will sign a notification requiring payment be made directly to the factor. While this in its own right is not unusual, in construction factoring an arrangement must be in place to provide the general contractor with a *conditional mechanic's lien release* at the time of payment.

- **VERIFICATION:** A reliable method of obtaining solid verification from the project manager or company officer that binds the payment from the general contractor must be in place.

Focusing on sub-contractor factoring deals usually requires the broker be very active with both sub-contractors as well as general contractors in the community and although we will discuss marketing in more depth in later chapters, this is a segment where holding breakfast or after hours workshops (where both general contractors and sub-contractors attend) can be very beneficial to building your business.

NOTES

Sub-contractors are often *paid-as-paid* which means they do not expect to get paid in a set time frame such as 30 days under normal terms of payment, but rather paid after the general contractor receives funds from a lender making a *progress payment.*

PROGRESS PAYMENTS

Aside from the obvious benefits of factoring for the sub-contractor (getting an early payment advance), there are notable benefits to the general contractor as well. Many sub-contractors can ill afford to be strung out 60-75 or even 90 days before being paid by a general. An early advance by a factor to the sub-contractor can relieve a great deal of pressure on the general to make early payment prior to receiving its scheduled *progress payment*.

Factoring General Contractors

PROGRESS BILLING

Factoring arrangements where the client is a general contractor are the most difficult and risk prone from the factor's standpoint. Usually, when a general contractor contracts for a job, a payment schedule will be created so the general contractor receives periodic cash draws at certain stages during the construction process. Such cash draws are termed *progress payments* and are the result of an invoice called a *progress billing* being generated and forwarded to a paying bank or the project owner.

When certain criteria or tasks have been accomplished on a normal construction job, the general contractor submits an invoice for a progress payment. When factoring a general contractor, it is this progress payment invoice they wish to factor. The primary problem when factoring invoices from a general contractor for a progress billing is that the payment for that invoice from the bank or project owner can be reduced or set off due to *mechanic's liens* filed by any unpaid sub-contractors.

MECHANIC'S LIEN LAWS

Though they vary from state to state, all states now have some form of *mechanic's lien law* which protects property owners, construction professionals, and suppliers from non-payment when they have performed services to a job site. Under these laws, a *notice to owner* is typically filed in the form of a lien or pre-lien on the jobsite and will not be released until the sub-contractor is paid.

NOTES

Mechanic's liens work to the benefit of factors when financing sub-contractors as they put additional payment pressure on the general contractor. Conversely, they work against the factor and represent significant additional risk when financing a general contractor. If a factor purchases a progress payment invoice from a general contractor who has made no payments to subs on the job, the factor is at risk of receiving a reduced payment on its invoice as the bank or property owner pays the sub-contractors so mechanic's liens will be satisfied and removed.

OFTEN PAY SUBS DIRECTLY

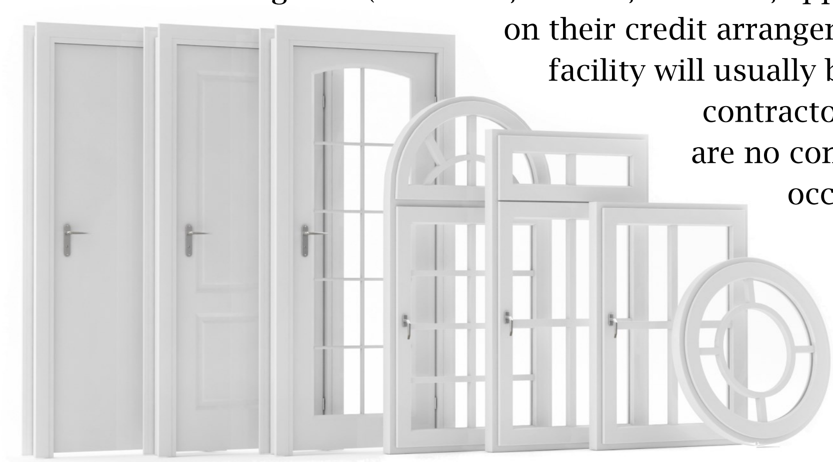
SLIGHTLY HIGHER FEES

Factors will usually offset risk of sub-contractor mechanic's liens by paying the subs directly from the general contractor's advance on the progress payment. In return, the factor will be provided a lien release by the sub. Clearly, when financing a general contractor's progress billing, the factor must know all sub-contractors and suppliers who have worked or provided services on the jobsite. This can be a difficult task and is one reason construction factoring fees for general contractor factoring arrangements tend to be slightly higher than for most other factoring segments.

