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Factoring

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FACTORING

By CHARLES P. YATES

Mr. Charles P. Yates has been affiliated with Wm. Iselin & Co., the oldest and largest factors, for twenty years, and is assistant treasurer of the company. He attended New York University, and took special courses at Cornell University and at the National Institute of Credit. He has had experience in all phases of factoring. Mr. Yates wrote this paper especially for the Grand Rapids Chapter of ASWA, and it is a pleasure to publish it in this issue of our magazine.

The factor like the CPA is measured entirely by the service he renders to his clients.

When a business man retains an accountant he engages far more than a human calculating machine. He acquires a friend, confident, advisor, a source of ideas and a sounding board, a guide and mentor in planning budgets and projecting campaigns, a devoted watchman of his debtors and a word-in-bond to his creditors and investors.

The accountant, on behalf of his client, constantly seeks right answers, to a host of vital questions—how can working capital be put to maximum use, could this client of mine do a greater volume of business if cash were more readily available, what volume is it safe for him to plan on, what is the most advantageous source of working capital, is the lowest rate necessarily the least expensive, should he buy or not buy, should he place commitments or not. Among many possible answers to these questions, factoring certainly merits consideration as the means of bridging many gaps and providing a flexible financing, a credit and accounting service.

Factoring as we know it today started over 140 years ago in this country when William Iselin & Company opened its doors in 1808. While this business was established primarily to serve foreign merchants dealing in the United States, Iselin and the other first line factors today operate almost entirely as financial service organizations, rather than as commission merchants. A first line factor operates solely on the basis of checking credits and cashing of sales on a notification basis without recourse.

The objective of all business is profits. The specific objective of factors is to increase the turnover of each client's working capital safely to enable him to earn maximum profits without having to share them with new investors or to encumber himself with debt. As you know, when a business factors its receivables it literally sells its products for cash. First line factors generally buy 100 per cent of its clients' net sales and assume the total risk of collecting these accounts.

What does it mean to the operation of a business to be able to turn its accounts receivable daily into cash; literally to collect for its goods the minute they are shipped, while still being able to extend normal terms to its customers?

For the business man who has been insufficiently capitalized to maintain his current volume of business it means that he can now operate comfortably without borrowing or raising additional capital. For the business man who has enough working capital to maintain his current volume of business but wishes to take advantage of his abilities to grow, it means that he can finance his expansion without going into debt or sharing his larger profits with others.

In addition to buying accounts receivable for cash the first line factor performs many other services for its clients. This is particularly true in the case of unsecured advances where close cooperation with the accountant of the client is required. This occurs when funds required are in amounts larger than are available from current sales. In years past all factor's loans were secured by merchandise collateral, regardless of the clients financial statement. Now, however, it is found to be a great deal more practical and less cumbersome to make unsecured loans, although there are occasions when merchandise loans are still used. Unsecured advances are made after a thorough study of a client's budget projections. Confidence is the keynote of these loans since they are frequently made without a maturity date but with the understanding that the client will operate within the framework of the projected budget and that the client will consult with the factor in matters of production or shipments that would materially affect the budget.

In setting up an unsecured advance it is obvious that the factor must have complete reliance upon and full cooperation from the client's accountant.

When a business man enters into an association with a first line factor his accounts receivable ledger books are greatly simplified. Naturally, instead of a great number of individual accounts, only the factor owes him money for goods sold. He needs no longer be concerned with the cost in time, money and equipment put into his accounts receivable ledger. There is no further need for the handling of customers checks, ageing of receivables, or costly collection procedures.

Since 100% of a client's sales are purchased without recourse, the checking of credits by the factor is all important. The huge spread of risk permits the factor to follow a considerably more liberal credit policy than would be possible for the average credit department of any individual manufacturer. Again, due to this spread of risk as well as the volume of business handled, a factor may, without comparable risk, carry outstanding receivables for a longer period of time and in larger individual amounts than would be possible by an individual manufacturer. In essence, this means that a manufacturer under a factoring arrangement, as opposed to checking his own credits, may develop more business in border line accounts without an accompanying increase in credit exposure. It frequently happens that a business man in order to avoid credit losses that could jeopardize his business has done so at the expense of real profits by refusing credits which a factor could and would grant readily and safely in the client's behalf. The factors' credit men, by the very nature of their business and experience, have a broader base from which to operate in determining credit lines. They are trained to find some reason to check an account rather than turn it down inasmuch as their profits along with their client's are earned through sales not rejects.

