

THE JOURNAL REPORT: SMALL BUSINESS



The Money Game

Fast Money

Factoring isn't for everybody. But for companies that need cash quickly -- or don't want to hassle with banks -- it's one way to go.

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Businesses often need more cash than they have on hand. It may be for an emergency, a fleeting opportunity or, sometimes, such ordinary events as a payroll to meet.

How to be prepared and avoid a cash-flow squeeze? Short of having an ATM in-house, many firms are using what once was a controversial way of obtaining quick money.

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[Small businesses find blogging](#) can be useful -- but awfully time consuming. Plus, [to hook executives of large companies](#), entrepreneurs try a variety of recruiting tactics.

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It's called factoring, and it's based on a simple idea. A business sells its invoices or accounts receivable to a firm that specializes in collecting their payments. That firm, called a factor, advances most of the invoiced amount -- 70% to 90% is common -- to the business after checking out the credit-worthiness of the billed party. After the bill is paid in full, the factor remits the balance to the client, minus a transaction, or factoring, fee.

The process can be swift. Once the factor is satisfied that he or she will be paid, money from an invoice can be in the hands of the issuing client within 24 to 48 hours. Indeed, for many businesses, the biggest attraction of factoring is not being held captive by slow-paying customers.

"As a subcontractor for glass and glazing on construction jobs, we'd have to wait 30 to 60 days for our money," says Theresa Woods, controller at Metropolitan Glass Systems Inc., a Tampa concern. So her company began using AmeriFactors Financial Group, based in Celebration, Fla., to collect its bills. "We'd get our money on the spot," Ms. Woods says.

Help at the Start

Some businesses use factoring to get started. Because it is the financial soundness of their customers that most concerns a factor, firms with scant history can nonetheless sell their invoices. "We weren't profitable then, so didn't qualify for bank financing," founder Alton Johnson of Bossa Nova Beverage Group says of the juice maker's early days.

While Mr. Johnson says venture capital was a possibility, he decided that even with factoring's higher interest rates, paying them was preferable to selling part of the company. Factoring got the Los Angeles firm through a critical start-up and growth period, he says.

Factoring Do's and Don'ts

Advice for those thinking about using a factor

■ **ASK AROUND.** Talk to others in your industry who have used factors about their experiences and recommendations.

■ **CHECK REFERENCES** for any candidates you're considering.

■ **PERFORMANCE PREVIEW.** Make sure the candidates can handle most of the invoices you want factored. Provide a range of samples for them to review.

■ **LISTEN UP.** Check out their professional manner. "Always speak with a potential factor before agreeing to work with one," says BuyerZone.com, an online marketplace for businesses. "Since the factor will have direct

contact with your customers, you want to ensure the factor is courteous and professional in their communications."

■ **ROOM TO HAGGLE.** When ascertaining costs, don't automatically accept the first rate a factor offers. Instead, negotiate.

■ **PICK YOUR SPOTS.** Be smart about which invoices you want funded. "If you have a large invoice from a customer you know will remit payment right away, collect the funds yourself and skip the factor's fees," BuyerZone says.

Source: BuyerZone.com

Although it has helped many businesses get on their feet, some that have factored accounts receivable to meet their cash-flow needs say they viewed it as a stopgap measure.

"It's something we will wean ourselves from over time, as we're able to establish other funding -- which we're working on," says Jeff Brain, chief operating officer of SFGL Foods Inc., a Glendale, Calif., concern that markets seafood gumbo and other items under the Smokey Robinson brand.

Perhaps chief among factoring's drawbacks is its cost. A factor may charge several percentage points more than a conventional lender.

"We know we're not the cheapest form of financing," says Jonathan Schuster, chief

operating officer at Premium Financial Services, a factor in Santa Monica, Calif. And for some clients, he adds, "we're a temporary fix, not a long-term solution." But he and other factors can rattle off lists of clients who have been with them for years -- some because they consider banks to be, in Mr. Schuster's word, "intrusive."

Factoring's origins go back thousands of years, to the Mesopotamians. It was also a vital source of financing for American colonists who would ship furs, lumber and tobacco to England. Subsequently, one of factoring's biggest users was the U.S. garment industry, where the time between procuring cloth to be made into a suit, say, and being paid for the final product could be many months.

Today, though, the process is at work across the commercial landscape. Some factors specialize in certain types of businesses, such as trucking, construction or health care. Industry sources estimate that billions of dollars in accounts receivable will be factored this year.

Changing Ties

One reason cited for factoring's increased popularity is what some entrepreneurs say has been the breakdown of the personal relationships that once characterized banking. A decade or so ago, Roger Shorey, president of Accurate Metal Fabricators Inc., Kissimmee, Fla., says he could call his bank and say, "I need \$40,000 in my account," and they would say, "OK. The next time you come in you can sign the [requisite] papers." "

Today, Mr. Shorey says, he'd have to do the paperwork before receiving the money. "That makes factoring more attractive to a guy like me," he says.

Factoring isn't for everyone. It probably wouldn't be economical for a firm that sends out thousands of small-denomination invoices, because of the service fees a factor may assess for reviewing each one for

risk.

Another deterrent some cite is a negative connotation tied to factoring's garment-industry heritage, where companies factoring often were found to be financially fragile. A related commonly held impression is that a company uses a factor because it isn't credit-worthy enough to deal with a bank.

The U.S. Small Business Administration says it doesn't have a position on factoring as a financing source. However, it contends that some firms "may be able to find more advantageous terms and conditions through the use of an SBA-guaranteed business loan."

Advocates point to various ways factoring can save a business money. Since the factor handles credit checks and bill collections, a business can reduce its overhead by not having to staff for that in-house. Moreover, because factors won't accept a questionable invoice, businesses can avoid the headaches -- and losses -- that come in dealing with a customer who turns out to be a deadbeat. In those instances, factoring becomes a safety net.

"Any time we get a new customer we forward the name [to the factor] and they check them out immediately," says Tampa Bay Press President John Hedler, who has sold accounts receivable for a decade or more.

Depending on what his factor, AmeriFactors, learns, it may suggest a maximum line of credit his firm should extend to a customer. And while that vetting may deter Mr. Hedler from a sale, AmeriFactors is "really doing us a favor," he says. "Otherwise, if somebody doesn't pay, you have to have an attorney go after them, and it comes out of my pocket."

Factoring can be a big help for those who want to do business overseas but worry about being paid. That's especially true for smaller companies that have little or no experience abroad, or lack the financial means or connections to collect from a customer thousands of miles away.

Mr. Shorey of Accurate Metal Fabricators says he often uses factoring to obtain discounts for his Florida kitchen-cabinet company by paying for large quantities of supplies upon delivery, knowing that he can cover that check by factoring invoices. On a \$120,000 truckload of steel, the discount could be \$6,000 or so, he says. That's more than enough to cover his factoring costs, Mr. Shorey says. "So I'm using Kevin's money to make money," he says, referring to Mr. Gowen, AmeriFactors' CEO. Businesses also can save money by paying cash on delivery, of course -- something factoring may facilitate.

Even one-person operations can benefit from factoring. Stephen D. Lemish, a lawyer in El Cajon, Calif., who specializes in court-appointed work for indigent people, uses Premium Financial to collect from the courts and other government agencies.

"You can't usually bill until a case is over, and that could be anywhere from two months to a year," Mr. Lemish says, noting that his bills sometimes can run to several thousand dollars. Of factoring as a business tool, he says, "For anybody who has a big cash-flow problem, I would recommend it."

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