Factoring Suppliers to the Jobsite

Suppliers selling to general contractors represent the easiest group to factor in the construction industry. This is because they enjoy the safety of the same mechanic's lien rights if goods are delivered to a specific job site but are seldom subject to retainage or rights to setoff as with a sub-contractor.

A general contractor will most often have 30-60 days to pay for goods (hardware, lumber, windows, appliances, cabinetry, etc.) based on their credit arrangements and the factoring facility will usually be based only on the general contractor's creditworthiness. There are no conditions of offset (other than occasional issues of damaged goods) to be dealt with nor difficulties regarding invoice verification due to a hard to reach site manager.



NOTES

Performance Bonds

When underwriting general and sub-contractors, performance bonds often come into play. Basically, on jobsites where invoices are being factored, general contractors may be required to have a bond in place. Sub-contractors cannot have a bond in place. This is because a bonding company can theoretically "prime" the factor's payment if the sub-contractor decides to walk away from a job and the bonding company hires a replacement to finish the work.

PRIME THE FACTOR

Types of Sub-Contractors That Commonly Factor Their Receivables

Construction is an enormous segment of the economy with hundreds of specialty sub-contractors operating within its borders. Freelance brokers practicing in cities or service areas of size can often focus 100% of their time in this area and make a good living. To do so, however, you will need to align yourself with several good factors specializing in the construction industry and learn their programs inside and out.

SOME BROKERS FOCUS 100% OF THEIR TIME

Types of sub-contractors that will often utilize factoring to smooth out their cash flow include:

- **site preparers**
- **well drillers**
- **directional boring companies**
- **landscaping companies**
- **roofers**
- **framers**
- **drywall installers**
- **crane and backhoe operators**
- **utility contractors**
- **electricians**
- **demolition companies**
- **steel erectors**
- **paving companies**
- **construction clean-up companies**
- **lumber distributors**
- **truss builders**
- **tile / carpet installers**
- **plumbers**
- **many others**

NOTES

Factoring Staffing / Temp Services

The staffing industry represents a primary market for factors and brokers should always maintain a keen watch for new staffing companies opening their doors in the community. As you are aware, one of the primary reasons for factoring is to fund weekly or bi-weekly payroll. No industry has a greater need for payroll financing than staffing.

Staffing companies come in many shapes and sizes, often specializing in a particular niche. There are medical staffing companies, construction staffing companies, those that specialize in accountants and bookkeepers, companies that provide computer programmers, hospitality staffing, and the list goes on and on.

INTENSE PAYROLL NEEDS

Many staffing companies exhibit the classic business characteristic of a small business supplying a large customer who demands terms of payment. Even if a staffing company client pays its invoices in 30 days, it means the staffing company will need to fund at least two payroll cycles before the client's check is received. They will also need to pay normal bills, costs associated with advertising, and make timely payroll tax payments to IRS. Because of their intense payroll needs, virtually all staffing companies will require some method of working capital finance and without hard collateral for a traditional bank loan, factoring often provides the best cash flow solution.

Factors will generally provide significant additional services to even the newest of staffing companies. In many cases, factors completely run the back office, allowing the staffing business owner to focus fully on marketing and business development. Such services include:

- **Advances of cash against invoices**
- **Integrated accounting with programs such as *QuickBooks***
- **Invoice mailing and processing**
- **Time card management and payroll check printing**
- **Credit checking and collections**
- **W-2 and 1099 document preparation & tax return support documents**

Factoring Agricultural Receivables

NOTES

Factoring trade receivables linked to food and the sale of goods and services in the agricultural sector can be very difficult for factors. In fact, many factors have a strict policy against factoring "anything that grows". Still, as with all difficult niche areas, a small group of factors have developed a process or formula which reduces the risk to the extent that financing can be performed confidently.

