

# The Future of Factoring is Here and Now—Why Alternative Lending May Be the Best Interim Solution to Counter the Sour Credit Market

By **Mike Semanco**

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The practice of factoring along with its companion financing vehicle asset-based lending have the time-tested ability to sustain and grow companies when traditional bank financing does not fit, or, in today's economy, frequently is unavailable.

Factoring is the sale of accounts receivable or invoices at a small discount to a factor to obtain immediate cash. Asset-based lending--a credit line based on various asset classes such as accounts receivable, inventory, equipment or real estate--often is viewed as a stepping stone to traditional bank financing. Loans focus on the value of the asset and not solely on a company's cash flow. Today, the practice acts more like a bridge than a stepping stone--and perhaps a very long bridge at that. That's because there are no definitive answers as to how long it will be before we see traditional lending back in full force. In the meantime, commerce must continue to move forward.

Today's economic uncertainty has caused factoring to aggressively resurface as a viable financing option. While its historical track record reflects that factoring never really disappears from the financial landscape, it does get a harder look when lending becomes constricted. When credit tightens, the reality of paying a bit more for access to capital is much more palatable, especially when the alternative is shuttered businesses, missed opportunities for new business and the inevitable layoff of skilled and valued staff. Frustrated entrepreneurs and other traditional bank borrowers, stymied in their efforts to obtain working capital, may welcome the opportunity to obtain financing through factoring and asset-based lending, finding it to be a credible and solution-based approach.

In a recent statement from the asset-based financial-services-industry trade group, the Commercial Finance Association, CEO Andrej Suskavcevic reinforced the legitimacy of asset-based lending. "As other lending disciplines are literally in crisis mode, asset-based lending has remained a strong, steady and viable option for businesses struggling for working capital," said Suskavcevic. "As many banks have had to virtually close their doors on even creditworthy businesses, our members continue to serve as a lifeline for the global economy. It is important to note that this is in large part due to the responsible way in which the asset-based lending industry operates."

Indeed, viable, growth-driven businesses are using asset-based lending and factoring as a preferred financing vehicle as they discover the flexible but disciplined approach to accessing credit. As sales increase, a company can borrow what it needs against the increased sales to cover costs and pursue new opportunities. As sales are repaid, the credit line is repaid, with no additional debt hanging over the company.

Despite the distinct downward turn in the economy that has affected traditional lending and, to a lesser degree, alternative financing, anecdotal evidence supports that asset-based lending and factoring can contribute to the sustainability and growth of business today. For example, a furniture manufacturer whose bank line was capped on real estate received \$75,000 of spot financing during 2008, until December, when a \$250,000 line secured by invoices and an advance against a new purchase order allowed the company to increase sales by \$500,000 over a 3-month period. And, in another case, an engineering design and manufacturing firm received a \$1 million line of credit over and above what its current bank was providing on real estate. Company growth increased by \$5 million in 2008, because it could fund new programs. And, lastly, a precision machine shop was provided a startup factoring facility of \$10,000 based on current annual sales of \$100,000. New projected orders for 2008 totaled \$600,000. The factoring facility grew with new orders and eventually maxed out at \$175,000. Annual sales approached \$900,000 in 2008, and the current annual sales run rate for 2009 is projected at \$750,000.

If a small business can secure bank financing to meet its working-capital needs, it should do so. However, the current economic climate is making that more difficult for many owners of small to medium-sized businesses. Alternative lending options such as factoring

and asset-based lending frequently allow companies to say “yes” to new opportunities that wouldn’t otherwise be possible.

If our economy is to return to stability, we need more “yeses.” Thankfully, alternative lending is resurfacing as a key player that can reintroduce “yes” into the conversation.