

How to shop for a finance company

You may have exhausted your options at the banks in town and you could start to lose valuable business if you don't get some financing soon. Maybe you have received bank financing but because you've had a tough year the bank says you no longer fit their lending guidelines. Or maybe you have a good relationship with the bank and you are looking at some strong growth, but the bank has given you all they can. Before you get to this point, it is appropriate to shop for non-bank financing alternatives in the form of factoring or asset-based lending. Alternative finance is an unregulated industry. Prices, service quality, and reliability vary widely. Pricing may vary from 10 to 40 percentage points above the Prime Rate (nominally, the rate banks offer their most creditworthy customers) so the savings to be gained from smart, old-fashioned comparison shopping can be considerable.

How are Factors and Asset Based Lenders (ABLs) different from bank financing¹?

Fast and Easy

Factoring or Asset-Based Lending is easier and quicker to obtain than conventional bank lending. Most good providers can routinely evaluate an application and provide funding in 2 to 3 weeks.

Flexible

Factors and ABLs are often more willing to work with borrower adversities such as:

- Startups
- Rapid growth
- Business contractions
- IRS problems
- Small or negative equity
- Troubled industries
- Troubled pasts
- Bankruptcies

¹ For more information on how Factors and ABLs differ, read "Factoring or Asset Based Lending? Which is Better for You?" from our free PDF download page at www.FNPinfo.com.

More Expensive

As mentioned above, alternative finance companies are normally more expensive than conventional bank lending. But it is important to note that just being with a bank doesn't mean you won't pay more than you must. Many banks now offer alternative products such as factoring or asset-based lending at the same or higher prices as good finance companies and are usually not as flexible.

Unregulated

The industry is unregulated which brings some good and some bad. Being unregulated means finance companies are able to fund under riskier circumstances and are not subject to swings in appetite due to regulatory/economic contraction. However, all of the terms of financing, price, service, responsiveness, reporting thoroughness and reliability, can vary widely and agreements can be deceptive or even predatory. The worst of it is that anybody with a little money can do it. There are even several trade schools that teach people to use a little retirement money in the bank to do it. As a result there are literally hundreds of small finance companies across the country, some very good... but many who are not.

What are some risks that an unworthy provider presents?

Illiquidity – They may run out of money.

Perhaps they have taken on more clients than they can support and the receivables aren't paying as promptly as they planned,

They may have violated their borrowing agreements with their own lender and their lender may have cut them off,

Or, they may have suffered a big loss with another customer that has impaired their ability to serve you.

The greatest risk is that without notice, they can fail to support you for your next payroll. You would never be able to set up with a new provider before your relationships with your employees, vendors and customers are irreparably damaged. You may also be unable to recover your reserves (the amount of your receivables that your finance company did not advance to you) because they have misdirected the funds to help with their own problems or because they are tied up in a bankruptcy.

Poor Service – They may be unable to competently and professionally process your activity with them.

They can make payment errors, misdirecting your funds to other customers,

They can mistreat your clients, casting unfavorable light upon you and your circumstances,

They can fail, simply through neglect or incompetence to meet critical funding deadlines,

And they can provide inaccurate or untimely reporting making it difficult for you to manage your business.

It is easy to underestimate the importance of good service. Many people, accustomed to dealing with regulated institutions for their money, take key service points for granted and tend to think only in terms of how long it takes for a knowledgeable representative to return a phone call or help solve a problem. But the service considerations cited above are not just inconvenient... they can carry very high costs for you and your business and under the worst circumstances, can threaten your livelihood.

So, how do you shop?

Referrals - Ask around. Get referrals from accountants, banks, attorneys and other business contacts who may have experience with alternative finance.

The Internet - Search the internet. Research a prospective provider on their website. A responsible provider should tell you a lot about themselves, their management qualifications, their ownership and the way they do business on their site. Perform searches on their name and on the names of their managers and owners to see if independent information is available about them... good or bad.

Competitive Bids - Get preliminary proposals or written estimates from at least three providers. Ask questions and take notes about how the charges will work. It is strongly recommended that you retain the services of your accounting and legal professionals to help you evaluate proposals and arrive at meaningful comparisons. Every provider structures their pricing differently and it can be extremely difficult to arrive at an “apples to apples” comparison. Remember, subtle

structural differences in pricing can make very large differences in actual cost.

Credit Check - Pull a D&B credit report for each provider (your bank should be willing to do this for you for about \$40 each). The report may not provide much direct financial information since many finance companies are privately owned and do not share audited financial information. Unaudited financial information is of little value. However, there will be independent information in the report with regard to how promptly they pay their suppliers. There will be some background information on the officers to help you determine if they are likely to be competent, and there will be a record of lawsuit and judgment activity. You probably are not interested in working with a firm involved in many lawsuits and judgments.

Reference Check - Obtain references to at least three current customers of each provider that are about the same sized and activity level as your firm. Call them all and ask how it works, what they like and what they don't like, etc. Obtain professional references to their outside accountants, attorneys and their lender. Are they strong, well-established firms? How long have they worked together? Have they always been in good standing with their payment obligations? In the case of the lender, how large is the line of credit they have? You should expect to hold your finance company and their professional providers to a higher standard than you might hold yourself.

Basic Services Review - Obtain samples of reports and statements and be sure they will be adequately detailed and timely. Be sure to understand their funding timetables and standards.

These efforts aren't foolproof but you would be surprised at how effectively they will help you identify the best deal for you and your company.

Federal National Payables, Inc. has been in business since 1992 and provides accounts receivable finance to more than 100 small and medium sized businesses throughout the country.
7315 Wisconsin Avenue, Suite 820W
Bethesda, MD 20814
800-523-0881
www.federalnational.com