Factoring...

For Your Small Business

Factoring is arguable the most powerful tool available to small business entrepreneurs and easily solves the problems of cash flow caused by customers requesting 30, 45, or even 60 day payment terms or simply paying invoices late. This is especially true for employee-intensive businesses in the service sector such as staffing companies, guard services, janitorial and maintenance companies, etc. Factoring is generally accessible for even the newest small businesses. Because factors actually purchase your invoices rather than lend and focus their credit analysis on your creditworthy customers, small business owners can compete head on with larger companies, comfortably soliciting new business from large, creditworthy customers.

CASE STUDY: JOHN'S SECURITY COMPANY

John runs a small security guard company in Tallahassee, FL which primarily provides guards for the area's gated communities. Typically, John's customers pay within 45 days but John must pay his guards their salary every two weeks.

John's company has an excellent reputation for good service and he receives a request from a large property management company to supply guards to 5 communities locally. Each property requires a guard 24 hours per day at the main gate or in other words, three shifts.

John pays his guards $10 per hour and he quickly calculates the salary cost for the new proposal to be $1,680 per week per community or $8,400 per week for all five communities. The property management company is a very large, creditworthy provider and as such, pays its invoices in 60 days. This means John will not receive his first check for guard services for nine weeks and will have to finance his $8,400 weekly payroll for 9 weeks from his own pocket or in other words, John must have over $75,000 for payroll while he is waiting to receive his first check from the property management company. This is money John simply does not have and he feels he must turndown the opportunity.

Before declining the offer, however, John, remembered a flyer he received in the mail a few weeks earlier from a local commercial finance consultant which explained the power of something called "factoring" used for just this type of problem. John called the consultant and set up an appointment for the same day.

The consultant explained that by setting up a factoring arrangement, John would receive an 80% "advance" each week for the invoices he submitted for the completed services. The advance would provide more than enough money to make payroll for the guards. When the management company paid the invoices in 60 days, John would receive the 20% balance of the invoice minus a small fee for the factor.

John asked how quickly such an arrangement could be set in place and the consultant quickly set up a conference call with one of the factors he worked with. After a brief conversation, the factor told John he would have the factoring agreement in his email within the hour and the first funding could occur starting with the first of the invoices for the new customer.

For John, factoring arrangement provided the catalyst to begin dramatically expanding his business. He now spends more time seeking out more opportunities to provide service to new larger but slow paying customers.

Asset-Based Lending

For Your Small Business

Asset-Based Lending, for many small manufacturers and distributors, is the natural successor to factoring. Unlike factoring which finances invoiced sales only, asset-based loans also address the need for financing a company's growing inventory and in some instances, even equipment. Asset-based loans typically do not finance real estate.

Asset-Based loans are often structured as "revolving lines of credit". Like a factor, the asset-based lender will typically advance 80% against accounts receivable. The advance percentage against the inventory component will depend heavily on the estimated liquidating value of the inventory in the event of a default.

CASE STUDY: MEDICAL CYLINDER CO.

Medical Cylinder Co. is a U.S based manufacturer of oxygen cylinders and valves. Their primary customers are medical supply companies, hospitals, and nursing facilities.

John Smith, president of Medical Cylinder Co., started his company with savings and a home loan but the company has now grown and has outpaced its capital. John set up a factoring arrangement which provided a great deal of liquidity over the years but John now needs a financing arrangement for his growing inventory.

John made an appointment to speak with his local community bank about a loan but was declined due to the fact that Medical Cylinder Co. has only been profitable for about 18 months and the company's financials were simply not sound enough to meet the bank's stringent lending requirements. The lack of available capital for inventory was causing problems for Medical Cylinder Co. as John was required to get cash in advance for many sales simply to keep up with the inventory problem. He knew asking for up-front cash was costing him business and limiting him on his ability to attract new customers.

John's banker suggested he look at an asset-based line of credit and gave John the name of a local commercial finance broker that could help him.

After calling the broker, a conference call was set up with a bank that provided ABL financing. John was pleased to find out that his factoring facility could easily be rolled into an ABL as a revolving line of credit.

Contracts were sent to John which provided for an asset-based credit line based on an 80% value of accounts receivable and 50% C.O.G. value on cylinders in the warehouse. The line also included a $20,000 provision for two fork lifts John had previously purchased for cash.

Each week, Medical Cylinder Co. is provided with a "Borrowing Base Certificate" which sets forth the current line of credit. As payments are received from customers on John's financed invoices, the line is automatically paid down. The line is adjusted each week based on new sales and customer payments upon invoices which have been received by the lender.

John's ABL line grows as his company grows and has allowed Medical Cylinder Co. to expand its business to other product areas including propane tanks and welding equipment.

Purchase Order Finance

For Your Small Business

Purchase Order Finance is so often associated with import export trade finance that many don't realize its also common use to provide financing for standard domestic transactions. Simply put, where factoring and asset-based lending provide financing for goods and services already delivered to a customer, purchase order finance provides financing for sales where the good are not available and must be manufactured. It is important to understand the subtle difference between purchase order finance and inventory finance regarding the manufacturing process. Purchase order finance is a method of financing finished goods prior to delivery. Inventory finance with finance parts needed for assembly of a product.

CASE STUDY: AMZ TOYCO

AMZ ToyCo Inc. distributes a line of unique wooden toys which it contract manufactures in Indonesia. The company was the brain-child of Jim and Jan Petersen and was started as only a part-time company but quickly blossomed into a full fledged business. Though growth of ToyCo Inc. has been slow, it has been steady. Jim and Jan have grown the company from a garage business to one with ten full time employees and nearly 500 customers.

ToyCo has always been a "specialty" business and its customers have been boutique toy stores specializing in one of a kind toys for high-end discriminating buyers. But that is all about to change.

At a recent trade show, Jim and Jan were displaying a new line of brightly colored wooden railroad-based toys which caught the eye of a buyer for a large retail chain. Throughout the next 30 days, Jim and Jan made several trips to the retailer's home office which resulted in an order for over $750,000 in wooden toy trains and equipment. The order nearly doubled the size of ToyCo overnight and Jim and Jan were elated until they thought about how they could actually build such a large order for delivery.

ToyCo typically enjoyed a nearly 200% markup on its toys when sold to their small "mom and pop" retail customers and even after discounts to their new retail customer, their profit was still well over 100%. The problem, however, was in the terms of the purchase order which required delivery of all goods within 90 days.

ToyCo's Indonesian factory could easily meet the build specifications but required full payment up front for wood, labor and materials. This meant that Jim and Jan would need to post a letter of credit for roughly $300,000.

Jim and Jan had been factoring their invoices for years and called their factor and explained the problem. The factor set up a conference call with a purchase order finance company which agreed to post the letter of credit for the manufacture of the goods provided Jim's factor would finance the invoice once the goods were delivered. The factor agreed and the paper work was created for the transaction.

Once built, the letter of credit "triggered" and paid the Indonesian manufacturer $300,000. The goods were shipped directly to the retailer and ToyCo invoiced $750,000. The factor, purchased the invoice and from the original advance, paid off the purchase order finance company ($300, 000) and associated fees. The factor then waited for payment.