FEATURE STORY

Members of SFNet's Factoring Committee Discuss Sources of Business, Supply Chain Issues and More

BY MICHELE OCEJO

TSL's editor-in-chief sat down with several members of the SFNet Factoring Committee to review the current landscape in early 2022. Participants include Carol Apicella, senior vice president, BankFinancial Government Finance; Tina Capobianco, senior vice president, J D Factors Corporation; Dan Karas, executive vice president, Allied Affiliated Funding; Kevin Laborde, president, Cash Flow Resources; and Paul Schuldiner, executive vice president & chief lending officer, Rosenthal & Rosenthal, Inc.

W**hat were your most frequent 2021 sources of new business?**

LABORDE: Some start-up activity was evident in 2021, but perhaps the more interesting observation I have is the lack of new business sources, in general, in 2021. As a firm serving the truly small business community, government funding has frozen the entrepreneurial market we serve. The unprecedented competition from the SBA has distorted the financial landscape and shows no signs of abating. In addition to crowding traditional and non-traditional funders out, it is also putting fear into many of the mom-and-pop companies CFR serves, with them thinking that if the government is doing this, things must really be bad. It is prompting some to question why they should even put capital at risk.

KARAS: We all strive for client relationships that are sufficiently strong to lead to referrals for new business opportunities. Half of our new relationships in 2021 were based on introductions from our existing clients. This is a testament to the bond our team builds with clients over time. With respect to industry, 3PL was our strongest sector as those that have expertise in managing the ongoing supply chain crisis needed working capital to support strong growth.

CAPOBIANCO: 2021 was a milestone year for J D Factors. We hit record purchases and new business numbers. After 2020, it was unclear what 2021 would bring and we have been surprised by the trends that we experienced. We saw tremendous growth in staffing and transportation, as we expected. We funded a lot of new companies, where we bought their first invoice on day one of the factoring arrangement. In both industry sectors, entrepreneurs were prepared to take on a start-up company and, with J D's help, became quite successful. We also saw a significant organic growth, our existing client base grew well beyond what we expected. The trend seemed to be the survival of the fittest. We also found that debtor credit became an issue in that there was a large demand of certain account debtors. The same trend followed them as well in that the strongest account debtors succeeded and grew; the weaker ones unfortunately failed to survive.

APICELLA: My bank, BankFinancial NA's Government Finance department, was a start-up launch in May 2021, therefore I would have to say that my continued interaction with colleagues at other lending companies (i.e., banks, commercial finance, etc.) and in professional

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organizations, such as SFNet, TMA and IFA, among others helped industry awareness of my lending programs and kept the phone ringing. The majority of opportunities I reviewed were relative to new contract growth, though many businesses flush with cash from the 2020-2021 government hand-outs programs seemed reticent to make decisions to move forward.

SCHULDINER: Our most frequent sources of new business were a combination of centers of influence such as CPAs, commercial bankers, investment bankers, as well as existing clients. Each of these referral sources has either had clients or are clients of our company and who are able to give credible testimonials to their positive experience with our company. There is no better source of new business than someone who has seen first-hand how we assist companies in all aspects of their financing requirements.

What kind of impact do you think the supply chain issues and inflation will have on factoring/lending markets in 2022?

SCHULDINER: The supply chain issues will continue at a minimum for the first six months of 2022. We are continuing to see logistics delays affecting our clients' ability to import, off-load, and distribute products on a timely basis and absorb the increase in freight costs. The rise of all costs coupled with an expected rise in interest rates may negatively impact our client's viability. Close monitoring of financial performance, accounts payable as well as collateral performance will be as important as ever to stay out in front of potential portfolio issues.

APICELLA: Supply chain interruptions have already and will continue to impact most areas of lending in 2022 and the foreseeable 2023. Not being an economist, I sense that we will experience longer turn cycles and those lenders nimble enough to adjust to an extended repayment cycle will be in the forefront, albeit maybe not comfortably. Additionally, inflation's erosion of purchasing power then adds additional strain on the already delicate state of the economy, which I believe will require lenders to be more creative in back-office credit operations.

Have you witnessed a growing acceptance of factoring as a tool in off-balance sheet financing? What effect has this had?

CAPOBIANCO: It has an been an interesting year for factoring and the acceptance of it. We thought that banks would be conservative during the pandemic and we would see more accounts go into special loans. It seemed that the banks took the same approach as us and decided to stand by their clients and support them. What we did see was a large surge of start ups and their only option was factoring. Factoring is now on the list of alternative financial tools and it was more widely accepted in many industries. In the transportation industry, factoring is the financial tool for carriers, thus making the sales pitch "what can you do for me?" rather than "what is factoring?" After many years of educating, promoting and explaining the process of factoring, we are finally at a point where you do not see a blank face when you say factoring.

LABORDE: Thanks, in part, to the MCA space, I have seen factoring really become more mainstream over the last several years. The expense of factoring, as perceived by some, is now a middle of the road option. It was not viewed that way when MCA funders first arrived on the scene. Companies embracing factoring, as the financial tool it is, compared to more restrictive banking facilities and more liberal and expensive MCA products, positions factoring in a more competitive position than was the case a couple of decades ago. At CFR we have often compared factoring to merchant products used by small businesses in the retail space as those products have been embraced as a normal way to operate and they can be comparable to factoring on the expense side.