The problem with financing invoices related to foods or goods that are perishable (fresh produce, meats, flowers / plants, etc.) is, of course, spoilage. This is one reason that factors who do provide such services in this "fresh" niche, will usually advance at a much lower rate, holding additional reserve for spoilage.

PACA LAWS

Another major problem when factoring agricultural products is something called the *PACA Laws* (*Perishable and Agricultural Commodities Act*). PACA Laws are similar to the mechanic's liens found in the construction industry and provide growers with the rights to file financial damage claims if they are not paid for shipments and are victimized by buyers and merchants. A grower not paid for its shipment of produce, can file a claim with the PACA Trust and if valid, will have the right to "prime" a lender for payment upon an invoice. For example, a grower not paid for tomatoes shipped to a ketchup manufacturer, will have the right to claim invoice payment from a grocery store chain which purchased the ketchup. If a factor or similar lender is financing the manufacturer and expecting payment upon the chain store's invoice, it could suddenly find itself in second position for payment due to the PACA claim.

Another issue that makes financing foods even more difficult is the ability to fully ascertain what is and is not covered by PACA. Certain foods may be exempt from PACA if processed in a certain way. Others may not. Such ambiguity elevates financing agricultural products to a level of high risk and an area where only very specialized lenders with significant PACA experience will tread. When performing lender research as an industry broker and building your lender database, make certain you locate at least one or two factors who provide services in this important but difficult niche area.

NOTES

EXCEPTIONAL RISK WITH GOVERNMENT RECEIVABLES

Factoring Government Receivables

On the surface, factoring government related receivables might seem like a perfect factoring opportunity. After all, there is little risk that most governmental entities will go bankrupt and those in trouble are well known in advance. In reality though, factoring receivables payable by federal, state, and municipal entities represents an exceptionally risky financing loaded with all sorts of dangers for factors and lenders. Brokers marketing to government contractors will immediately find the need to build a relationship with a factor specializing in this problem niche area.

THE FEDERAL ASSIGNMENT OF CLAIMS ACT

The *Federal Assignment of Claims ACT of 1940* was enacted to facilitate a method of financing government contracts during World War II. Referred to as *FACA Laws*, the act sets forth regulations which outline methods for lending institutions to take assignment of government payments due government contractors.

Unlike the normal system of notification provided by Article 9 of the Uniform Commercial Code, the FACA Laws present a set of different rules and regulations for a lender to establish legal assignment of accounts and payment thereon. These rules and processes include specialized release forms, the need for approval with notarized signatures, and a *notice of assignment* form unique to the Federal Government. In some cases, granting an assignment to a lender will actually require a new contract to be drawn between the government and the supplier.

ASSIGNMENT FOR STATE CONTRACTORS

EVEN LARGER MINEFIELD

Factors experience significant additional risks associated with misdirected payments when financing entrepreneurs who provide goods or services to the federal government. An even larger minefield, however, can exist when dealing with states and occasionally even municipalities.

NOTES

In many states, an assignment is only valid if authorized by a specific officer of a particular state agency and there is little commonality in requirements from state to state. Factors providing financial services to clients engaged in state work must have a very expansive knowledge of the various state laws regarding assignments. For example, Minnesota prohibits a lender from filing suit against it if the state should make payment to the wrong entity after valid notification, thus completely voiding the safety that notification normally provides.

CONTRACTS DUE TO MINORITY STATUS

From the freelance broker's standpoint, marketing to small and minority business owners engaged in bidding for government contracts is a very good niche. Many small business owners, awarded exceptional contracts because of their minority enterprise status, subsequently have a difficult time fulfilling the award due to working capital limitations. Factoring can alleviate a great many of the payment problems associated with such small business awards. Make certain you include several government receivables factors in your lender database.

Factoring Real Estate Commissions

FAST GROWING SEGMENT

The factoring of commissions due agents from sales of real estate is a relatively new area of specialization for certain factors. While it slightly breaks the standard rule of B2B for only non-consumer related transactions, it is looked upon as a valid factoring niche by the factoring industry anyway.

