

Commercial Finance Consulting

Factoring

A Guide for PAL Affiliates and Associates

*Learn How You Can
Earn Our Industry's
Near-Legendary Residual
Commission Income as
an IACFB PAL Affiliate*

**Includes Subscription to
Commercial Finance Consultantss
Magazine**



International Association of Commercial Finance Brokers

PART ONE: FACTORING BASICS



The Basic Concepts of Factoring



Welcome to IACFB and Factoring. Consultants are utilized throughout various industries as a result of having a specialized expertise or unique knowledge of a product, service, concept, etc. As a new factoring broker, you will need to gain such expertise in factoring and several related areas of asset-based finance if you want to be a true professional. The more you understand about the industry and the more knowledge you accumulate, the more valuable you become to small business owners as well as to your important sources of referral such as bank lending officers and accounting professionals. In short, you need to know your stuff.

**THE MORE YOU LEARN,
THE MORE VALUABLE
YOU BECOME**

Fortunately, factoring is a relatively simple form of commercial finance and once you grasp a few basic concepts, your product knowledge will expand fairly rapidly. Factoring is really just a financing method used by businesses to obtain cash. Factoring is considered a type of *asset-based finance* (ABF) along with asset-based lending, equipment leasing, inventory finance and purchase order finance among others.

**A RELATIVELY
SIMPLE FORM OF
COMMERCIAL
FINANCE**



Asset-Based Finance is pretty much exactly what it sounds like, a method of financing based on the assets of a business. In the vast majority of instances, however, asset-based finance will involve only the “primary” assets found in almost any business entity. Primary assets include:

- **accounts receivable**
- **inventory**
- **equipment**

MORE OFTEN FINANCED WITH AN AMORTIZED LOAN STRUCTURE

Real estate, also an often found business asset, is usually excluded in discussions of asset-based finance since real property is more typically financed in a separate transaction utilizing long-term amortized loan structures.

DYNAMIC VS. STATIC COLLATERALS

Asset-based finance often tends to deal with the financing complexities associated with *collaterals* which are dynamic and whose value and location can change rapidly. An example would be business inventory, which is constantly being decreased as sales are produced and increased as replacement goods are purchased or manufactured. Real estate, on the other hand, tends to be more static in nature and an asset whose value (and location) is always easy to ascertain and monitor by the lender.

Important Factoring Terminology

All industries tend to have a certain amount of industry-specific jargon associated with day-to-day operations and the factoring industry is no different. To follow are some basic (but important) terms you should become very familiar with as an industry broker.

- **ADVANCE:** an initial disbursement of funds by a factor to the seller upon purchased invoices. (Typically 80 percent)
- **ACCOUNT:** an account receivable or simply, an invoice
- **ACCOUNT DEBTOR:** another name for the customer or the party obligated to make payment upon an account
- **ASSIGNMENT:** the assignment of ownership to a factor of the invoices and rights involving such invoices

- **CLIENT:** the business that is selling its invoices to a factor
- **CUSTOMER:** a more common term for the account debtor obligated to make payment on an invoice
- **DISCOUNT:** the fee amount charged over the period an account is outstanding for the factor's service (the "Factoring Fee")
- **NON-RECOURSE:** a factoring arrangement in which the factor assumes the non-payment risks associated with the bankruptcy or insolvency of a customer
- **NOTIFICATION of ASSIGNMENT:** a notice sent to an account debtor regarding the assignment of ownership in the accounts of a business and rights to payment upon those accounts
- **RECOURSE:** a factoring arrangement where the factor has the right to charge-back purchased invoice amounts to the client if payment is not received from the account debtor within a specific period of time (usually 90 days)
- **RESERVE:** the percentage of the face value of an invoice not advanced and used to secure the factor against trade disputes, reduced invoice payment, or non-payment
- **RESERVE DISTRIBUTION:** commonly called a "rebate", is the periodic payment to the client of the excess reserve held by the factor

NOTES

**SENT TO
ACCOUNT
DEBTORS**

Factoring Traditionally Defined

Fortunately, and as previously mentioned, factoring is a relatively simple form of commercial finance and it takes very little to become knowledgeable regarding its implementation. Factoring is traditionally defined as:

A method of commercial finance in which a business (known as the client) periodically sells its accounts receivable or invoices to a specialized finance company (known as the factor). Such "factored" invoices are purchased by the factor at a discount to their face value.

**A RELATIVELY SIMPLE
FORM OF COMMERCIAL
FINANCE**



A Simple Discount Transaction

So factoring is simply a *discount* transaction where an asset of a business is purchased at a small discount of its face value. In the case of factoring, the asset is *commercial accounts receivable*. The purchase discount or fee charged to the seller for such services depends on many things such as:

- The size of the invoices to be purchased (dollar value)
- The total dollar amount sold weekly or periodically
- The creditworthiness of the account debtor (customer)
- Type of transaction (recourse or non-recourse)
- Other risks (international, governmental, perishable goods, etc.)

Say a client generates \$10,000 in invoices each week but each invoice is only \$250 (40 invoices). Let's also say that those invoices represent sales to customers who might be best described as very small "mom and pop" operations. The discount charged by the factor would be higher than average for such a transaction due to the amount of additional work necessary for processing such small accounts as well as the risks.

Conversely, if a client generates 5 invoices of \$10,000 per week representing sales to several large, creditworthy customers, the discount would be less than average, reflecting the minimal amount of work needed to process the transaction and also the minimal amount of credit risk.

REVIEWING CASE STUDIES

Case Studies

Before we delve any deeper into factoring, its time to look at a few samples of real life examples. One of the best ways for new brokers to learn about any new concept is through *case studies*. For our purposes, the case studies featured in this short contest guide will provide you with some examples of true life financings and of how factoring has been used to solve particular problems of various small businesses. All are based on real financed clients, although the names of clients and customers have obviously been changed. The following three case studies are very typical examples of what you will run into as a freelance factoring consultant.



Lester's *Security Plus*

Guards for Gated Communities

Lester Thornton started *Lester's Security Plus* on a shoestring budget in 2015 initially financed with a \$20,000 Home Equity Line of Credit (HELOC). *Lester's Security Plus* primarily provides guards for local gated communities and has gained a good reputation among the real estate management companies in the area.

Last year, Lester received an offer to provide gate guards for four existing communities from a local management company. The management company, *ManageCo*, was replacing their previous service and wanted Lester to provide a bid which he did. Lester was awarded the new contract but immediately found he had a problem. The new management company was a very slow payer on its invoices, taking nearly 60 days in fact. Lester had always paid his guards weekly which meant he would have to fund the payroll for the new guards for roughly nine weeks before the first check came in from *ManageCo*. With guards required around the clock at all four facilities, Lester would be making payroll for the new guards of over \$6,000 per week (168 hours per week x \$9 per hour x 4 facilities). He would need to make that payroll for 9 weeks or come out of pocket nearly \$55,000 before he received *ManageCo's* payment on the very first invoice.

Lester simply did not have that kind of money available and unfortunately, had no ability to borrow more using his HELOC. He did, however, remember meeting a small business finance specialist named Jerry Goggins at a recent *Chamber of Commerce* meetup. Jerry and Lester had discussed the possible use of something called *factoring* to finance *Security Plus* if it ever became necessary. Well, it had suddenly become necessary and Lester made a call to Jerry.

After the call, Lester and Jerry met for lunch to discuss financing and Jerry quickly recognized that factoring would solve this problem. Jerry worked with a factor that specialized in service sector finance and he knew the factor's flat fee rate was about 5-6 percent for 60 days. Lester had over a 50% profit margin on his services so he could easily absorb the factoring fee. After lunch, Jerry went back to Lester's office and they made a quick call to the factor who was immediately available to discuss a factoring arrangement.

On the call, the factor asked about the business loan and was assured it was secured by Lester's home and not the business assets. The factor gave Lester a tentative rate of 1.25% for 15 days which meant the 60 day payment would only be charged 5% but it also meant Lester could factor all of his other receivables, which were usually paid in 30 days or less. All in all, *Security Plus* would be financing about \$120,000 per month.

Lester's finance problem was solved. Jerry, because of his relationship with Lester, now would earn a monthly referral commission from the factor. **FACTORING COMMISSION EARNINGS: \$400 - \$600 per month.**



Ziggy's Welding Specialties

Onsite Equipment Repair

Dieter Ziggins started *Ziggy's Welding Specialties* in Tampa, FL to provide onsite welding services for construction equipment. Ziggy's has grown rapidly since opening in 2005 and currently has two (2) mobile welding trucks to provide services to local contractors.

Dieter Ziggins was pleasantly surprised to receive a call one day from a national steel building contractor in need of mobile services. The contractor was beginning operations in Florida and would need an onsite mobile operator for at least the next 24 months to service new steel building being erected. The hourly fee offered was exceptional, however Ziggins would need to submit a single invoice each month for all work completed during that calendar month. The invoice would then be paid within 30 days. That meant Ziggins might have to wait as long as 60 days to be paid on some work. Additionally, Ziggins would likely need to outfit another vehicle just to handle the steel building contractor's additional business which was estimated to be \$100,000 per month. Ziggins was already billing about \$150,000 per month with local contractors who paid in 30 days or less. This new business meant billings of roughly \$250,000 and Ziggins decided to talk to his banker about a loan.

At a meeting with a loan officer at his local bank, Ziggins was given the unfortunate news that the bank would not be able to help since they only offered real estate financing and not asset-based loans. The loan officer said it really sounded like Ziggins could use something called *factoring* and he provided Ziggins with the name of a local consultant he had referred business to before that specialized in *factoring* for the construction industry.

