# When Banks Say "NO"

The Small Business Guide
to
FACTORING

# *"Lack of Money is the Root of All Evil"*

For large and small businesses alike, capital, in adequately supplied amounts, is the key to business expansion and growth.
Large, established companies with favorable credit histories, have many options from which to choose when periodic injections of working capital are needed.

# *"Lack of Money is the Root of All Evil"*

Small, newly formed businesses are often challenged, however, to find adequate sources of ready cash simply for daily operations much less sources for continuous growth.

# *"Lack of Money is the Root of All Evil"*

The lack of excess working capital often prevents small business entrepreneurs from taking advantage of those periodic "exceptional" business opportunities that present themselves. In many cases, lucrative contracts or purchase orders must be declined simply due to working capital limitations.

# *"Lack of Money is the Root of All Evil"*

One of the most common problems faced by small business owners is the need for payroll capital when lucrative opportunities are offered by large, creditworthy customers that demand payment terms for services provided of 30 days, 45 days, 60 days or even longer.

# *“Lack of Money is the Root of All Evil”*

The necessity to make a weekly or bi-weekly employee payroll while waiting for the first checks to come in from new customers can mean a small business owner may need tens of thousands of dollars available just to accept the new contract. Without accessible payroll capital, such contracts must often be declined.

# *"Lack of Money is the Root of All Evil"*

The most common and best known source of small business finance is, of course, local community and commercial banks.  Unfortunately, however, banks must work under very stringent lending requirements and in many instances, attempting to access and employ bank credit lines often is just a source of frustration.

# *"Lack of Money is the Root of All Evil"*

Banks will always require a source of collateral and a credit history...both difficult to obtain for many new business owners in the early stages of business growth. Without collateral for lines of credit, the difficult decision to pass up "golden opportunities" for business must be disappointingly made over and over.

# *"Lack of Money is the Root of All Evil"*

When banks say "NO", small business owners must turn to alternative methods of finance for growth capital.  This can often include friends and family, angel investors, credit cards, home equity lines of credit, and on occasion, venture capital providers.

# *"Lack of Money is the Root of All Evil"*

For companies that provide products or services on a <u>business to business</u> basis, rather than retail, one of the most powerful forms of easily accessible business finance is that of invoice finance or as it is universally known, accounts receivable FACTORING.

# *FACTORING*

In its purest form, factoring refers to a well-practiced method of business finance in which short-term trade debt (invoices) having terms of payment other than C.O.D. are purchased at a discount by a company (the factor) for immediate payment to the seller.

# *FACTORING*

Though certainly not a household word, factoring in the United States is an enormous industry with current purchase volumes in excess of 125 billion dollars annually. Well known lending institutions such as SunTrust, Wachovia, GMAC, General Electric Credit account for billions in factoring volume each year.

# *FACTORING*

For many start up and “first stage” businesses with little or no access to traditional bank lines of credit, factoring has no equal in its capacity to provide working capital and deal with the funding problems associated with growth and business expansion.

# *FACTORING*

One of factoring's strongest attributes is its simplicity. Factoring is nothing more than a method of commercial finance that relates to the accounts receivable (invoices) of a business. Factoring is never a working capital loan. It simply does one or two things……

# *FACTORING*

Factoring....

- allows businesses that are currently operating on a cash basis with their customers to begin offering terms of payment of 30, 45, or even 60 days. In virtually all cases when terms of payment are offered, customers will tend to by more and more often thus increasing business.

# *FACTORING*

Factoring....

- allows businesses that are already offering payment terms and which may have tens of thousands of dollars “trapped” in accounts receivable to free up that cash by selling the accounts to a factor for immediate payment.

# *FACTORING*

In many ways, factoring is like a mirror image of bank lending. While bankers focus entirely on a business owner’s credit score and ability to repay the loan, factors primarily focus on the creditworthiness of a business owner’s customers since it is they who will be making payment upon the invoice.

# FACTORING

In most cases, factors care little if a business owner has tarnished credit or if the business itself is new with no credit history.  A factoring arrangement will generally be approved so long as the customers of the business are creditworthy.  Even large, slow paying customers are generally acceptable.

# *THE FACTORING PROCESS*

One of the most powerful attributes of accounts receivable factoring is its simplicity. As opposed to bank lending with lengthy application times and “approval by committee”, factoring arrangements can generally be put in place in a matter of two or three days.

# *THE FACTORING PROCESS*

Once accepted, the process of receiving working capital through weekly advances is relatively simple.

- Your invoices generated for weekly services or goods delivered to customers are batched and sent to the factor via overnight courier.

# *THE FACTORING PROCESS*

- The factor's operations department will process the invoices and create an advance schedule listing each invoice to be purchased.
- Once created, the advance schedule will be faxed to the client (seller of the invoices) for review and signature.

# *THE FACTORING PROCESS*

- After review and signature, the client will return the advance schedule via fax. Based on the rate of advance (typically 80%), the funds for purchase will be wire transferred directly into the client’s business bank account.

# *THE FACTORING PROCESS*

- The purchased invoices will be “noticed” with the factors legend, directing the customer to remit payment (under normal terms) to the factor’s lockbox.
- The invoices are mailed to the customers of the client, usually within 24 hours of processing.