In the real estate industry, this type of factoring transaction is referred to simply as a *commission advance* and has become quite common in large real estate agencies. It is very beneficial to sales people who often experience many peaks and valleys regarding income. Commission advances help to smooth out income droughts when sales are slow. Real estate agent commission advances are now one of the fastest growing segments of factoring.

NOTES

OVER 10% OF SALES NOW BENEFIT FROM A COMMISSION ADVANCE

In most cases, the commissions earned by real estates sales people are paid at the time the transaction closes or shortly thereafter. In other instances, and especially in large transactions, commissions earned can be scheduled for payment over longer periods of time due to multiple closings. A typical example of this is when a large piece of vacant land is sold to a developer and closings will occur periodically, as the development expands and opens different sections. It is not unusual for such property transactions to close in 3, 4 or even more installments with the commission due the salesman paid at each individual closing. It is estimated that over 10% of all current real estate sales now benefit from a commission advance.

Real estate commission advance factors will advance on agent commissions earned from the sale of residential properties, condos, commercial properties, industrial, and raw land. Advance rates can run from 80% to 90% depending on the factor and the transaction and advances can be made upon closings scheduled up to 90 days in the future with even longer advances made on a case-by-case basis. Once capped at just $10,000, today's real estate commission advance providers now have virtually no advance limits on qualified transactions.

Fees charged on commission advances are a bit more expensive (roughly double) than those charged on traditional factoring, evidencing the elevated risk of financing such one-off spot transactions. Recipients can expect to pay 5% - 6% for 30 days with longer advances being commensurately higher. Still, this is a much appreciated financial tool for many agents when sales are slow and funds are scarce.

Most large real estate franchises already have commission advance agreements in place for their franchisees and this is not a particularly attractive area in which to market for factoring brokers. Still, there are some opportunities available for setting up arrangements in larger non-franchise operations with 10 or more agents. Brokers will additionally need to explore which commission advance factors work with brokers on a referral basis. Many do not.

Trucking & Freight Bill Factoring

NOTES

The factoring of trucking receivables is currently the largest sector by volume of the domestic factoring industry with roughly 17% of all factoring in the U.S. involving freight bills. This area has proven to be very "fertile ground" for niche factors and also for large factors with specialty freight bill factoring departments.

LARGEST SECTOR OF THE FACTORING INDUSTRY

Factoring in this popular area is actually very similar to normal advance / reserve factoring and includes high advance rates and expert credit and collections services. In a typical freight bill factoring transaction, the over the road hauler will pick up and deliver the goods to a customer. Instead of submitting the invoice to the customer, the freight company will submit it to the factor who will provide an advance of cash usually within 24 hours.

When advancing against freight bills, factors often provide "above and beyond the call of duty" services and benefits such as:

PROVIDES FUEL CARDS

- **FUEL CARDS:** for the purchase of diesel fuel along the route
- **FUEL TAX REPORTING:** assistance in report preparation
- **DISCOUNTS:** on fuel, tires and truck maintenance
- **STATE AUTHORITY FILING:** assistance in filing for their state authority with the FMSCA (Federal Motor Carrier Safety Admin.)
- **APPLICATION MONITORING:** assistance with all permitting
- **FREIGHT BROKER SERVICES:** assist their clients in finding return shipments after delivery

VERY COMPETITIVE NICHE AREA

Because of its size, freight bill factoring is a very competitive niche area with some of the industry's lowest rate structures. Factors servicing this area are aggressive buyers and factoring services are generally available to almost anyone in the industry regardless of size or time in business. The many additional services provided to the sector means that factoring can be an exceptionally attractive financing alternative for start-ups and small operators.

NOTES

Third Party Medical Receivables

Every year, hospitals and physicians provide billions of dollars in services to patients with a large portion of billing for such services being submitted to medical insurance companies and governmental entities such as Medicare / Medicaid. It is not unusual for a doctor with even a small practice to have in excess of $500,000 tied up in such receivables. For a broker initially exploring this industry, its important to distinguish between third party medical receivables and normal healthcare receivables.

- **THIRD PARTY MEDICAL RECEIVABLES:** represent "claims" paid by an insurance company , HMOs, PPOs, Medicare / Medicaid, or similar state agency for medical services performed on an individual. No workman's comp. claims are allowed
- **HEALTHCARE RECEIVABLES:** are invoices of those companies billing physicians, labs, hospitals, etc. for goods delivered or services performed.