After leaving the bank a little worried, Ziggins called the consultant who met with him that afternoon. The consultant agreed that so long as the steel building contractor's credit was good, factoring would do the job and a conference call was set up with a factor for later that afternoon.

On the call, the factor quickly researched the credit of the steel building contractor and found it was good. He also requested an accounts receivable aging report to pull credit on Ziggins' other clients. Once received, he would provide Ziggins with a "Terms Sheet" with pricing.

Within 48 hours, *Ziggy's Welding Specialties* was provided with a \$250,000 factoring credit facility. Ziggins would now be factoring all of his invoices and the factor would act as his accounts receivable finance and management team. At an average discount rate for services of 4%, the factoring fees would be little more than accepting a credit card and Ziggins could now hire additional staff as well as purchase and outfit an additional vehicle. **FACTORING COMMISSION EARNINGS: \$1,000 - \$1,250 per month.**



Cactus Jack's **Custom Tanks** *Specialty Motorcycle Tanks & Fenders*

Jackson Sprockett, better known as “Cactus Jack”, was a metal fabricator specializing in custom fenders and fuel tanks for motorcycles. He started *Cactus Jack's Custom Tanks* in 2010.

Jack was an expert in the use of an English wheel, a special tool used to shape sheet metal, and had become well known in the custom bike community after being featured in a well-read biker magazine with national circulation. Business had picked up dramatically after the article and, his shop was always busy, although primarily for one-off custom fabrications for individuals.

Shortly after the featured article, Jack was contacted by a regional motorcycle custom parts supplier about supplying an exclusive line of "Cactus Jack" fenders and tanks. The supplier had 37 stores and would be carrying "Cactus Jack" inventory in each, along with special order options. They estimated they would need about \$3,000 in tank and fender inventory in each store monthly or a little over \$110,000. Terms of sale would be 45-day net, which gave the supplier ample time to sell the goods prior to payment.

Jack was delighted with the prospective order, but his was a small custom shop, and he would need to hire at least one additional aluminum fabricator and one gas welder skilled at thin-gauge aluminum welding. Neither would come cheap. He would need some payroll financing because of the 45-day terms of payment required by the supplier.

Jack's brother had a local janitorial service that had been using something called *factoring* for years to finance its payroll, and he wondered if factoring would also work for him. He called his brother and got the phone number of the factor, and made a call.

On the call, Jack explained the opportunity to his brother's factor, who quickly looked at the credit rating of the parts supplier. It was excellent and would be enough to provide a credit limit of \$100,000 so that Jack could finance 100% of the supplier's invoices. Jack had no bank financing in place, so the factor could enjoy a secured 1st lien position in accounts receivable, which is always required in factoring.

The factor assigned an account executive to the account and, Jack then received a factoring contract (called a Master Purchase and Sales Agreement) via overnight courier. He quickly executed the contract and returned it to the factor. *Cactus Jack's Custom Tanks* could now comfortably hire the two new employees needed to fabricate the quantity of tanks and fenders needed to meet the new orders.

FACTORING COMMISSION EARNINGS (Had one been involved): \$350 - \$450 per month.



NOTES

FACTORING IS NEVER A LOAN

Factoring vs. Lending

Factoring is easily distinguished from the more common methods of business finance provided by most banks in that true *factoring* is never a structured as a *loan*, but rather as a *purchase and sale* transaction. Also, since factoring only relates to invoiced sales, it is strictly a method of financing business-to-business or B2B transactions. It is very important for brokers to understand that factoring is not used to directly finance retail consumer transactions. Understandably, when immediate payment is received by cash or credit card at time of sale, there is no invoice or extension of payment terms and factoring would be, by definition, unnecessary.

FACTORING INVOLVES THREE PARTIES

Rather than just the two parties commonly involved in a normal business loan (the borrower and lender), there are always three parties involved in any factoring transaction. These are the:

- **client**...the seller of the invoices
- **factor**...the buyer of the invoices
- **account debtor**...the client's customer obligated to make payment upon the invoices

ALWAYS USED TO FINANCE TERMS OF PAYMENT

Working capital generated by factoring business accounts receivable can be used for hundreds of purposes such as payroll, buying equipment, paying suppliers, purchasing inventory, etc. The factoring process itself is only utilized for one thing, however, and that is to provide a method of financing extended *terms of payment* for customers. Financing sales made to customers on credit terms is an essential component of good cash flow management. Factoring provides that financing solution for small businesses worldwide.

The use of the term "factoring" has grown over the years to include any financial transaction which involves *discounting*. For example, buyers of *structured settlements* are said to "factor" the annuitized settlement payment streams when making lump sum annuity purchases. Credit card companies are said to be factors due to the discount charged to the merchant for guarantying the payment made by a consumer. For our purposes, however, we will limit the discussion of factoring and the presentation in this guide to the simple discounted purchase of business trade receivables.

Understanding Terms of Payment

NOTES

Because factoring tends to be used solely to finance the *terms of payment* extended by a business to its customers, brokers should become very familiar with this concept and why the granting of terms of payment is so important (and often problematic) to small business.

In everyday business transactions, terms of payment are simply the conditions set forth regarding payment for delivered goods or services. When providing over-the-counter retail products or services, terms of payment are NOW, by immediate cash or credit card! In invoiced sales transactions between businesses (B2B), extended terms of payment are granted and will set forth the amount of time the customer has to remit payment for the goods or services purchased.



In B2B commerce, common terms of payment granted to buyers are 10, 15, or 30 days. In large international transactions, terms of payment can become much more complex and may include payment "conditions" such as trade documents processing or the posting of a *trade* or *standby letter of credit* guarantying timely payment to the seller. Terms of payment granted to customers may also feature discount offers for fast payment. For example, terms granted to a buyer of "two percent net 30" means the seller can discount the amount due upon the invoice by 2% of the balance if the payment is remitted in less than 30 days.

**TERMS OF PAYMENT
MAY FEATURE
DISCOUNTS**

There are many reasons for a small business to grant terms of payment to its customers. In some cases, it is simply because the customer is a large, creditworthy company that demands them. The small business will agree to grant terms of payment so it can receive the order. In other instances, extended payment terms are granted to keep existing customers happy and to maintain competitiveness in the marketplace. Attractive terms of payment can also be used to "woo" customers away from more established competition.

**LARGE, CREDITWORTHY
CUSTOMERS DEMAND
TERMS OF PAYMENT**



But, no matter what the reason for granting terms, the result is always the same. The small business owner has suddenly found himself in the position of *financier* and is, in fact, financing a customer's business by granting credit in the form of payment terms.

Unfortunately, by helping to finance the enterprises of customers, a business owner may also be creating a serious cash flow problem for his own company. All of those attractive payment terms granted to customers can suddenly add up and an owner may find himself chasing the checks of late paying customers just to make sure the cash is available for his own weekly employee payroll.

ONLY TWO WAYS TO ATTACK TERMS OF PAYMENT PROBLEMS

For businesses with limited working capital, there are really only two ways to attack the terms of payment issue:

- 1. Stop extending credit to customers (which may result in losing existing customers and may cripple the ability to attract new ones).**
- 2. Arrange for a method of financing accounts receivable.**

Factoring, and several other forms of asset-based finance, are specifically designed to remedy such cash flow problems associated with invoiced sales. For smaller, non-bankable companies with a limited credit history, factoring is often the only readily available financing choice. That is because of how factoring is structured, as a “purchase and sale” transaction and not as a loan.

FACTORING WORKS ON "OPC" OR OTHER PEOPLE'S CREDIT

Almost everyone has heard of the term OPM or “other people's money”. Factoring is a readily accessible cash flow solution for very young companies with minimal financial history because it operates on OPC or “other people's credit”. Unlike a traditional bank loan where the bank looks at the borrower's creditworthiness, with factoring, the business owner's credit (or lack thereof) is of a secondary consideration. When underwriting a new client, the factor is much more interested in the credit history of the business owner's customers, the ones who will actually be making payment on the purchased invoices, rather than the business owner himself.

Invoices & Eligibility



Factors are NOT buyers of *delinquent debt* or invoices with perceived payment problems. While this concept may seem relatively straight forward, it actually is not. This is because not all invoices are created equal and certain types of invoices having conditions for payment, can disqualify them for purchase by a factor, such as...

- **CONSIGNMENT INVOICES:** Goods sent to a customer on *consignment* are goods which the customer will use its best efforts to sell but will not actually purchase. In the event the goods do not sell, they are then returned to the manufacturer / distributor and payment is only made upon the goods actually sold.
- **PRE-SHIP INVOICES:** This is not a valid invoice since the service has yet to be performed by the client or the goods have yet to be shipped and delivered.
- **GOVERNMENT RECEIVABLES:** Invoices payable by cities, states, or the federal government will sometimes not be acceptable to a factor. This is usually due to the factor's inability to properly "notice" the governmental entity regarding payment. Fortunately, there are specialized "niche" factors that routinely handle such difficult transactions involving governmental entities.
- **OVER 90 DAY RECEIVABLES:** Factors only purchase invoices payable under normal terms (under 90 days). Factors are NOT bill collectors and do not purchase delinquent debt and questionable invoices.
- **INVOICES SUBJECT TO LIEN:** Invoices which are subject to a *mechanics lien* represent a minefield when purchased since payments can be subject to "priming" or having someone jump ahead of the factor for payment. This is very common when factoring general contractors and can also occur when factoring certain food producers.
- **CONTRAS:** A *contra* occurs when a factor's client and an account debtor sell goods or services to each other and subsequently exchange invoices. When a contra exists, there is always the risk that both parties will agree to simply offset or cancel invoice payments due.