A factor's service, contrary to many possible misconceptions, is not on an in and out basis but is instead, on the average, a long term arrangement. Clients in some cases engage the services of a factor for the service of the credit department alone or to reduce expenses connected with the keeping of accurate accounting records. However, the vast majority of companies employing factors do so because of the multiple advantages provided by the combination of services rendered by a factor. While all first line factoring contracts follow a general pattern each association should be tailor-made to fit the needs of the prospective client. The operation should be sufficiently flexible to cope with any financial problems that might arise. The credit and collection service should meet the needs of the client under consideration. Where necessary and at the client's request provision should be made for counseling and advising in budget and merchandising problems. The vast experience absorbed by a factor in dealing with various clients in a particular trade or industry can be used in a strictly confidential manner to advise clients regarding sales or other problems that might develop during the life of the factoring contract.

One of the most important but perhaps less apparent gains made possible by a factoring agreement lies in the sphere of management and the most profitable utilization of management's time. With credit, collection, accounting, and to some degree financial problems in the hands of the factor, management is free to devote a greater amount of time to production, merchandising, and sales efforts which materially enhance his opportunity to increase sales and profits. Increasing sales in this period of a rising break-even point is almost a must in some lines of business in order to show a profitable operation.

Costs of factoring vary with services rendered. The commission rate for credit, collection, and accounting services is determined in part by the volume of the prospective client's business, the type of customer sold, terms of sale, and the size of the unit of sale. The commission rate is set in line with the cost of these services, were they to be performed by the client in his own office. Interest is charged only for money which is actually used and for the exact number of days used plus a reasonable time for collection and clearance of checks.

Factoring, which was primarily established to service the textile trade, has been found to be so adaptable to almost every field of industry that it now serves greatly diversified lines of business including the furniture, shoe, paper and pulp, pottery, metal trades, electrical appliances, leather, arts and crafts, plastics and many other trades.

WHAT'S NEW IN READING

By MARY NOEL BARRON, CPA, Carbondale, Illinois

BUSINESS BUDGETING AND CONTROL by J. Brooks Heckert. (The Ronald Press, New York 10, N. Y., 546 pages, Price $5.00.)

This book covers everything from principles through methods and procedures for the preparation and operation of budgets for all types of business both large and small. Specific problems of budgeting will vary in concerns of different type, but the basic purpose, objectives, and methods of approach are fundamentally the same in all business and must be observed in all successful budgeting.

Step by step, the book follows each budget through from the time the budget figures are constructed to the time when they are compared with the actual results, the variance analysis made, and the budget reports drawn up. The orderly arrangement makes everything easy to find and use, whether your interest is in a whole new plan or in improving an existing one. Consideration is given to the flexibility required in managing and working under every type of budget.

This book shows how budgeting as a tool to management can be used to base action upon careful, systematic study and research; to enlist assistance of the entire organization in determining the most profitable course to follow; to serve as a guiding principle for declaring business policies; to define clearly the objectives which CAN be reached through a sensible plan of action; to relate the activities of business to the expected general trend of business conditions; and to direct capital and effort into the most profitable channels by means of a balanced and unified program. Budgeting may also be used by management to coordinate and correlate effort; to control operations; to reveal weakness in organization; to stabilize employment and to make more effective use of physical equipment; and to prevent waste.

BUSINESS BUDGETING AND CONTROL will be of help to business executives upon whom falls the ultimate responsibility for planning and control; to accountants who largely direct the budgeting and control procedure; and to all those whose training and experience are being directed to better management.

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MAPI ACCOUNTING MANUAL, compiled by MAPI Accounting Council (Machinery and Allied Products Institute, 120 South La Salle Street, Chicago 3, Illinois, Price $15.00).

The MAPI accounting Manual was written by financial officers and accounting exectutives of leading capital goods and industrial equipment manufacturers comprising the MAPI Accounting Council and its Subcommittee on Manual Revision. This manual is an official Institute publication.

This book uses charts and tables frequently to explain modern accounting theory and practice as applied to capital goods and industrial equipment industries. Beginning in Section I with a classification and description of accounts, it offers authoritative coverage of up-to-date accounting policies and practice accepted by leading companies.

Section II presents a guide to the construction, analysis and interpretation of financial statements. An important feature of Section IV on Manufacturing Costs is the discussion of inventory pricing methods, including the LIFO and FIFO methods. Other sections give individual treatment to Sales Engineering and Administrative Expenses, Pensions, Internal Control and Auditing, Profit Planning and Budgeting and Recognition of Changing Value of the Dollar.