Where to Turn When Banks Say No?

MGI Pagán-Ortiz & Co., CPA, PSC

BUSINESS SOLUTIONS WORLDWIDE

Factoring

❖ Definition

FACTORING COMPANIES, typically buy a business's accounts receivable at a discount and collect the receivables themselves. It is not a loan but a purchase of a financial asset, offering businesses quick access to cash and leaving customer debt-collection costs to the factors.

❖ Pros

- ❖ It is among the quickest way to get advance cash and overhead charges get automatically reduced with the cut in invoice processing activities
- ❖ The business owner becomes free of various other obligations
- ❖ Getting cash with factoring helps in eliminating the risks of bad debts
- ❖ By undertaking the task of debt collection it helps the company in concentrating over more value added activities
- ❖ Without acting as hindrance to cash flow it gives an opportunity to offer credit terms to customers
- ❖ Factoring brings no extra liability in balance sheet and hence does not result in creating hassles while obtaining other types of financing

Factoring – cont.

❖Pros

- ❖ Early payment discount is another benefit of factoring. Payment of bills before the scheduled time brings in many benefits in the form of discounts
- ❖ It is an easy way to have an access to unlimited capital as with an increase in sale more money becomes immediately available to business owners
- ❖ Some other benefits include building credit, quick and easy process, concentration on marketing and securing new accounts and no long-term obligation

Factoring – cont.

❖Cons

- ❖ The biggest disadvantage is it makes the process complicated as it acts as an extra link in the process
- ❖ It is useful for companies with disputes and queries
- ❖ The ambit for borrowing gets narrowed, as account receivables will not be available for security
- ❖ Factors may want to get your customers examined and may have influence over your ways of doing business
- ❖ In case the customers do not repay the money, you have to pay their amount entwined in factoring
- ❖ It is costly than other sources of finance though it is competitively priced
- ❖ Few customers don't want to deal with a third party and are not interested in factoring

Factoring – cont.

- How to find them?
  - http://factor.org/
  - http://www.business.com/directory/financial_services/commercial_finance/factoring/united_states/
  - http://www.liquidcapitalcorp.com/
  - http://www.acrecent.com/

Merchant Cash Advances

❖Definition

- ❖ A merchant cash advance is a form of receivables financing that is based on future credit card sales. The financing company purchases a portion of these credit card transactions from the business at a discount (the rate of which is generally based on the business' sales history). The business then receives an instant lump sum of capital, while the financing company collects a fixed daily percentage of the business' credit card sales until the full agreed upon amount is paid off.

❖Pros

- ❖ This method of financing comes with several benefits that are particularly attractive to small businesses
- ❖ Unlike banks loans, there are no closing costs or upfront fees

Merchant Cash Advances – cont.

❖Pros

- ❖ In addition, there is usually no fixed timeframe for repayment of the cash advance; the deductions will just continue until the total balance has been repaid
- ❖ There is also no worry about making scheduled payments during periods of slow sales
- ❖ This method of financing has the benefit of a quick approval process that requires very little preparation or paperwork, and since financing is based on future sales, credit and sales history are generally not a factor for approval
- ❖ A cash advance also comes with no restrictions on the use of the money

❖Cons

- ❖ One of the biggest drawbacks to financing with a merchant cash advance is that the cost of borrowing money is always going to be higher than getting a traditional loan
- ❖ One can expect to be paying about 30% on the money received. These products should also be used responsibly

Merchant Cash Advances – cont.

- Cons
  - Applicants should make sure that they are clear with the company's terms and conditions, that the payback rate remains fixed, and that they can afford it (If a business is operating on a sales margin that is less then 10%, then a cash advance is probably not a good option)
  - Though the majority of applicants receive approval for financing, a business must already be in operation (start-ups are generally not funded) and have a history of processing a significant amount of credit card sales per month

- How to find them?
  - http://www.fastmerchantadvance.com/
  - http://www.fastupfront.com/

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Sale and Leaseback

❖Definition

The basic concept of a sale-leaseback arrangement is simple: A business sells a piece of machinery or equipment to a third party that, in turn, leases such machinery or equipment back to the company.

❖Pros

- **Better use of assets -** A sale-leaseback arrangement converts equity in land or property to cash, allowing the seller to retain use and control of the asset. While a conventional financing package might limit a business owner's borrowing capacity to 80 percent of the property's appraised value, a sale-leaseback deal can usually deliver full value, less any required capital gains taxes
- **Improved cash flow.** A sale-leaseback deal can be an "off-the-balance sheet" way to boost cash flow without creating new mortgage or loan debt. This often reduces the company's "book value," which can improve overall return on assets. And, the monthly payment under a sale-leaseback arrangement is often less than the cost of borrowing a comparable amount of money using conventional financing

Sale and Leaseback – cont.

❖Pros

- ❖ **Potential for flexible terms -** Because of the strong demand for sale-leaseback deals, sellers can negotiate favorable terms. This may include the ability to fix lease costs with little or no price adjustments for inflation, a stepped schedule that includes lower payments in the early years, and wide latitude on any required insurance or environmental provisions in the agreement. Most frequently, a sale-leaseback arrangement allows the seller to retain full operational control of the property
- ❖ **Lease deductibility -** Under a well-documented sale-leaseback deal, the value of the land on which the property sits can factor into a lease payment that is tax-deductible. That makes this form of financing very attractive from an after-tax viewpoint, because IRS rules do not allow companies to depreciate the value of land under other circumstances

Sale and Leaseback – cont.