# *THE FACTORING PROCESS*

- Each week as payments upon the purchased accounts are received, the client will receive a collection report which documents the payment, the account for which it was paid, and the check number.  Overdue customers are contacted by the factor’s collection department.

# *THE FACTORING PROCESS*

- Periodically (usually twice each month), the factor will release reserve (the 20% not initially advanced) which will be wired directly into the client’s business checking account.  Prior to its release, the factor will deduct its service charge or factoring fee.

# *THE FACTORING PROCESS*

- Chargebacks, those invoices not paid within a specific time (usually 90 days), are also deducted from reserve distributions.
- The process of weekly advances, collections, and reserve distributions continues indefinitely providing a never ending supply of working capital to the client.

# *OPENING A FACTORING ACCOUNT*

Establishing a factoring account is a relatively simple process when compared to applying for a bank loan. In general, it includes...

- Completing a *company profile* providing a “snapshot” of your company, its business, and how you operate.

# *OPENING A FACTORING ACCOUNT*

- Providing a current accounts receivable aging report and customer list.
- Receipt of a *Terms and Conditions Letter* provided by your factor outlining the proposed factoring relationship, factoring fees to be charged, and other important features.

# *OPENING A FACTORING ACCOUNT*

- Receipt of the Factoring Agreement or *Master Purchase and Sales Agreement* which is the contracts and documents necessary to begin the factoring relationship.

- A UCC Search and Filing which will perfect the factor’s security interest in your accounts receivable as collateral.

# *OPENING A FACTORING ACCOUNT*

- Notification of customers regarding the assignment and rights to payment upon all accounts receivable. This is generally done through an introductory letter signed by the factor and the client.

# *OPENING A FACTORING ACCOUNT*

Collateral Note:

Unlike banks which require an abundance of collateral and *blanket liens* for even small lines of credit, factors only require a lien on accounts. This means other collateral such as equipment, real estate, etc. are free to pledge for other forms of business finance.

# *SPECIALIZED FACTORING TRANSACTIONS*

While the vast majority of factoring transaction focus on the everyday working capital needs of the average small business owner, there are other transactions that address the special requirements of certain non-typical businesses or special situations. These include...

# *SPECIALIZED FACTORING TRANSACTIONS*

- International Factoring: Which offers a complete financial package of working capital solutions, credit risk protection, accounts receivable bookkeeping, and professional collections on an international basis. International factoring provides non-recourse payment guarantees to the exporter without letters of credit.

# *SPECIALIZED FACTORING TRANSACTIONS*

- Medical Receivables Factoring: Providing working capital to physicians, surgeons, ambulance services and other medical practitioners which are billing insurance companies for medical services performed and waiting 90 days or longer to receive payment.

# *SPECIALIZED FACTORING TRANSACTIONS*

- Construction Factoring: Which provides advance payment to sub-contractors which are forced to wait extended periods to receive payment from slow paying but creditworthy general contractors or progress billings due from lending institutions.

# *SPECIALIZED FACTORING TRANSACTIONS*

- Factoring Clients in Bankruptcy: Factors are one of the few financing institutions which are able to provide financing to companies operating under a Chapter 11 Bankruptcy Petition. This is primarily due to the “purchase” nature of factoring as opposed to lending.

# *SPECIALIZED FACTORING TRANSACTIONS*

- Purchase Order Finance: Although not true factoring, purchase order finance goes hand-in-hand and addresses the need for the working capital required to actually build products prior delivery. Once built and delivered, they are invoiced and factored under normal terms.

# *QUESTIONS AND ANSWERS*

Q. My company is less than a year old and my personal credit is tarnished. Will I still be able to secure a factoring facility for my company?

A. Yes, in almost all cases. Factoring is ideal for new startups and factors will care little about the owner's credit history.

# *QUESTIONS AND ANSWERS*

Q. How long does it take to establish a factoring arrangement?

A. Factoring arrangements can be set up must faster than a typical bank loan. Factors have no credit committees. Your account is generally set up in 2-3 days.

# *QUESTIONS AND ANSWERS*

Q. I was approached by a broker which introduced me to a factor. Will I be charged for his services?

A. Generally not although some consultants do charge a small initial consultation fee. Other that that, brokers will be paid by the factor.

# QUESTIONS AND ANSWERS

Q. I already give my customers a 2% discount for payment within 10 days. Should I continue this when factoring?

A. Absolutely not. Your factoring fee will generally be less than half that amount for 10 days.

# *QUESTIONS AND ANSWERS*

Q. What other services are provided by my factor?

A. In addition to finance, your factor will provide collections, statements and bookkeeping, and accurate records for income tax preparation.

# QUESTIONS AND ANSWERS

Q. What is the most common reason a company would utilize factoring?

A. Although there are many reasons, the most common is to smooth out the payroll cycle when providing terms of payment to large, creditworthy customers.

# QUESTIONS AND ANSWERS

Q. If I establish a factoring arrangement, will I be required to factor 100% of my invoices?

A. Generally not. Factors will want a good mix of customers to spread their risk but C.O.D. customers and those that pay quickly can be excluded.

# Thanks for Your Time

FOR MORE INFORMATION

CALL

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