PRE-SHIP INVOICES

MECHANIC'S LIENS



NOTES

- **CONTINGENT INVOICES:** A *contingent* invoice is one whose payment is dependent upon the performance of another service. For example, the payment upon an invoice for computer equipment and hardware might be contingent upon the seller's proper installation of that equipment and hardware.
- **FOREIGN ACCOUNTS:** Foreign accounts are those payable by a business in a foreign country. When dealing with foreign accounts, even though a factor may be able to perfect a foreign security interest, the problems which can occur regarding actual collection often make such foreign accounts undesirable.
- **POOR CREDIT QUALITY:** Some receivables are simply ineligible for purchase due to the poor credit quality of the customer.



The Bottom Line

MARKETING WITH DELINQUENT DEBT

As you begin to generate your first leads from your marketing efforts, you will probably get responses from quite a few small businesses with accounts that are "problem" accounts. Many small business owners carrying delinquent debt would love to sell some to a factor and recoup 80 percent of their money. Very few factors, however, are in the delinquent debt business. Brokers can earn commission income, however, by placing delinquent debt with debt collectors. In fact, making cold calls to business owners regarding delinquent debt can often lead to a conversation about financing their regular trade invoices through factoring or asset-based loans.

Another type of problem every broker is sure to run into is that of pre-ship invoices or invoices where the work has yet to be done or where the goods have not been delivered. For example, a janitorial service may actually invoice a client on the first day of the billing month for cleaning services which WILL BE performed over the next 4-5 weeks. This is *pre-billing* and such invoices cannot be purchased by a factor until the work is completed. Some factors, however, have gotten creative regarding client advances based upon monthly pre-billing by only releasing a portion of the advance, week by week, as the work is actually completed.

8 Reasons to Employ Factoring



The need for factoring is usually the result of an inability of a business to access traditional bank loans or lines of credit, a trait that is of even greater importance during periodic times of economic downturn. So it is really no surprise that modern business owners are becoming increasingly more aware of factoring as a ready form of alternative commercial finance and one which can be employed quickly in times of cash flow and working capital crisis.

From a technical financing standpoint, and as you now understand, factoring is only utilized to address the cash flow problems caused by extending terms of payment to customers and the working capital shortfalls such extensions can ultimately create. Shortages of working capital can result in serious problems for business owners who will then seek out some financial option as a remedy. Problems associated with working capital shortages which can drive a small business to seek factoring include:

PROBLEMS OF CASH FLOW CAUSED BY TERMS OF PAYMENT

- ⇒ **PAYROLL:** Shortages of cash when payroll is due are by far the most common reason for a business to seek out the services of a factor.
- ⇒ **SUPPLIER PAYABLES:** Making timely payments to suppliers or also being able to take discounts for early supplier payments.
- ⇒ **TAX OBLIGATIONS:** Especially payments associated with employee 941 payroll taxes.
- ⇒ **EQUIPMENT:** Raising cash through the sale of invoices to purchase equipment when leasing is not an option.
- ⇒ **INVENTORY:** Purchasing inventory when other forms of lending are not available.
- ⇒ **MARKETING:** Expanding and increasing marketing operations.
- ⇒ **EXPANSION:** Raising capital to enter new markets, buy out a competitor, or other forms of business expansion.
- ⇒ **INVESTMENT OPPORTUNITIES:** Raising cash for an investment opportunity such as buying a building or purchasing an additional franchise.



The entire list of reasons for a business to utilize receivables finance and establish a factoring arrangement is fairly expansive. In most cases, however, savvy brokers know working capital shortages will tend to first appear when cash is in short supply for the timely payment of *employee payroll*.

MANY BROKERS FOCUS ON THE SERVICE SECTOR

As you learn more as you get involve in marketing, one reason why experienced factoring brokers focus much of their business development efforts on payroll intensive services related prospects such as staffing companies, guard services, janitorial services, landscaping companies, etc., is because of their typically large payroll responsibilities. These are businesses that tend to have an abundance of employees and sizable weekly or bi-weekly payrolls. For brokers, they can represent "low hanging fruit" for prospecting and as we will discuss later, such small service companies with an abundance of employees are a great place to start marketing.

Characteristics of a Typical Factoring Client

You can now better understand why *terms of payment* can cause cash shortages and also why a small business owner would look to factoring as a ready solution to such shortages. But now let's look at factoring from the another viewpoint, the factor's viewpoint. So, what characteristics make a business a good candidate for factoring?

WHAT MAKES A GOOD FACTORING CLIENT

Over the last 50 years, factoring has expanded rapidly in the U.S. and now touches hundreds of industries. Still, all business owners in every industry do not qualify for factoring. For industry brokers, being able to focus your marketing efforts and campaigns on those business types which will yield the best results and have the highest possibility of becoming commission-generating clients is important. The following are some common characteristics of an acceptable prospect, from the factor's (and broker's) perspective.

- **UNENCUMBERED INVOICES:** The factor must have a FIRST PRIORITY lien secured by the accounts receivable of the client. This means there can be no previous lender in place that has a prior right to invoices as a collateral.

**NOTES**

- **BUSINESS TO BUSINESS (B2B) INVOICED SALES:** As a method of business finance, factoring only addresses one area, and that is the cash flow problems associated with granting terms of payment upon invoices. As such, only businesses that invoice to other businesses (B2B) for goods or services are eligible for factoring. Factoring, as a financial tool, MUST ALWAYS INVOLVE AN INVOICE. The goods must have already been delivered or the services already performed.

INVOICED SALES ONLY

- **ASSIGNABLE INVOICES:** Factors will require the ability to "notice" the customers of a client so they will make payment directly to the factor's address or lockbox and no longer to the client. For legal notification, this requires that the purchased invoices be "assignable".

Notification is typically not a problem with any normal trade invoices. Assignment provisions, however, can become complex when dealing with federal or certain state or municipal governmental entities.

- **ACCEPTABLE PROFIT MARGINS:** Factors will look at profit margins before taking on a new client to ascertain whether the client has enough transactional profit to absorb the costs of factoring. Most factors will want to see at least a 15% profit margin. Very few small business owners operate below or near this level. You will find most service providers to be in the 30% or above and many manufactures in the 50%-100% range or even higher. Still some industries, such as agricultural growers (fruits and vegetables), can operate on very low profits.

**FEDERAL TAX LIENS
JUMP AHEAD**

- **FEDERAL TAX LIENS:** Prior to establishing a factoring relationship with a new client, the factor will search for existing *federal tax liens*. Federal tax liens usually involve unpaid 941 taxes (payroll). Federal tax liens are "super liens" and can *prime* or jump ahead of a lender's assignment rights. A factoring relationship cannot be established if there is an existing federal tax lien which cannot be satisfied, remedied or subordinated.



SAVVY BROKERS LOOK FOR TAX LIEN PROBLEMS

NOTE: While an existing tax lien will often prohibit a financing relationship, there are several methods of dealing with such liens so a relationship can be established. These include:

- **paying off the tax arrearage out of the first financing**
- **obtaining a lien subordination from the IRS**
- **making payments to IRS under an existing payment plan**

Many experienced, well "seasoned" brokers will look for businesses suffering from tax liens and prospect them with a possible solution to their tax problem. In virtually all cases, a business owner with back taxes owing would much rather deal with a factor than with the IRS.

- **CONTINUOUS NEED FOR FACTORING SERVICES:** A business seeking the services of a factor should exhibit a continuous need for financing. In fact, most factors will require a minimum of a one year contract with a specified minimum acceptable amount of invoices submitted for factoring each month. Business owners that have only a periodic or a very occasional need for factoring will find it much more difficult to attract a suitable provider.

While most factors are relatively strict regarding the continuous need provision, exceptions are routinely made for those clients requiring only "seasonal" factoring. This is very common for certain companies whose business spikes markedly during the holiday season, for example, when sales to large, creditworthy retailers increase significantly for just a few short months.

SPOT FACTORING

Some businesses will not require factoring on an ongoing basis but will need a financial accommodation only once or twice a year for an extremely large, out-of-the-norm billing which they simply cannot handle without some method of financing. Such periodic transactions are routinely accepted by roughly one half of all factors (see SPOT FACTORING). Business owners seeking a *spot factoring* arrangement must usually meet some rather strict guidelines and must also be prepared to pay slightly higher fees.

Factoring Styles



Factoring is one of the oldest known forms of commercial finance and though it has grown steadily through the centuries, its basic structure and list of services is still very similar to those found in transactions referenced during the Middle Ages. Over the centuries, factors have created many transactional programs to accommodate particular customer types. Today, factoring programs and specialty areas are expansive and nearly as numerous as the factors themselves. Still, the nuts and bolts basics of accounts receivable factoring remain the same and can actually be divided into just two major styles; *Maturity Factoring* and *Advance Factoring*.