HIGH QUALITY HEALTHCARE RECEIVABLES

Healthcare receivables are normally very high quality with debtors being hospitals, labs and relatively large, creditworthy companies. Third party medical receivables are just the opposite, being paid by insurance and quasi-insurance companies where offset and claim denial are common. Such third party medical receivables are exceptionally difficult to finance and require a specialty factor with a very highly trained staff.

ADVANCE RATES OF 60% OR LESS

Because insurance companies are notorious for making payments which are substantially less than a claim (billing) or sometimes even making no payment at all, the risks involved in financing third party medical receivables runs high and justifies much lower initial advance rates. Rather than the normal advance rate of 80% or higher in a standard factoring transaction, advances of 55% or lower are common when purchasing third party medical receivables.

NOTES

Few medical receivables finance companies limit their financing to receivables alone and brokers should know many provide such services as:

- **Bankruptcy and Debtor-in-Possession Financing (DIP)**
- **Revolving and Non-Revolving Credit Lines**
- **Acquisition Finance**
- **Letters of Credit**
- **Medical Equipment Leasing**

For most brokers, the third party medical receivables business represents a relatively difficult sector to penetrate unless you have some history in the medical industry with very robust networking opportunities. You certainly do need to be aware of this type of financing, however, and also make certain you add at least one “third party” medical receivables factor along with several healthcare factors to your lenders database.

DIP Financing

FACTORING A BUSINESS IN BANKRUPTCY

Factoring is one of the few methods of financing readily available to small business owners struggling to re-establish their business through a Chapter 11 bankruptcy or reorganization. While such "restructuring" of debt is commonly provided through the asset-based lending community for larger business entities, small business operators are only served by the factoring community.

Bankruptcy factoring or "DIP" financing (Debtor-In-Possession), is a unique niche area of factoring which requires a high degree of due diligence and additional legal processes not found in everyday factoring transactions. Because of these additional requirements, all factors do not provide service in this unique niche area. DIP factoring is an area that most brokers ignore. It is one, however, that can generate significant annual revenue for those that become familiar with its inner workings.

When underwriting a prospective client for DIP factoring, the factor will look closely at the cause of the insolvency to determine if a factoring arrangement can solve the problem. If factoring can address the cause of the business's problems and, under normal circumstances, help return the business to profitability, a factoring arrangement may be established.

RELIEF FROM THE AUTOMATIC STAY

To establish a DIP financing arrangement, the factoring agreement must be approved by the federal bankruptcy court. If approved, the factor will be granted relief from something called the *automatic stay,* which is part of federal bankruptcy law and provides protection for debtors (and customers) from collections during the period of the bankruptcy. Since factors will be purchasing invoices and collecting upon them, they must be granted relief from the legal limitations placed upon them by the automatic stay. Additionally, factors will be purchasing assets (invoices) of the insolvent business and all such asset sales must be approved by the bankruptcy court.

For small business owners, access to DIP financing through factoring during troubled times can literally make the difference between survival and a complete business liquidation. Very few business owners, however, are aware of this critical financing option available through factoring. In many instances, factoring can help to return the business to profitability and provide the means for the business to meet its obligations owed to previous lenders and creditors.

CHECK THE LOCAL NEWSPAPERS

LOCATING DIP DEALS

DIP deal financing opportunities are overlooked by most brokers yet it is often very easy to find a lead or two. When a business is involved in bankruptcy, that bankruptcy is a matter of public record and while few personal bankruptcies are considered news, business bankruptcies often are. By occasionally reading the public records posts in your newspaper, you may come upon a golden opportunity for factoring a DIP deal.

Spot Factoring

NOTES

Occasionally, a factoring transaction will be requested by a prospective client which involves the purchase and advance upon what amounts to a one-of-a kind invoice of unusual size or payment terms. An example of such a transaction would be when a small products distributor, billing perhaps $30,000 per month, suddenly finds itself faced with a single, unexpectedly large $100,000 order from a very creditworthy retailer who demands 60 day payment terms. The distributor is currently not factoring its invoices, but doesn't want to decline the order simply because it cannot afford to ship that much product and wait 60 plus days to get paid. The small business owner clearly needs some creative financial assistance on this particular order. The problem's solution involves something called *spot factoring*.

