Factoring: An Old World Tool for a Modern Age

By Paul Schuldiner

Factoring has been around for generations, but the current landscape isn't what it used to be. Today, many independent factors have cropped up and are specializing in factoring to more service-oriented businesses, such as staffing or transportation companies. But only a handful of the more traditional factors – many of whom benefit from having expertise in managing every conceivable marketplace condition, business or credit circumstance – still specialize in servicing clients that sell consumer goods into retail on terms.

When one looks closely at the state of retail today, it can be difficult to recognize any semblance of what that sector once was, even just a generation ago. Only a fraction of the once-profitable, well-known retailers are still in business, and even then, only a few of those stalwarts still remain profitable today. The businesses that continue to be financially healthy are those that had the foresight to make investments in innovation early on and commit to adapting their business models to the new reality of retail.

Although dwindling brick-and-mortar locations has been one unfortunate consequence of the volatility that has gripped the retail sector in recent years, not every outcome has been negative. In fact, according to the National Retail Federation, for every retailer that closed its doors in 2018, there were two that were actually opening stores last year. That particular indicator, while perhaps unexpected, can be linked at least in part to the rapid rise of digitally native companies. Likewise, the overall trend of businesses embracing e-commerce alongside their brick-and-mortar operations has helped to bring the transformation of the retail sector full circle.

Each of these unique circumstances has contributed in significant ways to how businesses are funded and financed today. But one thing that has not changed when it comes to financing businesses, is the role that factoring can play in the ongoing success of a business.

Occasionally characterized in the past as "last chance finance," factoring is no longer the lender of last resort. In fact, thanks to the myriad of new pressures facing businesses operating in the current retail market – from more complex supply chains to the hurdles of selling into online retail giants like Amazon and Walmart – today's modern factor has now become more relevant than ever before.

Companies have become more and more sophisticated in the ways they run their businesses, as they seek out unique collaborations and partnerships, pursue innovative sales programs and explore new e-commerce platforms and channels to reach more and more customers. As these companies become savvier, they require more sophisticated financing tools that not only help to address problems before they arise, but also give them the funding they need to take advantage of these new opportunities.

The successful factor today looks very different than it may have looked a decade ago, let alone a generation ago. The factor of the future must have a strong grasp of the many challenges – and opportunities – that businesses face today, be nimble and adept enough to help clients address them head on and commit to being more than just a lender.

Stay Two Steps Ahead

Most lenders regularly reassure their clients that they understand the ups and downs of their businesses. But in reality, when it comes to the pain points that consistently crop up for a business, it's clear many lenders do not appreciate how certain challenges can affect – sometimes significantly – the overall financial health of a company. A good factor takes the time to understand how seasonality might affect a business' cash flow or how the unpredictability of a large, unexpected order could potentially put a strain on a company's finances.

Many businesses struggle with complex supply chains that require adjustments to advance rates, deposits or other cash outlays that are not necessarily considered in their initial financial plans. For these businesses, they need a factor that is more than just flexible and understanding, but also responsive to the business' unique circumstances. Simply put, a factor today should know what a business needs well before the business even knows they need it.

Nowhere is that sentiment more relevant than in the battle over brick-and-mortar and e-commerce that continues to unfold across multiple sectors from apparel and consumer products to furniture and home goods. As the push-and-pull between brick-and-mortar and e-commerce has heated up in recent years, the businesses that have ultimately been successful have learned how to sell into traditional retailers, while simultaneously building their own effective e-commerce platforms. For most businesses, the margins online have been much higher than in brick-and-mortar, but that additional profitability comes at a higher cost. Simply put, building up a reputable brand online is not an inexpensive proposition.

Likewise, on the production and fulfillment side, the old paradigm followed a "palette-in, palette-out" model, which while not as profitable, was certainly more predictable. Digital native e-commerce platforms are just the opposite. What they make up for in profitability, they lose out on in increased labor costs, a breakneck sales and production cycle and a painfully small margin of error. One mistake – an inventory mishap or a delayed shipment – and that loyal customer is already out the door and on to the next retailer selling a similar product.

A business that can effectively blend brick-and-mortar with e-commerce requires more and more inventory stocked up in the warehouse, more complex contracts with overseas suppliers and manufacturers and, of course, higher operational costs. But when the costs go up, the margin must be there for the company to make it all work seamlessly.

