Can Your Bank Do This?

Factoring companies have reinvented their services to work with clients during every phase of development

BY FREDERICK A. MOSS

Factoring companies have diversified their services into a number of specialized and highly flexible programs. The fastest-growing hybrid, invoice discounting or spot factoring, involves the purchase of receivables at a discount for immediate cash.

For small- and medium-sized business in Canada, there's no such thing as an unsecured bank loan. Banks take liens on inventory, real state, equipment and receivables, as well as personal guarantees from the principals. Without proper debt to equity ratios, finding a lender is next to impossible for a growing business. So what's a rapidly growing business in need of working capital to do? Pinch yourself but it's true: there are finance companies actively wooing non-bankable business growth.

Factoring companies have diversified their services into a number of specialized and highly flexible programs. The fastest-growing hybrid, invoice discounting or spot factoring, involves the purchase of receivables at a discount for immediate cash. With rates ranging from 3 to 6 per cent and no long-term commitment, this facility is highly attractive to entrepreneurs in a variety of sectors, many of whom already have a working relationship with a chartered bank. Because those companies don't lend money, the ratios regularly scrutinized by the banks aren't a consideration for clients with verifiable and credit-worthy paper. By working with a factoring company, clients free up working capital. Banks reduce their exposure. Spot factoring has become the "just in time" of the financial community.

The spot factoring business is built on knowing when and how to help rapidly growing, cash-strapped companies. Clients are not only looking for someone willing to help them finance their business, but an advisor who can partner with clients and offer assistance above and beyond the funding of receivables

Case Study-Lack of equity pinches growing transport company: The company is a well-established international household moving, commercial cartage and logistic warehouse operation. At the beginning of his busy season the president suddenly had the opportunity to purchase the company's Canadian division. A group of investors were brought in and the purchase was finalized. The trouble was, the transaction left the transport company with insufficient equity to secure an adequate line of credit with this bank. Cash was a definite problem.

When the factoring company met the client, receivables were running close to $2 million. Payables needed to be dealt with in order to ensure a steady supply of tractor operators, fuel and labour. And while the company expected to have adequate profit to finance the operations internally within six months, it needed a $300,000 facility in the short term to smooth out cash flows. And they needed it fast.

The factoring company helped the client select three steady customers' invoices to discount. The transport company would bill these customers weekly and send the invoices to the factoring company, which would purchase the receivables on receipt, assume responsibility for the administration of the accounts and wire the funds directly to the company's bank account within 48 hours.

The arrangement worked like a charm. With the necessary breathing space to ensure a smooth transition after the acquisition, the company was able to wind down the facility within six months as predicted. The alternative, pressuring customers for payments in order to run the business on cash flow from receivables would have wreaked havoc on their credit with suppliers and severely hampered their ability to take advantage of opportunities in the market.

Case Study-Restrictive covenant cripples industrial company: Things were slightly more complicated for the investors who purchased an idle industrial company in late summer of 1994. Their strategy had been to sell parts of the production line to foreign interests, divide the land and buildings into smaller lots for sale and development, and revitalize the primary operations of their investment. That the business had tremendous potential wasn't lost on the chartered banks and other asset-based lenders the investors

Without proper debt to equity ratios, finding a lender is next to impossible for a growing business. So what's a rapidly growing business in need of working capital to do? Pinch yourself but it's true: there are finance companies actively wooing non-bankable business growth.

approached. Most were willing to finance operations but only with very restrictive covenants and only if all assets and extensive personal guarantees were pledged as collateral security. Encumbering all of the assets would naturally limit the group's flexibility to carry out the sales they counted on and defeat the purpose of the group's acquisition.

The investors initially contacted a factoring company for a one-shot $200,000 invoice discounting facility to ease their start up. The company had already delivered several large orders and needed raw materials to fill orders on hand. With no credit facilities from their suppliers, cash was desperately needed to survive.

Within a week of being contacted by the nervous investors, the factoring company had designed and implemented a $1.3 million facility which was both flexible and expandable. The only collateral pledge required was the direct assets of the operating industrial company, not all the assets of the group.

This industrial company had sales of $15 million in its first year and will double its volume this year. The factoring company has expanded its credit facility to $2 million and has provided purchase order financing and guaranteed letters of credit. The factoring company was also instrumental in helping the company find a $1 million term loan

Case Study-Importer needs help servicing retail giant: A young immigrant to Canada established a business importing live product from his Asian homeland for independent retailers across Canada. The business was profitable but limited in scope. Aggressive sales efforts finally won the company the contract to supply a major retailer. Although the order was a windfall for the company, supplying more than 100 stores with two to three shipments a month placed a tremendous strain on the importers relationship with its overseas suppliers and transport company.

Working closely with the principal, the factoring company established a billing system which allowed the client to guarantee its live product for three days after delivery. With this system in place, a $250,000 invoice discounting facility was set up which enabled the importer to carry inventory and stay current with its obligations to the transport company. This smooth operating relationship has not gone unnoticed or unappreciated. The major client is now discussing expanding the products supplied by the company.

The spot factoring business is built on knowing when and how to help rapidly growing, cash-strapped companies. Clients are not only looking for someone willing to help them finance their business, but an advisor who can partner with clients and offer assistance above and beyond the funding of receivables.

Frederick A. Moss, CA., is president of Montcap Financial Corp., a wholly-owned subsidiary of publicly traded Accord Financial Corp.