SPOT FACTORING

Most spot factoring requests simply involve one or two very large invoices with extended payment terms. About one half of all factors will entertain such spot factoring requests. Others will not, simply due to the increased risks involved by having "all eggs in one basket" so to speak. When spot factoring transactions are approved by a factor, the client can expect to pay a much higher fee rate than it would under a normal factoring arrangement.

EXPECT TO PAY A HIGHER RATE

Spot factoring should not be confused with "seasonal" factoring where a company, because of the seasonal nature of their business, requires financing 3 or 4 months out of the year. Companies dealing in holiday products such as Christmas decorations, lights, holiday related clothing, foods, etc., often require factoring for the holiday season when sales spike but not during the rest of the year.

SEASONAL FACTORING

For brokers, the commission earned on such singular transactions will be minimal so it's certainly not worth your time and effort to market for such transactions. However, many such "one shot" accommodations eventually become excellent long term factoring arrangements with clients factoring all of their invoices once they see the cash flow benefits of factoring and the ease with which an arrangement for factoring can be put in place. When you are building your lenders database, make note of factors that mention spot factoring on their websites and create a record for one or two.

NOTES

Micro–Factoring

ACCEPTING INVOICES AS SMALL AS $1,000

Micro-factors are small factors often servicing their local community. In many cases, micro-factors are successful industry brokers that have made the leap to financier. Most regular factors will not accept clients factoring less than $15,000 per month with exceptions granted only on a case-by-case basis. Micro-factors, on the other hand, are true mini-financing entrepreneurs often accepting transactions as small as $1,000 while they expand their service areas and learn the financing side of the factoring trade.

LIGHT VERSION INVOICE TRACKING SOFTWARE

As brokers develop their business, they will naturally be exposed to various contracting documents required to create factoring arrangements. They will learn how to search the UCC and file a security interest. They will often have the capability of creating accounting spread sheets, advance schedules, and other documents in programs like *Microsoft Excel* or similar software products. Alternatively, they may even opt for one of the less expensive "light" versions of professional invoice tracking factoring software available from industry providers.

Micro-factoring is a natural area of business expansion for a small percentage of factoring brokers who want to make the transition from broker to factor. To make this move, however, you will need a reasonable amount of capital and some very specialized training in both the administrative and legal areas of the business.

ADDITIONAL TRAINING AND LEGAL ADVICE

MICRO-FACTORING

Micro-Factoring is a natural add-on for many factoring brokers as they grow their business. Do not take this addition lightly. You will need much administrative training and legal advice before you actually begin to purchase your first invoices. A good source of such training is the International Factoring Association. www.factoring.org

NOTES

Micro-factors tend to work closely with community banks and local small business incubators who welcome such mini-financiers. Micro-factors who will entertain investment in new and very small entrepreneurial enterprise can represent an excellent source of referral for banks and others who cannot finance such small, under collateralized, invoice-based transactions.

MAKE THE SMALL DEALS HAPPEN

Micro-factors can be a valuable resource but are also difficult to locate since they primarily only advertise in their local markets. Factoring brokers should be on the lookout for such entrepreneurs, however, since they can often make the small deals happen.

Poultry and Meat Packers

SIMILAR TO PACA LAWS

Similar to the PACA Laws which protect growers and agricultural products producers, *PASA Laws* (*The Packers and Stockyards Act*) protect the financial interests of poultry producers, livestock ranchers, and swine producers from non-payment and deceptive practices by dealers, distributors, and livestock brokers. The *PASA Laws* were originally passed in 1921 to curb certain monopolistic practices of the major meat processors of the time. The provisions and reach of the act have been modified and amended over the years.

Important to factors and factoring brokers is the statutory trust provisions introduced by amendment in 1976 which protects cash sales made between producers and packers. Under PASA, producers that remain unpaid for sales up to 30 days post delivery can file a written notice to the U.S. Department of Agricultural and submit a PASA claim.