Maturity Style Factoring

Maturity Factoring, with its historical roots entrenched firmly in the garment and textile industries, has been common in America since the 1920's and is known by a variety of other names such as *Traditional Factoring* or *Old Line Factoring*. All true maturity factoring arrangements are primarily structured around the factor's provision of credit and collection services rather than that of actually advancing cash for financing. In a standard maturity style factoring transaction:

**FIRMLY IMBEDDED
IN GARMENTS
AND TEXTILES**

- The factor provides credit analysis of a client's customer or group of customers.
- If not paid timely by the customer, the factor pays the owed amount upon credit approved accounts in an agreed upon number of days after sale, delivery, and invoicing.
- If a credit approved customer is unable to pay an invoice due to insolvency or bankruptcy, the factor provides payment as guarantor. There are no "advances" of cash made under a true maturity factoring arrangement. Payment is only made at the average maturity of the invoice batch if the purchased accounts remains unpaid.

**NO ADVANCES
OF CASH**



As mentioned, maturity factoring is historically related to the garment and textile industries where it is still routinely found. In fact, some aspects of modern maturity factoring in America are easily traced back to the Colonial era of “king cotton”. Because of the massive (and ever growing) amounts of offshore manufacturing now prevalent in this industry, true maturity factoring arrangements are no longer as common as they once were. In fact, recent polls of the industry reveal that well under twenty percent (20%) of all factors now offer a maturity-styled factoring product.

Advance Style Factoring (California Factoring)

CALIFORNIA FACTORING

Since maturity factors historically purchased and had control over a client's accounts receivable, a natural and eventual service addition to the maturity style was to provide some form of "pre-payment" or finance option upon the invoices purchased, rather than just traditional credit analysis and collection services. Such requests were already occurring on occasion in the maturity factoring arena and enough in fact, for some creative California-based factors to style a completely new type of factoring based upon an immediate advance of cash rather than just credit and collection services.



California factoring, most often called *advance factoring*, focused on industries other than garments and textiles and created a powerful new and accessible form of small business finance now available to cash-starved entrepreneurs nationwide. Unlike maturity factoring arrangements where the client expected to wait 30-60 days before payment was received, the new advance factors tended to put their clients on almost a C.O.D. basis. Advance factoring was initially directed towards smaller clients, typically those business owners generating under \$150,000 in sales each month, since this was a business segment largely ignored by the nation's large maturity factors.

Once the advance factoring transaction was perfected, this new factoring style grew exponentially. Today, the advance style of factoring represents a strong majority of all transactions and an ever growing segment of the asset-based finance industry.

The Growth of Advance Factoring

As the prevalence and popularity of the modern advance-style of factoring grew, hundreds of industry types and segments were added to the range of prospective factoring clients. It's now safe to say that the days of factoring services being primarily associated with the garment and textile industries have likely ended forever.

In a standard advance-styled factoring transaction today:

- ⇒ The factor advances funds on purchased accounts immediately with cash being wired directly into the client's business bank account.
- ⇒ The factor still provides expert credit analysis and collection service for the client's benefit.
- ⇒ If a credit approved customer is unable to pay an invoice due to insolvency or bankruptcy, the factor may make payment as the guarantor under *non-recourse* arrangements or may not under *recourse* arrangements. (See Recourse / Non-Recourse on the following page)
- ⇒ In a non-recourse arrangement, the factor's guaranty of payment only extends to matters of insolvency or bankruptcy of an approved customer and not trade disputes related to poor performance.

**IMMEDIATE ADVANCE
OF FUNDS ON
PURCHASED ACCOUNTS**

The Bottom Line

Though *California factoring* originally tended to focus on small, entrepreneurial startups, that has changed over the years. Today, it is not unusual to find this method of factoring employed to finance businesses generating a \$1,000,000 or even more in monthly receivables. Internationally, the growth of the advance style of factoring has been explosive and currently accounts for trillions of dollars of small business financing each and every year. Factoring brokers should be aware that maturity factoring still exists for the very rare occasion. Virtually all prospects you meet, however, will likely require the immediate injection of cash which is characteristic of the advance-styled transaction.

**EXPLOSIVE GROWTH
INTERNATIONALLY**



Recourse and Non-Recourse Factoring

One of the questions most often asked by prospective clients is: *What happens if one of my customers doesn't pay?* The answer depends on the kind of factoring facility provided or more accurately, whether the factoring arrangement is one of *recourse* or *non-recourse*.

FACTOR TAKES THE LOSS



Factoring brokers should strive to develop relationships with both recourse and non-recourse factors. In fact, many factors offer both services only with different cost structures. Some even offer a modified recourse product which has certain characteristics of both recourse and non-recourse factoring. When building your lenders database, make certain you create group segments for both recourse and non-recourse factors.

As you already know, traditional factoring (maturity factoring) was a service which provided credit analysis and collections rather than financing. The factor paid the face value of invoices ONLY if the customer failed to pay within the allotted time under the terms of payment granted. Since the factor is the guarantor in a maturity

factoring arrangement, all such arrangements are non-recourse by definition, meaning the factor has no option if the invoice is unpaid due to insolvency or bankruptcy. The factor takes the loss and pays the client.

In modern advance factoring arrangements, factors can provide their services either on a *recourse* or on a *non-recourse* basis. Under a *non-recourse* method, the factor will be responsible for the losses on credit-accepted accounts which are not

paid based on the insolvency or bankruptcy measure. Under a *recourse* method, however, the client is said to "warrant" the payment of the invoice by the customer. If the purchased invoice goes uncollected after a stipulated period of time (usually 90 days), the factor will charge back (force the repurchase of) the invoice to the client's account.

Its important to note that California-style recourse factoring, is most often employed to deal with smaller clients, often with even smaller, marginal account debtor credits. Strict non-recourse factoring often simply doesn't provide the necessary service to the client who is primarily in need of financing and immediate cash under all circumstances.

Obviously, a factor is not going to agree to guarantee and purchase large amounts of invoices generated from sales to very small retailers that could realistically "close up shop" tomorrow.



So in some cases, small customers may be responsible for a relatively large portion of the total sales of the factor's client. In such instances where a client sells to a majority of small "mom and pop" businesses and establishments, the guarantees provided by non-recourse factoring are unrealistic and simply will not do the job. Only some type of recourse-style transaction can provide the much needed working capital and cash flow solutions.

Verification of Invoices

From a lender's viewpoint, accounts receivable are generally looked at as a very high-quality collateral. This is because invoices are self liquidating. They will routinely be paid at or near their face value by the customer within a very short period of time and usually without so much as a collection call. And, even if there is a small deduction from full payment for a product flaw or poor service, such a deduction is seldom large enough to detrimentally affect the overall factoring transaction. The factor's advance is normally only at or near 80% of the invoice's face value, so the factor temporarily retains the 20% balance as a "reserve" just for such occurrences.

**VERY HIGH QUALITY
COLLATERAL**

Still, even though a very high-quality collateral, an invoice is a business asset very easily falsified. It is really only a piece of paper evidencing a commercial debt.

Anyone can print thousands of fraudulent invoices from their home computer and submit them to a factor for purchase. Unfortunately, such attempts at fraud are not uncommon. This is why factors, with tens or even hundreds of thousands of dollars at risk on a single client advance, have become experts at the verification of invoices and the detection of fraud.

**FRAUD NOT
UNCOMMON**





NOTES

REQUIRED TO "SIGN OFF"

During the *verification process*, factors will contact a client's account debtors to ascertain the validity of invoices subject to advance. This is done prior to purchase and the factor's operations staff will most often verify an invoice by speaking directly with the purchasing or accounting department of a debtor. In cases where invoices involve physical goods and are of substantial size, factors may require a copy of a *purchase order* from the customer as well as shipping documents from the client to show that the order is valid and that the goods have actually been delivered. In some instances, the customer's accounts payable or receiving manager will be required to "sign off" on the invoice, evidencing the goods were received as ordered and that the invoice will be paid under normal terms of payment.

Fraud and the Independent Broker

Verification is always one of the most important steps in the factoring process but is of premier importance when it comes to a broker's new client submissions. Fortunately, verification has become quite a bit easier with the growth and expansion of the internet. It has, for example, become much easier to verify the true existence of account debtors and it is much more difficult to pass off a fake. Brokers should understand, however, that even though they are independent in the nature of their business relationship with a factor, they are also there to protect their financing source from fraud.

FIRST LINE OF DEFENSE AGAINST FRAUD

A well trained and knowledgeable independent broker is a factor's first line of defense against fraud. Factors will very often accept small factoring referrals without physically visiting the prospective client's business offices. For brokers, however, that is most often not the case. Most brokers work locally and will almost always call on their prospect at the workplace. And while factoring brokers never get involved in the actual contacting of account debtors and verification of an invoice, they should always stay alert and be "tuned in" to a prospect's local business operation, making certain it is legitimate, at least in its appearance. Always be alert for the possibility of fraud and a fraudulent client. If you sense anything wrong or not aboveboard when visiting a prospective client's office, report it to your factor immediately.

The Concept of Collateral



Factors, as you know, are members of the asset-based finance (ABF) community of lenders and as a group, all asset-based financiers operate based on the concept of *collateral*. What really sets this group apart from traditional "financial statement" lenders, such as most banks, who gauge loan approval primarily on a borrower's financial strength, is that asset-based financiers focus more heavily on collateral assets and the ability to quickly liquidate a particular collateral in the event a financed party defaults on its obligations. For example, an equipment leasing company depends on its ability to repossess a piece of equipment and sell or re-lease it to recover or protect its invested capital if the lessee fails to make its timely lease payment.

Put simply, collateral is just a pledge of an asset which secures a borrower's repayment of a loan or similar financial accommodation. Anyone who has ever purchased a home is familiar with this concept with the mortgage lender having the right to *foreclose* on the real property if monthly payments are missed. The same is true for any business asset which is used to secure a commercial loan. In business finance, such lending is termed "secured lending", since the loan is secured or backed up by a collateral which can be liquidated in the event of default.

