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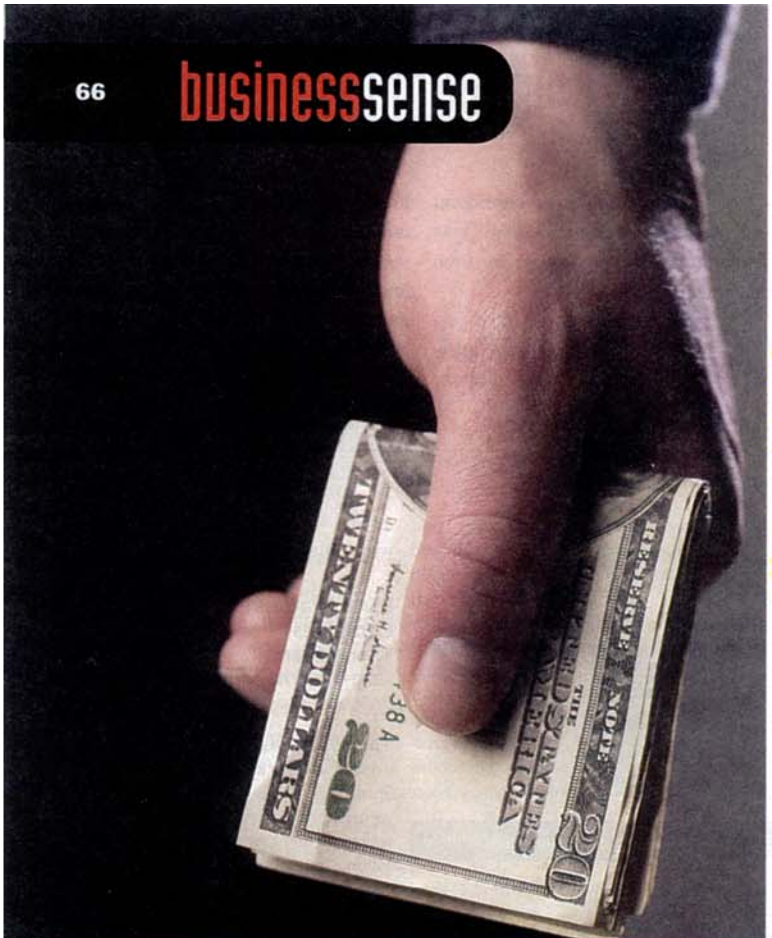

FACTORING SUCCESS

Electric motor company uses alternative funding to grow

By Stephanie Vaughan, Associate Editor

In 1989 Nick Hager had $4,000 and a dream.

Today his electric motor remanufacturing company makes $6 million to $7 million in sales in a year and employs 40 people.

In between those years, Hager learned all about the highest hurdle in growing his company: money.

It's the same story everybody hears when they're just starting out in any industry. You're new, so you need a job to get experience, but no one wants to hire you because you don't have experience. How are you supposed to get experience if no one hires you?

Getting the financial backing to expand a business can work much the same way, especially for small and medium-sized companies.

While banks are in the business of lending money, they think backward rather than forward, looking for tangible assets such as machines and buildings. In today's business world, assets are more often intangibles; in addition, if you look backward into a company's financial standing, it's very possible that the way the company looked financially is nothing like how it looks today.

So the question is: How do you finance a company if the bank isn't willing to lend you money?

Bank or Bust

"When you work your way up through the struggles and are trying to get yourself established with financial institutions, it's a long, drawn-out process," Hager told *The FABRICATOR*.

As the owner and president of T & N Electric Motor Exchange, Bluefield, W.V., which specializes in electric motor remanufacturing, repair, redesign, sales, service, support, exchanges, and consignment, Hager spent most of his time chasing customers, trying to collect money, and little time managing the business and focusing on opportunities that he couldn't get because he didn't have enough time to investigate them.

"Unless you just go into business and you have adequate financing or financial support, you deal with the whole cash flow issue," Hager said. "Our business is very capital-intensive. When you take your capital and you're constantly investing your profit back into your company, it tends to strain you.

"I spent most of my time just trying to make sure the money was in the bank," he said.

While Hager said the phrase "it takes money to make money" is true in any business, you have to have access to money in the first place. When you don't have access, you're caught up in a vicious cycle of making money, chasing it, and putting it back into the business without thinking about the company's long-term future, investments, and new opportunities.

"Your money stays tied up in the shop in jobs or in the books or your profits – you're constantly investing it back into the company in whatever part of the company you need to be more profitable, so you never really can manage or focus because you don't have a consistent work flow," Hager said.

Because Hager was getting enough business that it made sense to expand, his first logical step was to visit a bank. Unfortunately, the news wasn't good.

"When you sit down with the banks, they're more governed, so how they can help you and support you are limited in some cases until you get established," Hager said.

But he did learn about an alternative that could get his company more established: accounts receivable financing.

Accounts Receivable Financing: The Basics

The U.S. Small Business Administration puts accounts receivable financing into one of two categories:

1. Assignments. The business pledges, or "assigns," its receivables as collateral for a loan.

2. Factoring. The borrower sells its accounts receivable to a lender (factor).

Although these arrangements are not loans, in a pure sense, the effect is the same.

Receivables Assignment. When receivables are assigned, the amount of the loan varies according to the volume of receivables outstanding. Normally, the lender will advance a specified percentage of the outstanding accounts receivable up to a specific credit limit (see **Figure 1**).