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❖Cons

- ❖ **Loss of residual property value -** The major disadvantage of a sale-leaseback transaction is that the seller transfers title to the buyer. While owners can minimize this issue by inserting a repurchase option in the deal, that change will cause the sale-leaseback arrangement to be recorded as an asset, and therefore capitalized. For that reason, the company needs to show the obligation to make future lease payments as a liability on the balance sheet
- ❖ **Possible relocation.** At the end of a lease without any renewal options, the seller may need to negotiate an extension of the lease at current market rent or be forced to relocate any business operations in that facility

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Sale and Leaseback – cont.

❖Cons

- ❖ **Higher-than-market lease payments.** If the rental market softens, a company may find itself locked into a rental rate negotiated at the original date of the sale-leaseback deal. Such payments typically cannot be adjusted without the buyer's consent
- ❖ **Buyer bankruptcy.** If the buyer in a sale-leaseback situation files for bankruptcy, Valachi says, companies can find themselves before the bankruptcy trustee, who may reject any agreement to renew the leaseback or the seller's option to repurchase the property

Sale and Leaseback – cont.

- How to find them?
  - http://www.calkain.com/sale-leasebacks.php
  - http://gecapsol.com/cms/servlet/cmsview/GE_Capital_Solutions/prod/en/financial_products/all_products/sale_leaseback.html

Purchase Order Financing

❖Definition

- **Purchase order financing** occurs when a business sells its purchase orders to a factor or lender for access to cash. Institutions who engage in purchase order financing are called "factors". These institutions agree to lend your company a nominal amount based on the value of your purchase orders at a fee

❖Pros

- The entrepreneur passes on the collections risk and responsibility. Most factors actually accept the risk of non-payment as part of their service, so not only does the business get access to cash, it also gets to offload its collection responsibilities
- Factoring provides ready access to cash. This type of financing is convenient and it is usually granted within a short space of time, usually within 24 hours. It also avoids the embarrassment of having to turn to family to pick up the slack in your business loans

Purchase Order Financing – cont.

❖ Pros

- ❖ Factoring is cost effective. Purchase order financing is cheaper than using your credit card to fill in the blanks, so although there is an upfront fee for using this type of service, it can be balanced off by comparing it to alternative financing options
- ❖ There are no installments. Since factoring is not a loan the total is repaid when your customer or customers pay for their goods. You are not saddled with a monthly installment so there may be no payments if your financing arrangement spans several months

Purchase Order Financing – cont.

❖ Cons

- ❖ Factors don't release the total amount of the cash. Since the factor accepts the credit risk, they usually withhold a percentage of the funds they agree to lend until your customers pay up and honor your purchase order. This means you may be able to get approximately 80 percent of the value of your invoices with the balance paid out to you upon receipt of funds from your customers
- ❖ Customers don't deal directly with you. The factoring company accepts payment from your customers so there may be some issues with disclosure you need to discuss with your customers before you go this route
- ❖ Payment is taken upfront. Unlike traditional loans which are repaid by mixed portions of principal and interest the fee for a factoring arrangement is taken upfront before any money is made

Purchase Order Financing – cont.

- **Cons**
  - This is a short-term solution only. Purchase order financing cannot make up for long-term financing for contracts because they are designed to take care of short term capital needs

- **How to find them?**
  - http://www.ccapital.net/
  - http://www.purchaseorderfinancing.com/blog/po_financing/purchase_order_financing_companies_-_can_they_be_creative

Equity Financing

❖Definition

This option allows you to sell share of your company to investors, which then injects your business with cash and leaves the investor with the chance to make a high return.

❖Types

- ❖Angel Investors
- ❖Hedge Funds
- ❖Venture Capitalist

Equity Financing – cont.

- Pros
  - The use of equity financing will allow you to cut out the bank as a business partner
  - In addition instead of spending cash on loan repayments, you can use the infusion from equity investors to grow your business
  - Furthermore, equity investors can also help reduce your personal risk in the business
  - Also it is important to realize that in the event your business fails, you would still be required to pay back any bank loans you take, or reorganize the debt payment under bankruptcy protection
  - A crucial difference is that equity investors, however, usually do not have the same rights as debtors and you would not be required to return their original investment in the event your business collapses
  - Equity investment should be viewed as a long-term solution and a means that help you to inject both cash and experience into your start-up

Equity Financing – cont.

❖Cons

- ❖ You should keep in mind that if you are seeking cash for the short term, offering equity is not the right approach
- ❖ Investors will want their capital to help the company make <u>good</u> investments and position itself for medium- and long-term growth
- ❖ If your cash flow has not picked up as you expected, you may want to consider calling a bank instead
- ❖ Furthermore, you should understand that you have to cede some control over your company's operations if you offer stock to investors

Equity Financing – cont.

- How to find them?
  - Angel Investors
    - http://www.mycapital.com/companies/contactinv_comp_new.php?gclid=COe3vYmQ8aQCFVkJ2god_kg1zA
    - http://www.ventureworthy.com/Angel-Investors-Website.asp
  - Venture Capitalist
    - http://www.entrepreneur.com/vc100
    - http://www.vfinance.com/