

## More Small Businesses Are Selling Receivables

Owners who can't get bank credit or aren't selling much are tapping commercial financiers known as factors—despite their higher cost

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SMALL BUSINESS FINANCING

In February 2010, Tiffany Bucher's bank sent her an e-mail she assumed was a mistake: Her company's checking account had been frozen and her \$150,000 line of credit was being pulled. She later learned that the bank's new president was nervous because Bucher's company was involved in a lawsuit and its financial records were disorganized. "We had never missed a payment. I had \$80,000 in payroll due the next morning. I was completely panicking," recalls Bucher, president of Infincom, a Phoenix-based office equipment and software dealer.

Although she insists the company was having no trouble making its \$546 monthly loan payment, Bucher couldn't persuade her banker to change his mind. (The bank's president did not respond to a request for comment.) So the next day, she turned to a commercial finance company, Factors Southwest Funding. FSW Funding covered her payroll obligation within 24 hours and she now uses the company regularly. "Factoring has been my life saver," says Bucher, whose 48-employee company had \$8.5 million in revenue last year.

With traditional financial institutions curtailing small business lending in the aftermath of the economic crisis, commercial finance companies have stepped into the breach to fund expansions and operations at small and midsized U.S. businesses. Because commercial funding is considered non-lending finance (factors buy invoices or accounts receivables at a discount, rather than loan against them), the industry is largely unregulated, particularly in comparison to banking. Factoring often comes with higher cost and greater long-term risk for small businesses.

David Banfield, chief executive officer of Interface Financial Group, an invoice discounter founded in 1972 that has 160 franchise locations worldwide, says his company has seen exponential growth since banks began spurning smaller loans. Three new franchisees opened this summer. "Until the past few years, the main funding supplier of capital for business in North America was the banking system," Banfield wrote in an e-mail.

"There are now fewer banks than a couple of years ago. Many have failed and many have been acquired. What that means for the smaller companies is that there are now less opportunities to go and seek out capital."

### **CREDIT CRISIS SPARKED FACTORING BOOM**

Technology is also fueling alternate finance options, primarily for small businesses. Nic Perkin, president of the Receivables Exchange, conceived his company in 2007 as a kind of Ebay (EBAY) for accounts receivables. It began operations in November 2008. "We certainly weren't created as a business as a response to the credit crisis, but it has provided some wind in our sails," says Perkin, whose typical clients are business-to-business companies with \$2 million to \$250 million in annual sales and list receivables on the exchange regularly or occasionally. "I'd be lying if I didn't tell you that we got a big boost out of [the credit crisis]. We grew at 50 percent per month in 2009 and wound up with 500 percent first-year annual growth. The reality of it is, we probably would not have had that kind of growth otherwise."

The commercial finance industry experienced the same sharp drop in demand in 2009 as bankers did, says Andrej Suskavcevic, CEO of industry trade group the Commercial Finance Assn., whose 250 members are mostly large factoring companies and asset-based lenders that typically make loans secured by machinery and equipment. Indeed, in 2009 the association recorded its steepest downturn since it began keeping records in 1976, with factoring volume falling to \$116.6 billion, or 14.2 percent less than in 2008.

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Demand has rebounded in the past couple of years, says Brian P. Cove, the association's chief operating officer. And Mike Lubansky, a senior financial analyst at private company data provider Sageworks, says factoring is going mainstream: "In the past, some may have seen factoring, because of its higher cost, as associated with troubled situations. But now it's just another source of financing, especially for funding that businesses need to grow when banks that have tightened credit standards and are focused on preserving capital are not able to lend as much."

### **CAVEAT EMPTOR IN COMMERCIAL FINANCE**

That access isn't cheap. Factoring may double the typical credit costs for a small business, says Bill Hettinger, author of *Finance Without Fear* and principal of Connecticut consulting firm the Institute for Finance and Entrepreneurship. Tom Swenson, founder and CEO of the Bank of Montana, says he's advised small business customers considering factoring to shop prices aggressively before signing up. "Commercial financing is looked at as a caveat emptor, buyer-beware kind of situation. They figure you're a business and you should know better—even though a lot of small businesses don't," he says.

Mark Deo, Torrance (Calif.)-based executive director of the consulting firm Small Business Advisory Network, says many entrepreneurs he consults with have turned to factoring, not only because they lack access to credit but also because they are having problems getting new business. "Factors are oftentimes the only source of funding for desperately needed cash, but it is very sad that business owners who have worked for years to build their businesses are entertaining factoring just to fund new purchases, equipment, or improvements," he says.

Hettinger also worries about the long term: Companies with reduced profit margins are even less able to qualify for traditional credit. "Once you start factoring, it's a difficult process to break. The key to a factoring or discounting decision is a complete analysis of all the financial implications of the decision. It's more complicated to analyze than a bank loan," he says.

Bucher didn't have time for complex analysis when she turned to Robyn Barret, founder and managing member of FSW Funding. "I know it's not the best solution and the cost is more for factoring," she says, estimating that she paid \$75,000 in factoring costs in 2010. "But I need the cash for payroll, parts, and supplies, and Robyn supplied it. To me, she's the one that saved my business."