Chapter 9
Export Factoring

Export factoring is a complete financial package that combines export working capital financing, credit protection, foreign accounts receivable bookkeeping and collection services. A factor is a bank or a specialized financial firm that performs financing through the purchase of invoices or accounts receivable. Export factoring is offered under an agreement between the factor and exporter, in which the factor purchases the exporter's short-term foreign accounts receivable for cash at a discount from the face value, normally without recourse, and assumes the risk on the ability of the foreign buyer to pay, and handles collections on the receivables. Thus, by virtually eliminating the risk of nonpayment by foreign buyers, factoring allows the exporter to offer open accounts, improves liquidity position, and boosts competitiveness in the global marketplace. Factoring foreign accounts receivables can be a viable alternative to export credit insurance, long-term bank financing, expensive short-term bridge loans or other types of borrowing that will create debt on the balance sheet.

CHARACTERISTICS OF EXPORT FACTORING

Applicability

Ideal for an established exporter who wants (1) the flexibility of selling on open account terms, (2) to avoid incurring any credit losses or (3) to outsource credit and collection functions.

Risk

Risk inherent in an export sale is virtually eliminated.

Pros

- Eliminate the risk of nonpayment by foreign buyers
- Maximize cash flows

Cons

- More costly than export credit insurance
- Generally not available in developing countries

Key Points

- Recommended for continuous short-term export sales of consumer goods on open account.
- 100 percent protection against the foreign buyer's inability to pay – no deductible/risk sharing.
- An attractive option for small- and medium-sized businesses, particularly during periods of rapid growth, because cash flow is preserved and risk is virtually eliminated.
- Unsuitable for the new-to-export company as factors generally (1) do not take on a client for a one-time deal and (2) require access to a certain volume of the exporter's yearly sales.

How Does Export Factoring Work?

The exporter signs an agreement with the export factor who selects an import factor through an international correspondent factor network, who then investigates the foreign buyer's credit standing. Once credit is approved locally, the foreign buyer places orders for goods on open account. The exporter then ships the goods and submits the invoice to the export factor, who then passes it to the import factor who handles the local collection and payment of the accounts receivable. During all stages of the transaction, records are kept for the exporter's bookkeeping.

Two Common Export Factoring Financing Arrangements and Their Costs

1. In **discount factoring**, the factor issues an advance of funds against the exporter's receivables until money is collected from the importer. The cost is variable, depending on the time frame and the dollar amount advanced.
2. In **collection factoring**, the factor pays the exporter, less a commission charge, when receivables are at maturity, regardless of the importer's financial ability to pay. The cost is fixed, ranging generally between 1 and 4 percent, depending on the country, sales volume, and amount of paperwork involved. However, as a rule of thumb, export factoring usually costs about twice as much as export credit insurance.

Limitations of Export Factoring

- Only exists in countries with laws that support the buying and selling of receivables.
- Generally does not work with foreign account receivables having greater than 180-day terms.
- May be cost prohibitive for exporters with tight profit margins.

Export Factoring Industry Profile

While U.S. export factors have traditionally focused on specific market sectors such as textiles and apparel, footwear, and carpeting, they are now working with more diversified products. Today, U.S. exporters who factor are manufacturers, distributors, wholesalers, or service firms with sales ranging from $5 million to $200 million. Factoring is also used as a valuable financial tool for larger U.S. corporations to manage their balance sheets. International factoring volume in the U.S. is now over $6 billion annually, greatly contributing to the growth in U.S. exports.

Where to Find a Factor?

The international factoring business involves networks similar to the use of correspondents in the banking industry. **Factors Chain International (FCI)** is the largest of these global networks and can be useful in locating factors willing to finance your exports. Another useful source is the **International Factoring Association (IFA)**, an association of financial firms that offer factoring services. FCI has a Web site at *www.factors-chain.com* and is located in The Netherlands. The IFA also has a Web site at *www.ifa.org* and is located in California.