**COLLATERAL JUST
A PLEDGE OF AN ASSET**

SECURED LENDING

For factors, collateral is the *accounts receivable* of their clients, even though true factoring is never a loan. As you know, factors actually purchase the accounts of a business at a discount and contractually, the business accounts (and rights to collection thereon) are *assigned* to the factor by the business owner at the time of purchase. The accounts are pledged as collateral for the factoring arrangement at the time of contracting. The factor then becomes sole owner of the accounts and when due, will receive payment directly from the seller's customer, the *account debtor*.

**INCLUDES BOTH
PURCHASED AND
NON-PURCHASED
ACCOUNTS**

You should also know that in almost all instances, the pledge of accounts as collateral for a factoring facility includes both purchased and non-purchased invoices. In an event of default by the client, the factor has the right to collect on all invoices, purchased or not.



The Uniform Commercial Code

COLLATERAL FINANCED TWICE

Although the factor's purchase of the invoices through payment and assignment provides rights to collection, there exists another problem. What is to prevent a business owner from securing a loan from a bank or traditional lender, pledging its accounts to the bank as collateral, and then subsequently applying for a factoring arrangement and pledging the same accounts a second time to the factor? If done, the collateral would be financed twice and in theory, shared equally by both the factor and the bank. A battle surely would ensue to see who gets paid first in the event of default by the borrower. To prevent such a problem and enjoy a truly secure transaction, factors and lenders file a document called a *Uniform Commercial Code Financing Statement*.

ARTICLE 9

The *Uniform Commercial Code* (UCC) is a body of business related law that governs commercial transactions in all 50 states and especially those transactions involving the sale of goods, their transportation and delivery, and the payments upon such goods. The UCC is comprised of a series of *articles* or sections which, among their many focuses, define certain transactions and rights regarding those transactions. Included among these are sales, leases, deposit transactions, letters of credit, negotiable instruments, etc. Most important to factors and the asset-based finance community, is something called "Article 9", which deals with the laws and rules involving *secured transactions*.

When financing a company based on an asset or assets, a lender will file a "security interest" in the assets as collateral for the loan or financing. This filing document, called a *UCC-1 Financing Statement*, is said to "perfect" the lender's security interest in the collateral. In layman's terms, the UCC-1 filing:

- **notifies the world that a financing is in place**
- **describes what specific collateral secures the loan**
- **determines the "pecking order" regarding who's entitled to the collateral in the event the borrower defaults on the loan.**

When filed, a UCC-1 is time stamped and in the world of UCCs, first to file wins. The first filer (lender) is said to be *senior* lender, and is entitled to collect upon the collateral first in the event of default. Second or lower position filers are *junior* lenders. In the event of default, a junior lender is only entitled to proceeds from the collateral after the senior lender is satisfied fully. In factoring financings, the factor must always be senior lender on accounts.



Searching the UCC for an Active Lien

When underwriting a new client, one of the very first tasks a factor or any lender will perform is to search the appropriate UCC database to determine if the collateral for a loan is available or is already pledged and subject to lien by some previous lender or factor. The UCC requires that a UCC-1 security interest filing be:

SEARCHING THE UCC

- ⇒ **filed in the UCC filing database in the borrower's (client's) state of incorporation.**
- ⇒ **filed under the legal name of the borrower and exactly as it appears in the corporate records in the Secretary of State's office.**



Such a standardized filing and database system makes determining the availability of any collateral a relatively simple process. Lenders can search confidently for current active UCC filings on most business collaterals.

So as you now know, factors must have a senior 1st position lien on accounts in order to provide financing. If a search of the UCC filing database evidences a current active filing upon a prospective client where the client's accounts receivable are pledged, the ability to finance the prospect through factoring is prohibited unless:

- ⇒ **the current lender will *subordinate* (release) its senior position on accounts. (This will normally only occur if the lender has an abundance of other assets it can use to collateralize the loan).**
- ⇒ **the existing loan is of such a small size that the factor's initial cash advance upon invoices can pay off the loan's balance and *take out* the previous lender.**

SUBORDINATE IT'S LIEN POSITION



Even prior to the final contracts with a client being signed, it is not unusual for the factor to file a UCC-1 financing statement to secure its first lien position in accounts. In some instances of fraud, a borrower will apply to multiple lenders at the same time, attempting to quickly secure financing more than once on the same asset and thus defrauding the lender.

UCC-3 AMENDMENT STATEMENT

In the event the contracting with the new client is not finalized and does not occur, the factor will simply release its lien. Such a lien release is performed by filing a *UCC-3 amendment statement* which is used to extend, modify or to terminate an existing, related UCC-1 financing statement.

Notification of Assignment

Once invoices are purchased, factors monitor their investment and turn to collections. In fact, at this point factors are simply “waiters”, but not the kind you might find in your favorite restaurant. Factors wait for THEIR money on THEIR invoices. The use of “their” is emphasized here because as you know, factoring is a purchase and sale transaction and never a loan. Factors own the invoices.



Once purchased, the invoice is assigned and the factor is the legal owner of the invoice and has all rights to the invoice payment. In fact, if a factor's client receives a payment on an assigned invoice and doesn't immediately remit that payment to the factor, it can be construed as civil theft with varying legal ramifications and penalties, depending on the state of jurisdiction. In the industry this is called a *misdirected payment* or more commonly, *collection*.

To help avoid such problems of misdirected payments, factors will notify a client's customers of the invoice purchase, assignment of rights, and the existing financing arrangement in a process called *notification of assignment*. The rules regarding such notification are set forth in Article 9 of the UCC and basically state that once legally noticed, the account debtor's payment obligation is now to the noticer (factor or lender) and no longer to the borrower (client).

All Invoices of the Account Debtor

When a client's customer receives notification, the notification pertains to ALL invoices currently payable or payable in the future. It includes invoices factored as well as those invoices not factored. UCC law is written to be very black and white with little gray area for lawyers to argue over. Although the client may have an arrangement with a factor under which all invoices of a customer do not have to be factored 100% of the time, all invoice payments must, none the less, be made to the factor's address whether they were financed or not. Payments made to the factor on invoices not purchased will simply "flow through" to the client's bank account when reserve distributions are made.

If properly (legally) noticed, the account debtor has really no option but to pay the factor going forward. To ignore the factor's notification of assignment is to risk being sued and forced to make payment on an invoice a second time. Requiring ALL invoice payments of a noticed customer to be made to the factor preserves the legal integrity of the notification so there will be little available defense for the account debtor based on confusion or ambiguity if legal action is ever necessary.



**NON-FACTORED
PAYMENTS
FLOW THROUGH**



In many states, basic UCC searches are free and brokers will be able to access the service. If available to you at no cost, always do a UCC search on any prospective client prior to submitting a deal to a factor.

Learning to use the UCC properly can be an excellent method of prospecting. You will, for example, be able to explore active businesses financings in the state, determine if it's the type of business that can also benefit from factoring, and create a marketing campaign based on that probability. Don't, however, use a UCC search in an attempt to "steal" business from a lender.

**LEARN TO USE THE
UCC PROPERLY**

**NOTES**

Factoring Advance Rates

When contracting with a new client, the factor will determine an *initial advance rate* (percentage rate) upon invoices it purchases. Throughout the industry, the most common rate of advance is 80%, but on occasion, factors will advance 85%, 90%, or even higher. This higher advance rate can occur in situations where the account debtors are exceptionally strong, creditworthy payers and the payment for goods sold or service performed has very little chance of being reduced with credit memos, spoilage, chargebacks, etc.

**HOLDBACK KNOWN
AS RETAINAGE**

Initial advance percentage rates can also vary markedly depending on the client's industry. For example in the construction industry, where a 10% payment holdback is common (this is known in the construction industry as *retainage*), the advance rates on purchased invoices might be 70% instead of the more common 80%. This is to protect the factor from shortfalls caused by the 10% retainage holdback.

Advance rates on invoiced sales where the invoice amounts are very small may also be subject to slightly lower advance rates simply due to the overall increase in expense to the factor in processing such small transactions. Contrarily, clients who present large invoices for purchase with very strong, creditworthy customers are often provided with both higher advance rates and lower factoring fees.



NOTE: When explaining the advance to prospective clients, its important for them to know the advance is just the initial payment and there is more to come after the customer's payment is received.

Do not let the prospect think that the factor is purchasing the invoices for 80% and that's all they will get. Make sure they know there will be an additional rebate after payment is received.

The Factor's Reserve

The percentage of the face value of the invoice not initially advanced is referred to as the *factor's reserve*. An initial advance rate of 80%, for example, means the client will receive a wire of cash for 80% of the invoice face value. The 20% balance not advanced remains on the books as *reserve* or more specifically, *uncollected reserve*.



**80% INITIAL ADVANCE
20% RESERVE**

Uncollected reserve is simply a bookkeeping entry and represents an anticipated amount of additional cash to be available when the purchased invoice is paid. Once a payment is actually received, *uncollected reserve*, the bookkeeping entry, becomes *cash reserve* and such additional cash, less the factor's service fee, is then available to be paid to the client through what is termed a *reserve distribution*, or more often referred to as a *rebate*.



