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 factoring house, or factor, is a bank or 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. It also 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 non-payment 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 create debt on the balance sheet.

CHARACTERISTICS OF EXPORT FACTORING

Applicability

Ideal for an established exporter who wants (a) to have the flexibility to sell on open account terms, (b) to avoid incurring any credit losses, or (c) to outsource credit and collection functions.

Risk

Risk inherent in an export sale virtually eliminated.

Pros

- Eliminates the risk of non-payment by foreign buyers
- Maximizes cash flows

Cons

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

Key Points

- Factoring is recommended for continuous short-term export sales of consumer goods on open accounts.
- It offers 100 percent protection against the foreign buyer's inability to pay — with no deductible or risk sharing.
- It is an attractive option for small and medium-sized exporters, particularly during periods of rapid growth, because cash flow is preserved and risk is virtually eliminated.
- It is unsuitable for the new-to-export company as factors generally (a) do not take on a client for a one-time deal and (b) 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. The import factor then 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

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. 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, and usually ranges between 1 and 4 percent, depending on the country, sales volume, and amount of paperwork. However, as a rule of thumb, export factoring usually costs about twice as much as export credit insurance.

Limitations of Export Factoring

- It exists in countries with laws that support the buying and selling of receivables.
- It generally does not work with foreign account receivables that have more than 180-day terms.
- It may be cost prohibitive for exporters with tight profit margins.

Export Factoring Industry Profile

Although 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 use export factoring are manufacturers, distributors, wholesalers, or service firms with sales ranging from $5 million to $200 million. Factoring is also a valuable financial tool for larger U.S. corporations to manage their balance sheets. International factoring in the United States is now worth more than $6 billion annually, greatly contributing to the growth in U.S. exports.

Where to Find a Factor

The international factoring business involves networks, which are similar to correspondents in the banking industry. There are two sources for global networks: Factors Chain International (FCI) and International Factors Group (IFG). FCI is located in the Netherlands, and their Web site is *www.factors-chain.com*. IFG is located in Belgium, and their Web site is *www.ifg-group.com*. Another useful source is the International Factoring Association (IFA), which is the world's largest association of financial firms that offer factoring services. The IFA is located in Pismo Beach, California, and their Web site is *www.factoring.org*.