Someone has to pay for the inventory to sit in the warehouse waiting to be shipped to a customer. And the depth and variety of that inventory is more important than ever because you never know what a fickle customer might want that season – or even that particular day. Someone has to pay the overseas suppliers, the logistics fees and freight charges. Someone has to manage the account receivables and keep the cash flow in check. And, someone has to carefully vet the credit of a company's retail customers' so there are no surprises along the way.

Factors today must address all of these considerations and also be the eyes and ears for a business into what a retailer might be thinking and planning. Today's factor must have a strong grasp of the retail sell-through analysis and a familiarity with what the retailer's merchandising plans are and what impact it will have on a client's business. Factors must understand various licensing income streams so they can help their clients monetize their brands to create additional liquidity.

Factors today must also maintain a strong grasp on the constantly shifting credit environment. When a business gets a once-in-a-lifetime mega order from a big box retailer, it is only worth pursuing if the retailer's credit is sound. But most busy entrepreneurs and business owners don't have the time, expertise or judgment to evaluate a retailer's credit worthiness, at least enough to avoid bad debt and other related financial pitfalls. An effective factor should flag bad debt and help clients navigate these complicated retail relationships.

This all requires a very different kind of financing than what business have needed – or even sought out – in the past. The increased complexity of the supply chain, the lightning fast pace of the sales cycle and the added pressures of operating on all platforms, in all channels, all the time, demands it. In short, the successful factor today must be well positioned to not only provide the kind of flexible, sound financing solutions that companies need, but anticipate those needs even before the client realizes it.

Be Nimble

These days, the factor of the future must be as nimble as its clients are.

Understanding the ebbs and flows that companies face as they maneuver their businesses through this dynamic environment is critical, but really only half the battle. A successful factor today must be able to handle virtually everything – and anything.

Factoring's broader appeal and applicability are no longer only limited to fashion and apparel companies, the industries that have historically been factoring's biggest beneficiaries. As the retail environment has changed, the factor of the future now has the opportunity to support nearly every industry, from furniture and beauty to consumer products and food and beverage companies. While the products, customers and sales channels may differ, the financial challenges these companies must overcome are often quite similar.

Adapting to meet the current needs of today's entrepreneurs is essential. That often involves learning how to tackle challenges that businesses may face before they arise, and before troublesome problems become permanent ones.

Being nimble also means being creative. Traditional banks rely on formulas and balance sheets, but many businesses don't always fall squarely within a traditional model. More often than not, these businesses benefit from financial partners that have the ability and expertise to adapt quickly to problem solve and find solutions. Large public banks and lenders are often slow to react – and lend – when businesses need over advances for seasonal lows or funding for the build-up of inventory for the holidays or other big moments. Factors that are not restricted by stringent banking regulations or lengthy committee reviews are often more flexible and able to help a business ride out a rough patch without a hit to their bottom line.

Forward-thinking factors must work harder to make it possible to finance a company's entire supply chain. By providing a mix of products like purchase order financing and inventory financing, factors can help companies that sell to retailers on terms that also have stand-alone e-commerce platforms with no receivables. The challenge here for the modern factor is understanding the right combination of SKUs that a client's e-commerce platform should have, knowing what the right velocity should be and turnover, all of which allows the factor to create an appropriate advance rate on the inventory being sold directly to consumers.

Having access to the right financial solutions, an understanding of international trade finance, and logistics and sourcing issues can make all the difference for a business. The factor of the future should be able to finance both the brick-and-mortar side of businesses as well as manage inventory and production financing for e-commerce operations. For a company looking for a competitive advantage in a crowded market, that is an incredibly powerful combination.

Be More Than Just a Factor

Any effective financial partner should always be looking out for a company's best interests. That means providing guidance when a company needs it, especially when they don't even know they do. It means reviewing business plans, evaluating potential retail strategies, making introductions and being a sounding board for big ideas. It's about looking beyond the numbers to find an untapped opportunity, a great story or an extraordinary entrepreneur. For businesses looking to grow or expand, having the right financial partner in place is critical, both to smooth a path for growth and help manage the peaks and valleys that all too often wreak havoc on a company's bottom line.

A true partner in every sense of the word, today's factor should be fully invested in a client's business and their ultimate success, anticipating their every move. A tandem approach with tailored solutions will always prove more successful.

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