The availability for reserve rebates or distributions actually depends on a variety of circumstances. For example, does the client have some additional invoices which are aged over 90 days and in jeopardy of being *charged back* or are there invoices not being paid due to a trade dispute? Are there unforeseen expenses, such as legal or tax expenses, which must be paid by the factor for the client's benefit? If so, cash reserve generated from one invoice or a group of invoices may be temporarily held to guarantee the factor's repayment for the advance on the disputed invoice or to pay certain required expenses.

**AVAILABILITY
AFFECTED BY
CHARGE-BACKS**

The amount of *uncollected reserve* scheduled for rebate will also be reduced by the earned *factoring fees* before it can be distributed. Once a payment is received from a customer, that check payment and detail information will be entered into the factor's invoice tracking software and credited to the appropriate invoice. Factoring fees will be tallied and deducted, a collection report will be generated, and if there are no other circumstances which would prevent it, a *reserve distribution* (rebate) is then readied to be made to the client.



Factoring Fee Structures

When you begin to market the factoring product to small business owners, you will naturally be asked questions regarding how factoring works, how it will solve a particular problem, how fast can it be put in place, etc. One of the most common questions regarding factoring will naturally be: *How much does it cost?*

MASTER PURCHASE AND SALES AGREEMENT

The methods by which fees are charged by a factor are set forth in their factoring contracts (often called *Master Purchase and Sales Agreements*) and although there are hundreds of derivations, fee structures generally fall into just one of two basic categories:

- FEES CHARGED IN WINDOWS
- FLAT-FEE PLUS INTEREST FEES

Fees Charged in Windows

Fee structures using this method are very common among small and mid-size factors with the most common windows being 10 or 15 days. A sample of this fee structure can be seen below for a \$100,000 invoice, advanced at an 80% rate, and a fee of 1% for each window (roughly two-percent per month). Window fees are usually charged on the face amount of the invoice, not the advance amount.

DAY	FEE	REBATE	TOTAL PAID
1-15	\$1,000	\$19,000	\$99,000
16-30	\$2,000	\$18,000	\$98,000
31-45	\$3,000	\$17,000	\$97,000
46-60	\$4,000	\$16,000	\$96,000
61-75	\$5,000	\$15,000	\$95,000
76-90	\$6,000	\$14,000	\$94,000

Using the previous “windows” table, you can calculate that an invoice of \$100,000 outstanding for 40 days would be charged a factoring fee of \$3,000 (31-45 day rate) or 3% of the invoice face value. Once the invoice is paid in full, the factor will repay itself the advanced amount of \$80,000 leaving \$20,000 additional funds due to the client as a rebate. Prior to wiring those funds to the client, however, the factor will reduce that amount by deducting the factoring fee earned amount of \$3,000, thus leaving a net rebate of \$17,000.



Flat-Fee Plus Interest Fee Rates

Fee structures using this method are very common among larger factors wanting to make their fees more resemble those of asset-based lending. Here, a fixed discount is charged on the invoice face amount for the factoring services of credit analysis, collections, and operations. An interest component is also charged on the cash amount advanced. This is added to the fixed discount for a total financing fee.

The interest component is usually pegged to the published prime rate, LIBOR (London Interbank Offered Rate) rate or the 10 year U.S. Treasury Rate which acts as a *base rate* of interest. A *margin* for profit is then added to the base rate of interest which represents the total interest component charged. An example can be seen below for a \$100,000 invoice, advanced at 80%, with a flat factoring discount of 3% and 12% fixed simple interest rate for each 10 day period.

**BASE RATE PLUS
MARGIN**

DAY	DISCOUNT	INTEREST	REBATE	TOTAL
10	\$3,000	\$263	\$16,732	\$96,732
20	\$3,000	\$526	\$16,474	\$96,474
30	\$3,000	\$789	\$16,211	\$96,211
40	\$3,000	\$1,052	\$15,948	\$95,948
50	\$3,000	\$1,315	\$15,685	\$95,685
60	\$3,000	\$1,578	\$15,422	\$95,422
70	\$3,000	\$1,841	\$15,159	\$95,159
80	\$3,000	\$2,104	\$14,896	\$94,896
90	\$3,000	\$2,367	\$14,633	\$94,633



NOTES

Using the example chart of a flat-fee plus interest method, you can see that a client's \$100,000 invoice advanced at an 80% rate (\$80,000) and outstanding for 60 days would have been charged a 3% flat factoring fee or \$3,000 and would have accrued an interest charge of \$1,578 for a total finance fee of \$4,578.

Generally speaking, those factors using a window style structure will have slightly lower fees for invoices paid in less than 30 days. Flat-fee plus interest factors will be slightly less expensive for clients with invoices paid in more than 30 days. In the real world, with the broad diversity of fee structures, hybrids, and combinations found throughout the industry, a factoring fee structure needs to be examined closely to determine if one has a competitive advantage over another for a particular client. Additionally, most factors are reasonably flexible with their fee structures and accommodate small modifications. Changes necessary to suit a particular “fee-sensitive” client are very common.

NO REAL
COMPETITIVE
ADVANCE



The Bottom Line

When you begin to market factoring to small business owners and even referral sources, the subject of fees will always come up. Incredibly, too many CPA-types will look at a factoring fee of 2 1/2 percent for 30 days and say something like: *That's 30% per year. I could never recommend that to my clients unless they were desperate.* That calculation is, of course, ridiculous. The truth is, if a business provides 30 day terms of payment to its customers, the costs of factoring are about the same as taking a credit card. In fact, in some cases, it's cheaper.

FEE RATES ABOUT THE
SAME AS CREDIT CARDS

Credit card industry statistics show the average finance cost for a not-in-store credit card swipe to be 2.30% - 2.50%. The 30 day factoring fee for an average size client is about the same at 2.50%. Just like a credit card sale, factoring is a “transactional” method of finance. You cannot multiply the 30 day rate by 12 to get an annual fee rate because the fees stop as soon as the invoice is paid. They do not go on for a year. When you add in the additional services of the factor such as expert credit analysis and collections, you can build a strong case that factoring is a bargain when compared to any B2B business accepting credit cards.

Invoice Tracking Software



When a client's account is approved and invoices purchased, there's a lot of information which needs to be monitored and tracked. Documents must be prepared, reports generated (including your monthly broker commission report), and collection notes stored. All of this is the job of the factor's *invoice tracking software*. Among its many tasks, invoice tracking software:

- **Generates Advance Schedules and Collection Reports**
- **Generates Client Aging Reports and Monthly Statements**
- **Keeps Records of Notification and Verification**
- **Calculates Factoring Fees and Interest Charges**
- **Keeps Collection Records and Notes**
- **Monitors Credit Exposure and Concentrations**
- **Accounts for Checks and Wire Transfers**
- **Generates Client Year End Tax Statements**
- **Most Important...Generates Broker Commission Reports**

**GENERATES BROKER
COMMISSION REPORTS**

The Collections Process

All factors will become involved in the collection and payment process upon purchased invoices and will typically have in-house personnel assigned to that task. Each month, factors will generate monthly statements of account which will be mailed to all account debtors of all clients. The statements of account will list all invoices outstanding and will be directed to the customer's accounts payable department. Courteous collection calls will be made to check up on those payments which have not been received by their due date.

Some new factoring clients may be concerned about the factor's staff contacting their clients and being too harsh in collections. In reality, there is really no need for worry. A factor's collectors are highly trained professionals who are well aware of the relationship between client and customer. They are also aware that mistreating customers can lead to a client leaving a particular factor to seek another.

PART TWO: MARKETING AS A PAL



Marketing and Earning as a PAL

Ready to begin earning your fair share of the factoring industry's near-legendary residual commission income? If so, consider joining IACFB's popular PALs Program and get started.

The PALs Network (Partners Active Locations) is the perfect solution for those home-based entrepreneurs and mobile creatives seeking a truly professional home business. With its unlimited income potential and low entry and operational cost, the PALs program is the answer for many of those in need of supplemental monthly earnings in today's economy.

Joining IACFB's PALs Network allows you to invest only sometime in learning our industry while not investing thousands of dollars in franchises, courses, and more. Operating as a PAL at IACFB is easy and only requires you to network and develop those skills that lead to lead generation and the ability to submit SQL or Sales Quality Leads. The vast majority of PALs only focus their periodic lead-generation functions using social media and, especially, LinkedIn which is free to use and easy to learn and navigate.



**THE MORE YOU LEARN,
THE MORE VALUABLE
YOU BECOME**

**A RELATIVELY
SIMPLE FORM OF
COMMERCIAL
FINANCE**



One of the most appealing aspects of becoming a factoring broker is that it's open to virtually anyone with motivation and basic communication skills. You don't need a financial background or a degree in banking to succeed. Brokers act as consultants — matching small businesses in need of cash flow with the right funding sources — and modern training programs make it easy to learn the essentials quickly.

Benefits of Becoming a PAL

PALs, which stands for “Partners Active Locations”, is the proprietary referral agent program of IACFB and it provides substantial benefits for those new to the industry. These include:

RECESSION RESISTANT CAREER

- **Recession-Resistant Industry** – Businesses always need cash flow, especially during economic slowdowns. Factoring thrives when banks tighten credit and companies struggle with late-paying customers.
- **Low Start-Up Costs** – You don't need a license, office, or large investment to get started. A home office, internet connection, and a good mentor program are all that's required.

RESIDUAL COMMISSION INCOME STREAMS

- **Residual Monthly Commissions** – Brokers earn *ongoing income* from every client funded through their referrals — often for the life of the account. Each new client adds another stream of recurring revenue.
- **Relationship-Based Business** – Success comes from networking and building trust with small-business owners, accountants, and bankers — not cold calling for quick sales.

