



## Factoring In the Finance Options

### Cash flow solutions outside the bank

*Gremlyn Bradley-Waddell – January 1, 2011*

It's no secret that times are tough in the current economic climate. Many small to mid-sized firms and newer start-ups are strapped for cash, and the place that business owners typically turn to for a loan is the bank. But banks are particularly tight-fisted with the dollars these days, so what do business owners do when the bank turns down a loan request? Sadly, they often close up shop. "If the bank can't help, they go home," says Phoenix-based entrepreneur Robyn Barrett. "It's unfortunate that most small businesses don't look beyond their bank."

In fact, Barrett says, many economically stressed companies could likely be salvaged thanks to an alternative to traditional financing known as factoring, or accounts receivable funding. Factoring is the selling of accounts receivables at a discount to a third-party agency — a factor — in order to free up cash flow while the company waits for slow-paying customers to remit their balance.

Barrett owns such an agency, Factors Southwest, and has worked since 2001 to help firms access working capital. She says she carefully evaluates any client before signing on. "If a company's margin is thin and I factor them, it won't help," says Barrett, who holds a CPA license and an MBA. "It'll be a slow death, unless it's a really short-term relationship. If a company has a good margin, factoring makes sense."

Even though the financing solution is hundreds of years old, many people are not familiar with the concept. Essentially, factoring is akin to a line of credit, but the invoice is advanced upon almost immediately. A typical transaction at Factors Southwest, for example, would be a cash advance of 70 to 85 percent of the invoice amount deposited or wired to the client's bank account within a day.

Factors, or asset-based lenders, will collect the receivables on behalf of their clients and take responsibility for credit losses, explains Bob Wilson of Stoney-Wilson Business Consulting in Scottsdale. Factors do not act as a collections agency. They will, however, notify a client's customers that payments need to be forwarded to them.

"It's an accepted means of financing," Wilson says, observing there seems to be no stigma attached to using a factor. "Having a factor says [the company]

does have a credit facility in place, and in this economy, let's face it, who isn't hurting?" One of the most important points to consider, he says, is whether a company can afford a factor, as the fees are much higher than those surrounding traditional funding. Factoring fees may range from 1.5 to as much as 4 percent per month. "It's a pretty heavy price to pay, but if you need it, you need it," he adds.

As for why a factor may be of help and a bank may not, the difference lies in underwriting. Lou Wallace, managing member of Performance Funding Group and part of the finance industry for nearly 40 years, says a factor looks at the quality of the receivables — in other words, the client's customers — not the creditworthiness of the client itself. "If you're in business a year, the bank won't talk to you," he says. "We can make allowances. We can help someone who's been in business a short time."

That said, both Barrett and Wallace note that not every factor will work with every industry, so some shopping around may be in order. Barrett's company, for example, does not do consumer, medical, construction or trucking receivables. And even though the relationship is likely to be short-term, Wallace says there are a lot of fly-by-night firms interested only in collecting as many fees as possible — so you want to make sure you know with whom you're doing business.

Barrett emphasizes the point as well, and describes selecting the right factor as "almost like picking a partner or picking a spouse." She says smart business owners will do their due diligence, ask the hard questions and read any agreements before signing. "Make sure [the factor has] the backing and the financing," Barrett adds. "Ask them, 'Where are you getting your financing from?' Your factor should be honest with you. Also, ask how long they've been in business and ask for referrals. The good factors will give them to you, the bad ones won't."

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