Case Studies in Factoring

Case Study #1... James Manufacturing, Inc.

James Manufacturing is a small builder of boat trailers and related products such as trailer frames and axles in Southwest Florida. Bill James, its owner, was awarded a contract to supply the Florida Fish and Wildlife Conservation Commission with 72 new trailers to replace old units that were rusty and failing. Each trailer was $2,900 for a total value of $208,800 James had 20 trailers in inventory to begin delivery and the contract called for all trailers to be delivered within 60 days.

James Manufacturing had little excess capital. The problem it would now face is that the state pays slowly and Bill James knew he would not receive payment for the 20 trailers he could immediately deliver for nearly 45 days... cash he needed to order bulk steel and hardware to build the remaining 52 trailers and to be able to deliver them by the 60 day purchase order deadline.

James had virtually no credit history but he decided to go to a local community bank anyway, explain his problem and request a short term loan. The loan officer explained that what James really needed was factoring, a method of financing his accounts receivable that did not require a strong credit history for him, only his customers. Even more importantly, the community bank had a factoring department and James was introduced to the bank's factoring officer where an account was immediately established to provide the necessary working capital to meet the order.

Through factoring, James would receive an initial advance from the bank of $46,500 (80%) on the $58,000 invoice after delivery of the 20 finished trailers in inventory. That advance of $46,500 was enough to then buy the bulk steel and hardware to complete the other 52 trailers in time to meet the required delivery deadline. After the state paid for the 20 trailer shipment, the bank would then give James the $11,500 not initially advanced less a small factoring fee for services.

More importantly, with the bank's factoring arrangement now in place, James began to bid on many more state and municipal contracts, jobs he had shunned in the past due to the slow payment policies of those entities. The factoring arrangement was exactly what James needed to take his small company to the next level. It sped up the company's cash flow so much that James was able to pay his steel and parts suppliers within 10 days and take a 3% discount for early payment. That discount for materials paid for almost 75% of the bank's factoring fee making the overall expense for the factoring facility miniscule.

Another surprise to James was that the factoring arrangement with the bank had almost no upper credit limit. So long as James sold to approved creditworthy customers, the bank would immediately advance on each invoice once the trailers were delivered. There were no requirements for lengthy lending committee meetings to approve the credit line increase. So long as the invoices were bonafide and legitimate, the cash was available. The only limit to the growth of James Manufacturing was now how many contracts James could acquire.

Case Study #2... John's Security Guard Service, Inc.

John provides 24 hour security guard service to gated communities. He has slowly built his company up over 5 years and enjoys an excellent reputation for service. The property management companies responsible for payments to John's for its services are notoriously slow payers, however, and the further growth of John's Guard Service has been severely limited due to weekly payroll constraints. John has attempted to secure financing for his company at a local community bank but has been turned down on two separate occasions due to a slightly tarnished credit history and lack of any meaningful "hard asset" collateral to secure the loan.

Because of its excellent reputation, John's Guard Service was offered a contract to provide security guards to 37 local gated communities in the area that, if accepted, would more than triple the size of his company overnight. Unfortunately, the large management company offering the new business to John also had a reputation for 75 day payment for services. John calculates the number of guards needed to cover all entrances at the 37 properties to be 65 and the communities required 24 hour guard protection for a total of 195 guards. With a weekly salary of $480 per guard based on a 7 day work week, John's weekly payroll expense for the new contract would be $78,000. This meant that because of the management company's 75 day payment history, John would have to personally bankroll his company for 11 weeks at $78,000 per week or a total of $858,000 to accept the new contract. John had only $37,000 in his business account and felt he would unfortunately need to decline the new business offer.

John, however, remembered that he recently received a brochure through the mail that explained the benefits of something called factoring and its powerful financing capabilities. He contacted the factor that mailed it to him and explained the hopelessness of the new offer. The factor explained to John that factoring will provide him with the capabilities to say "yes" to the new contract and the factor immediately faxed over an application to get the approval process started..

John was quickly provided with a factoring arrangement to purchase accounts with a discount rate of 3% for 30 days. This meant that John's fee rate will be approximately 7.5% to finance his invoices but with nearly a 30% profit margin for his guard services, it will still allow him to record a gross profit of nearly $15,000 per week or over $750,000 per year from the new contract...a contract he was about to turn down.