Factors who have advanced on the receivables of meat processors and packagers can be "primed" regarding the payment of invoices from supermarket chains and food products manufacturers. For example, a dog food manufacturer using meat bi-products in its product and neglecting to pay for such bi-products, can have its invoices from sales to pet stores effectively "levied" by the Department of Agriculture and the PASA Trust. A factor providing financing services to the dog food manufacturer and advancing on invoices payable by its customers can be left without payment due to such a PASA claim.

NOTES

International Factoring

Domestically, factors provide well over $100 billion in commercial finance annually to American business owners. On a comparative basis, that's just a very small fraction of the volume of factoring services provided worldwide. For example, the United Kingdom, a relatively small nation, generates roughly double the factoring volume of America. International factoring is BIG BUSINESS.

HOW DO I GET PAID?

U.S. small business owners have one primary concern when selling to a cross-border buyer. That is: *how do I get paid?* In reality, those involved in international sales must deal with three primary risks:

⇒ **CUSTOMER CREDIT RISK:** dealing with the difficult task of determining the creditworthiness of a buyer located in a foreign country.

⇒ **CURRENCY RISK:** risks of being paid in a currency other than the U.S. dollar whose value can fluctuate.

⇒ **POLITICAL RISK:** those risks associated with the stability (or lack thereof) of foreign governments.

ELIMINATION OF NON-PAYMENT RISK

For experienced exporters, there are various methods of reducing or sometimes completely eliminating those risks when choosing a method of payment for international sales including:

⇒ **CASH IN ADVANCE:** a common method of payment but the least attractive to a customer and one which will limit sales.

⇒ **LETTER OF CREDIT (LC):** one of the most secure methods of payment but very complex, expensive, and one which will draw down the credit lines of a customer.

⇒ **DOCUMENTARY COLLECTIONS (DC):** less expensive than letters of credit and similar in some ways, documentary collections lack the implicit guarantees of an LC.

⇒ **OPEN ACCOUNT:** the most advantageous to the customer and one that will enhance sales, open account treats international customers identically to domestic customers.

NOTES

From purely a sales standpoint, selling on *open account* is by far the most advantageous method of conducting business but also the most risky. Without cash up front or the guarantees associated with an LC, domestic sellers may find themselves hiring a collections attorney in a foreign country. There are, however, many ways to reduce the risk inherit in *open account sales* and one of the easiest and most popular methods is simply to employ international factoring.

How International Factoring Works

A COMPLETE FINANCIAL PACKAGE

International factoring offers a complete financial package which combines finance, credit risk protection, currency risk protection, bookkeeping, and collections. Almost all international transactions are conducted on an advance / reserve and non-recourse basis to the exporter, thus protecting it from non-payment due to an importer's bankruptcy or insolvency.

There are always four parties to any international factoring transaction. They are the:

- **EXPORTER**
- **IMPORTER**
- **EXPORT FACTOR**
- **IMPORT FACTOR**

4 PARTIES TO AN INTERNATIONAL FACTORING TRANSACTION

Because of the growth of international factoring and the size of the many factors today specializing and providing services in this important niche, it is now quite common for the export factor and import factor to be one in the same.

In an international factoring transaction, an advance will be made to the exporter through the export factor just as in any common domestic transaction. The export factor will work directly with the import factor often adhering to something called the *General Rules of International Factoring* or GRIF, for short.

NOTES

60 / 40 SPLIT

The import factor acts as guarantor on the transaction and it is the import factor's job to establish the creditworthiness of the buyer (importer). In some cases, the import factor may purchase *credit insurance* to alleviate non-payment risk. Because of the additional risk associated with the import factor's role, factoring fees are typically shared on a 60/40 basis with the import factor receiving the larger share of 60% and the export factor receiving the lesser amount of 40%.

Many small and mid-size factors now routinely provide some services on an international level. Large international factoring transactions are often handled by members of the international factoring organization, *Factors Chain International.*

80% OF ALL INTERNATIONAL TRANSACTIONS

Factors Chain International

Factors Chain, established in 1968, is a global network of factors engaged in international transactions. With its recent (2016) partnership with the former *International Factors Group* (IFG), Factors Chain now boasts over 400 members operating in 90 countries. Its members are responsible for over 75% of all global factoring and approximately 90% of all cross-border international factoring transactions.