WORK FROM ANYWHERE

- **Work from Anywhere** – This is a truly portable business. You can manage clients remotely, conduct meetings on Zoom, and work from a home office or while traveling.
- **Growing Market Demand** – With record small-business debt and tightening bank standards, more owners are turning to alternative finance sources like factoring to survive and grow.

Beyond the simplicity of getting started, factoring brokers enjoy a wide range of income opportunities. Many soon expand their services into related areas such as SBA loans, equipment leasing, and merchant cash advances — multiplying their earning potential while building long-term client relationships. Over time, brokers become respected advisors in their communities, helping business owners stabilize operations, make payroll, and grow. It's a career that offers flexibility, professional prestige, and a sense of purpose — all while creating lasting, residual income streams in a recession-resistant industry.

Understanding Factoring Commissions at PALs



One of the most attractive features of becoming a commercial finance consultant is the commission structure. Unlike many traditional sales positions where you're paid only once when a sale is completed, factoring offers something far more valuable—**residual income**.

As a PAL Affiliate or Associate, you receive **10% of the factoring company's earned fees** on the clients you introduce. In other words, when a factor purchases invoices from one of your clients and earns factoring fees, you participate in those earnings through an ongoing commission.

**10% OF THE FACTORING
FEES EARNED**

What Makes Factoring Different?

Most sales commissions are "one-and-done."

A real estate agent earns a commission when a house sells.

An insurance agent may earn a first-year commission on a new policy.

An automobile salesperson is paid when the car leaves the dealership.

A note broker earns a single commission when he places a note.

Factoring really IS different!

A business that factors its invoices typically continues selling invoices week after week and month after month. As long as that client remains with the factoring company and continues factoring invoices, the factor continues earning fees—and you continue earning commissions based on those fees.

This is known as **residual income**, and it is one of the primary reasons so many consultants are attracted to the commercial finance industry.

**FACTORING IS REALLY
DIFFERENT**





What is a "Life of the Account" Commission?

Most factoring companies compensate brokers on what is commonly referred to as the **life of the account**. This means that as long as your client continues doing business with the factoring company, you continue receiving your agreed-upon commission.

Many factoring relationships (AND COMMISSIONS) last for years.

As a client's business grows, monthly invoice volume often increases as well. Instead of financing \$50,000 in invoices each month, they may eventually finance \$100,000, \$250,000, or even substantially more.

As the factor's earned fees increase, your commissions can increase as well. You are rewarded not only for introducing a client, but also for introducing a client that continues to grow.

**MONTHLY COMMISSIONS
CAN LAST FOR YEARS!**

Building Monthly Residual Income with PALs



One of the greatest advantages of the PAL Program is that commissions can accumulate over time. Imagine introducing just one successful client during your first few months.

Several weeks later, you introduce another. Then another. Each new client becomes another potential monthly income stream. Instead of continually starting over each month, you're gradually building a portfolio of recurring commissions.

Many experienced commercial finance consultants eventually receive commission checks from numerous active clients every month. While each account may produce a different amount, together they can create a steady and predictable stream of recurring income.

This is why many consultants refer to factoring as a business of **building an income portfolio rather than making individual sales**.

Operate Full-Time or Part-Time



Another unique advantage of the PAL Program is its flexibility. Many Affiliates participate on a part-time basis while continuing with another career or operating an existing business. Some simply refer opportunities they encounter through their normal business activities.

Others actively network within their communities, attend Chamber of Commerce meetings, volunteer with local organizations, or develop relationships with business owners who may eventually require commercial financing. Even referring only a handful of quality clients over several years can produce meaningful monthly residual income.

For members who later decide to become full-time commercial finance consultants, those early commissions often provide an excellent financial foundation upon which to build a larger consulting practice.

**EARLY COMMISSIONS
BUILD YOUR LARGER
CONSULTING PRACTICE**

Think Building a Long-Term Business

One of the keys to success in factoring is thinking beyond the first commission check. Every business owner you help today has the potential to become a long-term client.

As their company grows, they may finance more invoices, purchase equipment, require additional financing products, or introduce you to other business owners facing similar cash flow challenges. Each relationship can become the beginning of many future opportunities.

Your Goal Is to Build Income Streams

The most successful PAL members don't measure success by asking:

"How much commission did I earn this month?" Instead, they ask:

"How many recurring income streams did I add this month?"

**YOUR GOAL IS TO BUILD
TRUE INCOME STREAMS**

Every qualified client you introduce has the potential to generate recurring commissions for months—or even years—to come. Over time, those individual commission streams can combine into a substantial monthly income, whether your goal is to earn supplemental part-time income or build a successful full-time commercial finance consulting practice.



Join IACFB PALs on LinkedIn

As a new industry broker and certainly if entering as a PAL Affiliate or Associate, one of the most important steps you can take to accelerate your success in commercial finance is to join the **IACFB Network Group on LinkedIn**. This group serves as a dynamic **forum** where members can connect, learn, and grow within the industry, all while leveraging LinkedIn's powerful B2B networking capabilities.

JOIN LINKEDIN AND IACFB GROUP AND BROKER FORUM

The IACFB Network Group on LinkedIn is not just another social media group—it is a **forum for collaboration and education**. Here's why joining is a must:

- ♦ **Access to Expert Insights** – Engage with seasoned factoring professionals who share best practices, case studies, and valuable industry knowledge.
- ♦ **Real-Time Industry Updates** – Stay informed on industry trends, regulatory changes, and economic factors that impact your business.
- ♦ **Peer-to-Peer Learning** – Exchange ideas, ask questions, and get feedback from fellow PAL Affiliates and Associates who are on the same journey as you.
- ♦ **Exclusive Resources** – Get access to content specifically curated for PAL members, including training materials, articles, and success stories.

LinkedIn is the **go-to platform for professional networking**, and being active in the IACFB Network Group allows you to take full advantage of its benefits:

EXPANDING YOUR PROFESSIONAL NETWORK

- **Expand Your Professional Network** – Connect with industry leaders, potential funding sources, and fellow brokers.
- **Establish Your Credibility** – Engage in discussions, share valuable insights, and position yourself as a knowledgeable professional in commercial finance.
- **Generate Leads and Referrals** – The group includes experienced brokers and funding sources who can provide valuable introductions and referrals.
- **Stay Visible and Relevant** – Regular interaction in the group keeps you top-of-mind with key industry players and potential clients.

Subscribe to IACFB Magazine



For all new factoring brokers entering the industry through the IACFB PAL program, knowledge and resources are key to success. One of the most cost-effective and valuable tools available to new PAL Associates and Affiliates is a subscription to *Commercial Finance Consultants* (CFC) magazine. For just \$4.97 per month, this comprehensive online publication offers a wealth of insights, strategies, and best practices to help new brokers generate leads and close their first deals.

Factoring is a niche industry that requires a deep understanding of business finance, lead generation, and client acquisition. Many new brokers struggle with knowing where to start, but *Commercial Finance Consultants* provides a structured and strategic approach to building a successful career in factoring. With over 500 articles covering various aspects of the industry, PAL agents gain access to essential knowledge that can accelerate their progress.

What to Expect From the Magazine

- **Lead Generation Strategies** – Discover proven methods to find and attract potential factoring clients. Learn about networking techniques, social media strategies, and content marketing tailored for brokers.
- **Sales and Marketing Tips** – Effective sales techniques, direct mail campaigns, cold-calling scripts, and email outreach strategies help new PAL agents develop their pipeline.
- **Industry Trends and Updates** – Stay informed about the latest trends, regulatory changes, and economic factors that impact the factoring and alternative finance industries.
- **Case Studies and Success Stories** – Learn from real-world experiences of successful factoring brokers who started as PAL agents and built thriving businesses.

**COMMERCIAL FINANCE
CONSULTANTS
MAGAZINE**

**CASE STUDIES AND
SUCCESS STORIES**

For new PAL agents, investing in *Commercial Finance Consultants* is a small but powerful step toward success. The magazine functions as an ongoing mentor, providing guidance and industry insights that would otherwise take years to learn through trial and error. It serves as a valuable supplement to the IACFB's training resources, offering fresh content, new perspectives, and actionable strategies each month.



**JOIN LINKEDIN AND
IACFB GROUP AND
BROKER FORUM**

**EXPANDING YOUR
PROFESSIONAL NETWORK**

Investing in a PALs Website

The PALs program is designed to generate Sales Qualified Leads (SQLs), making content marketing one of the most effective strategies for success. In today's digital landscape, a strong online presence is crucial for lead generation, and having a dedicated website is one of the best investments PAL Affiliates and Associates can make. Here's why.

The Power of Content Marketing

Content marketing is the foundation of successful digital lead generation. By consistently posting informative articles on a blog, PALs can educate potential clients, establish credibility, and build trust within their network. The goal is to provide valuable insights that attract business owners seeking alternative financing solutions. Social media platforms like LinkedIn are invaluable tools for PAL Affiliates and Associates. By sharing blog posts on LinkedIn and other networks, PALs can expand their reach and engage with their target audience. Posting content regularly helps establish authority, increase engagement, and drive visitors to your website—where they can learn more about your services and get in touch.

A Website is Your Digital Hub

Your website acts as your digital headquarters, where all your marketing efforts converge. It provides a professional image, showcases your expertise, and allows potential clients to explore your services at their own pace. From blog articles to client testimonials and contact forms, a website serves as the ultimate tool for lead conversion.

