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Raise Cash Through "Factoring"

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The scenario: Customers are slow to pay, and unpredictable cash flow is disrupting operations.

The tactic: Sell unpaid accounts receivable to a factoring company that will trade them for cash. As the economy slows, so does the typical payment schedule from a company's roster of clients. And for many companies — typically small and mid-sized or privately held firms that don't sit on vast cash reserves — that means managing unpredictable cash flow, on top of all the other business priorities that a recession can trigger.

Through a process called 'factoring,' though, companies can outsource the problem, and in many cases use it to their advantage — accounts receivable, after all, are a bankable asset. Through factoring, companies sell their accounts receivable to a third party, which in return pays the company the cash value of what it's owed. (The third party gets a small percentage of the take for the service.) Factoring rose from being a $127.6 billion business in 2006 to a $135 billion business in 2007, and it is expected to jump significantly this year, according to the New York-based Commercial Finance Association.

Retailers, transportation and logistics companies, trucking firms, and health care/medical businesses are among the biggest practitioners of factoring, since they typically pay large sums or provide expensive services, then wait long periods of time for reimbursement. Trucking companies, for instance, often must fund truckers' gas and other travel expenses as they drive loads of goods from coast to coast, yet the companies may not get reimbursed swiftly once the load is delivered.

Factoring is also available to companies with a poor or recent credit history. Factoring firms look not at *your* credit quality, but at the credit quality of your paying clients, which means fledgling businesses can use it as an alternative means to keep business afloat. David Theobald, CEO of Stat Staff Professionals in Clifton Park, New York, has used factoring for six years. His company provides contract personnel to medical facilities, which then reimburse Stat Staff. But in order to make payroll among his 100 employees, Theobald says he's turned to a factoring firm for help. "Our business is service-based. It's difficult to fund payroll when you're waiting 30, 60, or 90 days to get paid," he says. Theobald says that Anchor Funding is currently handling $600,000 worth of outstanding receivables. Without factoring, he says, he'd have to have at least $1 million in cash on hand or a similar-sized revolving credit line to make payroll. "Using factoring gives me more opportunities to concentrate on growing," he says.
Caution: Factoring firms can charge higher interest rates than conventional lender loans. If clients don't pay, you are liable for the debt you sold — a risk in the current economy, when many companies are staggering payments. If clients pay extremely late, you pay more interest on the money advanced. In addition, larger public companies may run into accounting complexities if they use factoring.

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