Figure 1 shows that a company can borrow up to 80 percent of assigned receivables, up to a maximum of $100,000.

On the first line, accounts receivable are $100,000 and the amount loaned is 80 percent of $100,000, or $80,000. Similarly, on the second line, outstanding receivables are $125,000. The amount loaned increases to $100,000 ($125,000 × 0.80). On the third line, accounts receivable are $150,000. Eighty percent of this amount would be $120,000. However, this exceeds the established limit of $100,000, so borrowing is restricted to the $100,000 limit.

In many industries, accounts receivable financing is considered a sign of weakness. However, it is quite common in others. This is particularly true in the garment industry and in personal finance companies.

When accounts receivable are assigned, the borrower is still responsible for collection. Upon collection of any receivable, the amount borrowed should be repaid. Interest is based on the amount borrowed and the time between receipt of proceeds by the borrower and repayment.

Factoring Accounts Receivable. When accounts receivable are factored, they are sold to the factor, and the borrower has no responsibility for collection. The borrower pays the factor a service charge based on the amount of each receivable sold. In addition, the borrower pays interest for the period between the sale of the receivable and the date the customer pays the factor.

The factor is responsible for collection, so it will purchase only those receivables for which it has approved credit. When customers must pay invoices directly to a factor, it may create doubts about the company's financial stability and, therefore, its ability to deliver. However, factoring also is common in some industries. For example, high-tech companies often factor receivables to finance growth and research and development and consider this a way to outsource part of their accounting activities.

The Hager Factor

Hager chose to factor his invoices, using Capital Solutions, Fort Myers, Fla., starting in January 2004.

"I was the most skeptical person in the world, but I knew I was going to have to choose someone to do business with," Hager said. The way Capital Solutions' CEO, Carlos Weil, explained the system sealed the deal for Hager.

The first step was to call Capital Solutions and set up an appointment with them for an assessment.

"My problem was, we were making money, but we couldn't get your hands on it. At the same time you were growing, but you needed to establish yourself with the bank," Hager said. Because the company was generating sales, the accounts receivable funding worked to his advantage.

"You generate sales every day, so you generate an invoice," Hager said, explaining the process. "You package that weekly – say you invoice $100,000 in a week, then you put it in a package and fax it to Capital. Then they wire 80 percent to your account. Then you work on your cost percentage and pay that to Capital."

The company can use the money to pay bills, taxes, or anything needed for the company to function. Then on the 15th and 30th of the month, Capital takes its fees out of the remaining 20 percent and sends the remainder to Hager.

Unless a company can get a bank to finance it, Weil sees accounts receivable financing as an alternative that all businesses in need of funding should consider.

"I'm the first person to say, go for a bank," Weil said. "The challenge is that too often banks either don't give you enough money or take too long to decide. Sometimes banks take three to four months to decide. The other thing other lenders have is termination clauses; they'll give you a line for a year."

The first requirement a bank needs is financials, Weil explained. While some companies have the financial record the bank is looking for, it doesn't necessarily mean they'll get the amount of money they need.

"The bank comes back and says you've got good financials, but we can only give you $50,000, which is almost like if you ask for money to go to the movies, but someone gives you two bucks. It doesn't cut it," Weil said. "The banker says, 'Take it and we'll give you more when you perform,' but this probably won't happen for a year. So for a year you're stuck with $50,000."

Factors like Capital Solutions can offer manufacturing companies an opportunity to get the good financial record they need so banks eventually will finance them.

"We see ourselves as a stepping stone," Weil said. "Our hope is that you will grow to $5, $10 million in sales. Our experience says that when you're selling $10 million, you'll start showing up on the banks' radar screens. Now it's an interesting business, and you will be a much more stable company, so more bankers will be interested in you."

Is Accounts Receivable Funding Right for You?

Alternative short-term financing may not be the answer for every company, but a few questions can help you investigate it for yourself.

For example, Weil said, alternative financing generally is best for business-to-business companies. In addition, the company must have creditworthy customers and authentic invoices.

Generally, if your company could use more money to sell more products or services, it's a candidate for alternative financing, such as accounts receivable financing.

"[The question is], If you had more money, could you sell more?" Weil said. "For many people, the answer is no – they're maxed out with their machinery, the competition in the area – but I don't think there are too many companies that can pride themselves on not growing and think they're going to survive."

However, Weil said, some companies can finance their operations with the money they make.

If you find that your company could use alternative financing, the next step is to investigate your lender options. Weil advises getting references from the lender, finding out how much it will cost you to terminate the partnership if necessary, and who your contact will be at the lending company.

Finally, if the lender is financing receivables, one more issue is critical, Weil said.

"One of the things you want to make sure is that the lender has a very soft touch with the whole issue of the relationship with your customers," Weil said. "The most sacred thing in any of these situations is your customer. Anything that would alienate your customers needs to be eliminated."

Hager hopes and plans for the accounts receivable financing he's receiving now to be the stepping stone he needs to continue growing his company. Before he started working with Capital Solutions, Hager's company grew 21 percent every year. After the company had access to the capital it needed, it grew 80 percent last year and another 34 percent in the first quarter of 2005 compared to first-quarter 2004.

"It has helped our cash flow tremendously," Hager said. "It seems to be a really good way to manage your receivables and your cash flow."

Accounts Receivable Assignments	
Accounts Receivable	**Amount Borrowed**
$100,000	$80,000
$125,000	$100,000
$150,000	$100,000

Figure 1

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