To maximize the impact of your website, consistency is key. PAL Affiliates and Associates should aim to publish a new article every two to three days. These articles should address common financing challenges, industry trends, and success stories to keep potential clients engaged and informed.

Each article should then be promoted on LinkedIn and other social media channels, driving traffic back to the website. Over time, this strategy will build a steady stream of SQLs, positioning PALs as trusted experts in the alternative financing space.

Your Primary Marketing Targets



Your targets for marketing can be categorized into two very broad MAIN segments or groups.

1. **PROSPECTS GROUP:** A demographic target group of small B2B business owners who may need the services of a factor now or in the future.
2. **REFERRAL GROUP:** A target group made up of local community professionals who through referral, can send business your way.

Roughly 50% of all new factoring clients are sourced using some form of direct response marketing. The source of these new factoring clients will be your PROSPECTS GROUPS.

Roughly 50% of all new factoring clients are sourced as a result of referral from a professional such as an accountant, banker, etc. This would be the result of networking with members of your REFERRALS GROUPS.

SUB-DIVIDING PROSPECT GROUPS

Members of your first target group, your PROSPECTS GROUP, can be subdivided many ways. You may subdivide the list into sectors:

- **SERVICE SECTOR**
- **MANUFACTURING / DISTRIBUTION SECTOR**
- **GOVERNMENT CONTRACTORS SECTOR**
- **CONSTRUCTION RELATED SECTOR**
- **RETAIL COMPANIES SECTOR**

You can further subdivide your sectors into sub-sectors. You can, for example, subdivide your SERVICE SECTOR CATEGORY into:

- **Guard Services**
- **Staffing Companies**
- **Landscaping Companies**
- **Janitorial Services**
- **Maintenance Companies**
- **Freight Companies**



Members of your second target group, your REFERRAL GROUP, can also be subdivided dozens of ways. For example, you may create sub-groups of:

- **BUSINESS SUPPORT / INCUBATOR STAFF**
- **ACCOUNTING PROFESSIONALS**
- **LENDING OFFICERS**
- **BANKING PROFESSIONALS**
- **ATTORNEYS**
- **INSURANCE PROFESSIONALS (COMMERCIAL)**
- **BUSINESS BROKERS**

**JOIN LINKEDIN AND
IACFB GROUP AND
BROKER FORUM**

You can further subdivide these sub-groups into more manageable lists. You can subdivide your BUSINESS SUPPORT / INCUBATORS into:

- **SCORE members**
- **SBDC members (Small Business Development Centers)**
- **EDC members (Economic Development Centers)**
- **BAC members (Business Assistance Centers)**
- **Other Local Business Incubators**

As you know, it is not unusual for a seasoned industry factoring broker (one who has been in the industry 3 or more years) to have 2,500, 5,000, 7,500 or even more individuals in their various groups.

**EXPANDING YOUR
PROFESSIONAL NETWORK**

To market to such numbers efficiently, you must subdivide and manage each group. For example, if you stumble across an interesting online article on how factoring benefitted a small service sector business, you would probably want to send a targeted email with a link to that article to your service sector companies only. If you found an article on how a bookkeeper had doubled her client base by helping them source business loans, you would certainly want to send a link to that article to your accounting group. To do so, you will need the help of some quality contact relationship management software (CRM) and a good email marketing service.

Manufacturing Targets for Factoring



Factoring is not just employed by the service sector. There are many manufacturers and distributors that utilize the services of factors as well. Below is a very small list of examples

Forestry / Logging	Durable Goods
Fishing and Hunting Products	Automotive Accessories
Paper Goods	Commercial Equipment
Agricultural / Growers	Refrigeration Manufacturers
Oil and Gas Producers	Hardware and Plumbing Supplies
Oil and Gas Support Products	Sporting Goods
Mining (Coal and Mineral)	Toys
Fertilizer Producers	Hobby Crafts
Commercial Construction	Jewelry
Highway Bridge Construction	Petroleum Related Products
Food Manufacturers / Gourmet Prod.	Beer / Wine / Craft Brewers
Textile / Garment Manufacturers	Farm Supplies
Footwear Manufacturers / Distributors	Flowers and Nurseries
Lumber / Wood Products	Tobacco Products
Chemical Products	Paint Manufacturers
Rubber Products	Electronics Manufacturers
Plastics Manufacturers	Lawn Equipment and Supplies
Pharmaceutical Manufacturers	General Hardware
Paints and Coatings	Newspaper / Magazine Publishers
Soaps and Cleaners	Book Distributors
Glass Products	Power Sports Equipment Manufacturers
Pottery Products	Boats / Boating Equipment
Metal Fabricators	Specialty Aircraft Equipment
Electrical Equipment	Bakeries
	Sign Manufacturers



Service Businesses That Employ Factoring

There are hundreds of types of businesses from the various business sectors that have been known to employ factoring. If purchasing a databank list or constructing a complied list, below is a short list of service related industries you may wish to focus on.

**JOIN LINKEDIN AND
IACFB GROUP AND
BROKER FORUM**

Passenger / Bus Transportation	Office Administration Services
Freight and Trucking	Staffing / Employment Services
Air Transportation	Telephone Call Centers
Water Delivery	Pest Control Companies
Limousine Services	Janitorial Services
Warehouse / Storage Facilities	Guard / Protection Services
Broadcasting Services	Detective Agencies
Internet Services	Carpet Cleaners
Telecommunication Services	Waste Management Companies
Sound Recording Services	Commercial Building Maintenance
Data Processing Services	Welders
Property Management Services	Remediation Services
Equipment Rental Services	Medical Labs
Environmental Testing Services	Child Care
Accounting / Bookkeeping Services	Tutoring / Education Services
Engineering / Design Services	Sports Promoters
Drafting Services	Charter Bus Services
Building Inspection Services	Food Catering Companies
Surveying Services	Automotive Repair / Bodywork
Computer System Design	Electronics Repair Services
Environmental Consulting	Parking Lot Maintenance
Technical Consulting	Linens and Uniforms Cleaners
Advertising Services	Market Research Providers
Marketing Research Companies	Specialized Design Services
Photographers	Air Conditioning Maintenance
Translation Services	Commercial Contractors and

**EXPANDING YOUR
PROFESSIONAL NETWORK**

Excitement: Getting Your First Deal



There is little to compare with landing your first brokered deal in factoring. As an industry "newbie", you will likely:

- Grab your calculator and estimate your monthly broker fees (trying hard not to embellish them).
- Multiply that fee by 12 to estimate your annual income from the single deal.
- Divide \$100,000 by that figure to determine how many similar deals you'll need to break the \$100,000 mark.
- Start planning an exotic vacation.
- Call your mother.
- Call your father.
- Call your ex-wife or ex-husband...the one who told you that you'd never amount to anything.
- Call anyone else you think will listen.
- Ask yourself exactly why you're saddled with \$50,000 in student loans for a "puppy farm" education that taught you absolutely nothing about really making money.



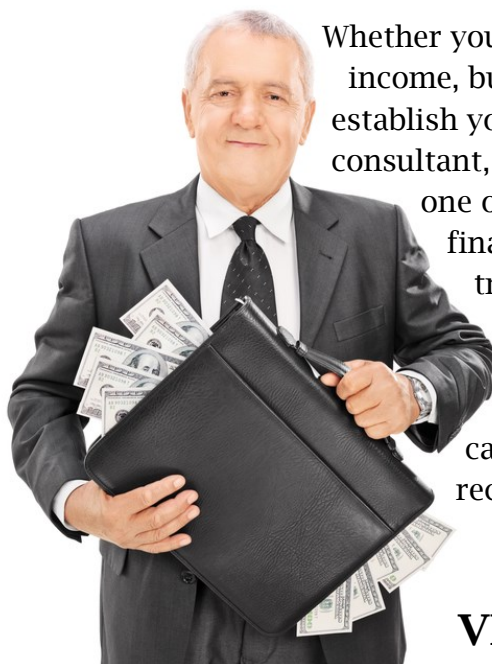


An Under the Radar Opportunity for Home-Based Entrepreneurs and Mobile Creatives

One of the best-kept secrets in commercial finance is that thousands of successful businesses rely on invoice factoring every day—yet relatively few people even know the industry exists. While millions of entrepreneurs struggle with cash flow and wait weeks or months for customers to pay their invoices, factoring companies quietly provide the working capital that keeps those businesses growing. Behind every funded client is often a commercial finance consultant or referral partner who simply introduced the business owner to the right financing solution.

A UNIQUE OPPORTUNITY WITH COMMISSIONS LASTING YEARS

For PAL Affiliates and Associates, this creates a unique opportunity to participate in an industry that rewards relationships rather than high-pressure sales. As you introduce qualified businesses to factoring companies, your referrals can develop into recurring commission streams. Unlike many commission-based opportunities that pay only once, factoring relationships can continue for years, allowing you to earn residual income as long as your client remains active and the factoring company continues earning fees. For many members, even working part-time, these recurring commissions can grow steadily over time.



Whether you're looking to supplement your current income, build a rewarding side business, or eventually establish yourself as a full-time commercial finance consultant, the PAL Program offers a practical path into one of the most overlooked industries in business finance. We invite you to explore the resources, training, and opportunities available through the International Association of Commercial Finance Brokers and discover how helping businesses solve their cash flow problems can also help you build a growing portfolio of recurring monthly income.

LEARN MORE

VISIT: WWW.IACFB.ACADEMY