With the factoring arrangement in place, John also quickly realized it would allow him to aggressively market for new contracts with larger local prospective customers, something he had shunned in the past due to his lack of adequate working capital to fund payroll while waiting for checks to come in. John was also a minority business enterprise and as such, was eligible for "priorities" from state and local government. He immediately registered as a minority contractor with the state and began to bid on their contracts as well.

Factoring Case Study #3... Betty's Building Maintenance Service, Inc.

Betty's Building Maintenance Service, Inc. provides exterior building maintenance including pressure washing and window cleaning. As a minority (woman-owned) business enterprise, Betty receives many opportunities to compete for local community, city and municipal county contracts but has declined these opportunities in the past as the contracts are relatively large and both the county and city take 45 days to make payment for services performed. Unfortunately, Betty's company has few hard assets to be used as collateral and she cannot secure any form of business loan or line of working capital credit from her local bank.

Betty was contacted by Bill, a loan broker and small business consultant, who explained to her the benefits of factoring and showed how selling her invoices immediately after her cleaning services were performed would allow her to accept the lucrative contracts offered by the city and county without worries of making payroll and payments to vendors for her supplies.

Bill then introduced Betty to a factor's business development officer by setting up a conference call and Betty was very quickly forwarded a proposal for a factoring arrangement whereby Betty would be charged a flat rate of 4% of the invoice face amount for the first 45 days the invoice was outstanding and 1% for each fifteen days thereafter on all invoices Betty factored.

Betty's profit margin of 25% easily absorbed the factor's fee and left her with a 20% or greater profit margin on highly profitable work she was capable of contracting but was currently turning away due to the crippling 45 day payment terms. And, she also reasoned that her minority business standing would possibly allow her to build in a slightly higher profit margin when bidding for the city and county's work.

When they arrived, Betty quickly executed her factoring agreements and established her client relationship with the factor. She then immediately began to bid on the city and county jobs that she had been turning down for years and was awarded a $25,000 monthly contract to provide maintenance on five local county buildings. She also won the bid for maintenance on the City Hall for over $100,000 per year.

With her factoring agreement in place and with no more payroll worries, Betty is now positioned to grow her business at an exponential rate, limited only by her ability to market, train employees, and contract with major customers. For service companies like Betty's, factoring is often the financing mechanism of choice. A factoring facility automatically grows in size along with its user. Most importantly for service companies like Betty's that have little in the way of collateral for a traditional bank loan, factoring is readily accessible. Like a mirror image of a bank, factors focus in customer credit, not the creditworthiness of the client. This makes factoring a perfect working capital solution for new startups and companies in their early stage of business development that have not yet developed a credit history.

Factoring Case Study #4... James & Sons Parking Lot Maintenance

Eric James, owner of James & Sons provides parking lot maintenance services including weekly cleaning, curb stone repair / repositioning, and landscape maintenance to small shopping centers and other commercial accounts. When providing services to shopping centers, James and Sons is usually paid by the tenant who's store the particular area of the parking lot serves.

James was contacted by a new management company that serviced the city's largest retail shopping mall. He was offered a contract to service the entire parking lot of the mall, billing the tenants separately for the service. The total contract value was for nearly $30,000 per month and with a profit margin of nearly 50%, the additional business would result in a handsome profit for the company.

James had always been reluctant to accept contracts from major malls since mall "anchor tenants" tend to be very large retailers that are notoriously slow at paying their invoices. Even with a 50% margin, payroll for employees for such jobs would be substantial. With major anchor tenants taking up to 60 days to pay invoices, James felt he could face serious cash flow problems regarding weekly payroll if he accepted such contracts.

Some time ago, James had received some information in the mail from a loan consultant regarding "invoice financing" which he had saved. He called the consultant who explained the process of factoring and how for a fee of between 4 and 5% for 60 days, James could receive advance payment upon the invoices sufficient to make payroll while he waited for invoices to be paid by the slow paying "anchor" tenants.

James almost couldn't believe he had never heard of such a financial accommodation and quickly saw that this thing called "factoring" would allow him to accept the lucrative contracts he had been shying away from for the last 15 years. A conference call was quickly set up by the loan consultant with a factor who told James they could indeed solve his cash flow problem by establishing a factoring facility for his company and contracts were sent to James by overnight courier.

James executed the agreements and a factoring relationship was established in les than 36 hours. With the establishment of the relationship, James called the management company and agreed to the lucrative contract. More importantly, now that James had the ability to finance his receivables, he began an active marketing program to the other large local retail centers that he had avoided prospecting for so many years.