The Balancing Act of Managing Your Factoring Portfolio

If you talk to ten different factoring companies about how they manage their factoring portfolio, there's a good chance you'll get a variety of different answers. We funders know that factoring is not an exact science, by any means.

Although most factoring companies do adhere to non-mandatory industry guidelines in their due diligence and portfolio management processes, each company has its own unique threshold, which is largely dependent on their tolerance for risk. For example, some factors will fund the construction industry or medical receivables, while others may prefer staffing or transportation. Some funders will exclusively work within a certain niche, while others fund all industries, based on a predetermined credit limit.

As a direct funder, I can tell you from personal experience that every client is unique and must be approached with that mindset. The International Factoring Association (IFA) and many other industry experts have produced materials available for new factors that can be utilized as guidelines for approving, funding, and servicing factoring clients. Unlike other finance industries, factors do not adhere to mandatory compliance regulations such as those for mortgage lending and banking. Therefore, any factoring guidelines serve as exactly that – a guide to conduct your business. For example, one key industry standard for most factoring companies is that they have a first lien position on their client's assets. This is accomplished by performing a UCC search and publicly filing a UCC-1 financing statement. By having a first lien position on your client's assets, you are protecting your company in the event of a dispute or bankruptcy. To illustrate my point, we have been approached by several factors that were willing to fund prospects in a second lien position. We don't recommend it, but there is always a niche that some company will fulfill in the finance industry. From our standpoint, we look at factoring guidelines as a tool that allows us to mitigate the risk associated with any new client. It's up to us to use the applicable tools to either fund or decline a deal.

If this is starting to sound like a bunch of factoring doubletalk, let me give you some real examples to illustrate how managing your factoring portfolio can fall into some real gray areas, depending on which side of the risk fence you reside. Let's say you have been factoring

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with John Doe Manufacturing for several years, and he has the same customer. The client's invoices generally pay on time and the verification process has never been an issue. However, when trying to verify the current funding schedule it turns out the accounts payable person that provides the approval is on vacation and there is no other person available to help you. Your client's payroll is due tomorrow, and without this funding, his employees will not get paid. So, what do you do? Remember, factoring 101 says to never fund a deal without proper verification from the account debtor. You can take the hard line and reject the schedule, which will put your client in a difficult predicament and possibly damage his business. Our position was the client had enough good history with our company and his customer for us to proceed. Although the schedule was funded, it was under the condition that we would not move forward with any future advances until this schedule was approved. We could have taken it one step further and given the client a smaller advance or withheld future rebates contingent upon verification. In the end, it worked out for all parties with the client's invoices approved and eventually verified.

Here's another example. You have a small client that just landed a purchase order with a national apparel retailer with extremely good credit. The customer, however, will acknowledge receipt of the goods but will not inspect them until several weeks later. Obviously, your client wants his advance so he can start paying overhead and vendors for both the prior and new orders. This is a tough one. Some of you may suggest credit insurance to cover any losses, but in reality, the issue is not with the account debtor's ability to pay. Trying to get any insurance claim paid is difficult enough, and in this case, it would be a breach of contract, which is usually not covered in a credit insurance policy. In this example, we passed on the advance since we were not comfortable with the large gap between the receipt and inspection of the goods. As it turned out, some of the goods were not up to specification, and the retailer rejected the entire shipment. The client was able to remedy the goods to specification (which took another four weeks) and reship them to the retailer for full payment. This is just a classic example of where you had a partial versus a full verification which led to a potential loss for the factor. Many funders would have chosen to move forward on this deal since the debtor was a nationally known corporation. This example brings us back to the point that all decisions are based on the risk tolerance of each factoring company. I can continue with other examples where servicing your factoring portfolio isn't always crystal clear. Unfortunately, in many cases, your decision to move forward on a deal will fall into a gray area that requires a real gut check. Manage your clients wisely, thoroughly check your new prospects, and most importantly, mitigate as much risk as possible. •

AFA UPDATE

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specifically targeting factoring, or simply the continuation of Operation Choke Point by DOJ, the results are the same. Factoring needs the AFA in Washington to make sure our voice is heard. If you are not currently supporting the AFA, please take this opportunity to become a valued member: www.americanfactoring.org.

Founded in 2009, to provide a unified voice for the factoring industry, the AFA is dedicated to promoting and protecting the interests of the factoring community. The AFA board is made up of volunteers who devote time and their own funds to travel to Washington, D.C. on behalf of the factoring industry.