For those brokers intending to focus heavily in the manufacturing and distribution sectors, having a strong working knowledge of export factoring can set you apart from all competition. You can find out more (including available FCI courses) at http://fci.nl

As cross-border trade continues to expand throughout the world, the area of international factoring will continue to grow exponentially, since it provides a readily available "simplistic" approach to such finance. Compared to *letters of credit*, international factoring is much less complex as well as being less expensive when dealing with the problems associated with payment on export sales and especially small (under $1,000,000) sales.

NOTES

Freelance brokers marketing in the manufacturing and distribution sectors will certainly run into questions regarding exports and how to insure payment upon them. And although the SBA and EXIM Bank have some excellent options for large transactions, international factoring is rapidly becoming the financing method of choice for small and mid-size business owners due to its non-recourse features as well as its inherent simplicity.

BOTH IMPORT AND EXPORT FACTOR

Because of the unique fee sharing arrangement between export and import factors, its advisable for brokers having client referrals who are heavily involved in exporting to work with an international factor of size who can play the role of both export and import factor.
Not only will this simplify the transaction, but it will also insure that the broker gets paid a commission on both sides of the financing.

A/R Trade Credit Insurance

Accounts receivable insurance or *trade credit insurance* is an insurance product which insures the accounts receivable of a business against loss due to the insolvency or bankruptcy of a customer. Though it is most often associated with international transactions where the credit history and rating of a buyer is unknown to the seller, trade credit insurance is just as commonly used in domestic transactions.

Trade credit insurance can be used to insure a single large sale but is more often employed as a *blanket* or *master* policy insuring a group of account debtors. The policy owner (the exporter or seller), is provided with policy limits per customer by the insurance company which details the maximum exposure to loss allowed per customer. A rider to the policy is typically used to include new customers as sales are made.

USED IN CONJUNCTION WITH EXPORT FACTORING

Credit insurance is sometimes used by an exporter in conjunction with an export factoring transaction. The insurance tends to lower the cost of factoring since the factor is no longer exposed to a possible loss due to insolvency or bankruptcy of an account debtor. While a credit insurance policy will guarantee payment, it is not a stand alone method of finance and will not provide an advance of cash like factoring.

Chapter 3 Quiz

1. A quasi-factoring product used to finance personal injury lawsuits is a _____________

   A. personal injury advance
   B. pre-settlement legal advance
   C. attorney's fee advance
   D. none of the above

2. Loans made to businesses primarily based on the strength of the business's balance sheet are ___________

   A. asset-based loans
   B. financial statement loans
   C. equipment loans
   D. all of the above

3. One of the most difficult loans for a young company to obtain is a (an)___________________

   A. asset-based loan
   B. financial statement loan
   C. factoring loan
   D. equipment lease

4. Asset-based loan providers are primarily interested in the liquidation value of a collateral rather than financial statements.

   A. True
   B. False

5. Asset-based loans typically provide___________________

   A. an 80% advance on accounts receivable
   B. a 50% -60% advance on inventory's fair liquidation value
   C. a revolving line of credit
   D. all of the above

TAKE THE QUIZ

6. To detail the available credit line, asset-based lender will periodically prepare a (an)______________________

   A. accounts assignment schedule
   B. accounts collection schedule
   C. borrowing base certificate
   D. all of the above

7. A method of financing the manufacturing of goods so they may be delivered against a valid order is_______________________

   A. asset-based loans
   B. factoring
   C. purchase order finance
   D. mobilization loan

8. An amount (often 10%) held back by a general contractor as security for poor performance by a sub-contractor is___________

   A. a setoff right
   B. retainage
   C. holdback
   D. mechanic's lien

9. *FACA Laws* provide for an agricultural grower to file a claim in the event it is not paid for produce shipments.

   A. True
   B. False

10. Roughly 17% of all factoring transactions involve______________

   A. freight bills
   B. construction
   C. staffing payroll
   D. real estate commissions

ANSWERS TO THESE AND OTHER QUESTIONS CAN BE FOUND IN THE BACK OF THE GUIDE