What sort of long-term effects has the pandemic had on employee and client/borrower relationships?

CAPOBIANCO: The client relationship has always been one of the most important parts of our success in factoring. We become partners with our clients and help them manage, advise and grow their business. We make efforts to be in front of our clients monthly and the pandemic affected that the most. We had to put more focus on calling, emailing, even texting clients to keep the connection strong. At the beginning of the pandemic, the goal was simply to make sure the client was safe and healthy. As we got further into the lockdowns and isolation, we switched our efforts to make sure they had the tools they needed to keep operating. Governments did their best to prop up businesses during the pandemic, but when that funding ran out, we were there to help them make it through. We believe we came out stronger and have built relationships that will last.

KARAS: Though unanticipated at the pandemic outset, the impact of providing first- and second-draw PPP loans to our clients to help them survive, even as our factoring volume declined, brought my team and our clients closer together. While we always focus on what's best for our clients and finding solutions to their complex needs, burning the candle at both ends in true partnership fashion solidified the bond. I'm really pleased about the result, even if the road was bumpy.

How important is it to offer complimentary products with factoring?

KARAS: Diversification of our product offering is a key strategic objective. Just as we want our clients to have debtor diversification, it's a smart business model to have more tools in the toolbelt than single-invoice discount factoring. Consequently, we broadened our offering to include ledgered line, asset-based lending, inventory financing and equipment term loans. In addition, if the risk exceeds our appetite, then we have strong partnerships that provide real estate, for example.

CAPOBIANCO: The factoring industry has become very competitive, especially with the increase in consolidation of companies. For those companies that want to stay relevant they will need to come up with creative ways to do so. Complimentary products have become very popular with factoring companies trying to differentiate themselves from their competitors. It is important to bring value to your clients beyond just funding their invoices. The market has dictated that businesses want more from their financial partner, so as a factoring company you want to keep your client happy. As a result, there has been a trend in complimentary products across the industry. It is important to note, however, that you still need to focus on providing quality factoring to your clients; those complimentary products should always come second and to those who qualify.

APICELLA: BankFinancial, NA offers lending products of inventory but also equipment finance/lease and commercial real estate, among others, which presents a full scope of solutions. Analyzing and underwriting the overall credit tied to a prospective borrower requirement, in many cases, creates an atmosphere of confidence while affording them ease to carry-on with what they do best, while as a lender you may focus on what/how to structure the best credit offering.

LABORDE: As a small shop, we have simply not had the resources to formally entertain a broader product line. Out of necessity, we have found ourselves offering other products, like PO funding /real estate loans/equipment loans to accommodate clients or just to work through difficult situations, rather than formally putting them in our lineup. That experience positions us to offer more, but we remain cautious in staying in our lane of expertise. In fact, when I got into this business in 2003, I was counseled not to venture outside of our defined operating parameters. When we have lost money, it was largely attributable to doing just that!

SCHULDINER: We have a stand-alone purchase order financing division that supports both our existing factoring and asset-based lending clients as well as working in tandem as a trusted and preferred provider of PO finance to clients of third-party banks, factors, asset-based lenders and private equity. These third-party capital providers have come to rely on our long-term capital stability and industry expertise especially in supply chain issues. In 2021, our PO business volume was over 60% related to working alongside of third-party lenders. We also established our PIPELINE division in 2021 that provides rapidly growing e-commerce and direct to consumer businesses with inventory and trade finance programs as a non-dilutive alternative to raising permanent equity.

How is the industry dealing with debtor concentration risks?

SCHULDINER: This is and will continue to be a challenging area, especially for clients selling consumer products into a retail channel of distribution that remains dominated by a narrow field of performing retailers. Non-recourse factoring companies are especially adept at being on the forefront of retailer credit risk and establishing appropriate line of credit approval, which helps clients to mitigate concentration risk. One of the results of the pandemic was a renewed interest in factoring due to our credit protection (we have our own stand-alone in-house credit department that assesses debtor risk), ledgering and collection effort abilities that became more critical.

CAPOBIANCO: As a nonrecourse factor, we do factor a client with debtor concentration. As long as we can approve the account debtor credit and the verification is solid, we will factor the account. We have seen our competition still stay away from debtor concentration. The industry is still uncomfortable with concentration, but given the competitive climate we have, more and more factors will consider taking on a concentrated deal. They will be forced by what drives the market, not necessarily what they are comfortable doing.

APICELLA: Speaking from the Government Finance side of the industry, the main focus is not necessarily on debtor concentration; it is more focused on the contract of engagement and the performance thereto as if goods were delivered and/or service provided, the government agencies will remit payment. Further, technology advances that provide electronic tracking, verification and money movement have additionally given comfort. Perhaps thoughts should be given to the B2B space as well where the main focus should be on contracts of engagement coupled with reliance of the debtor's credit wherewithal and ever vigilant monitoring.

How concerned are you about legislation that are likely to become effective in 2022, such as the financial disclosure laws in CA and NY?

LABORDE: CFR does not market itself as a nationwide funding source. While we do have a few outlying clients in other markets, we mainly serve our region in the Gulf south. As a result, we are not subject to the issues now facing providers that operate in NY and CA. That has caused me to question our industry requesting a federal solution to what is now a regional problem. Still, I appreciate the compliance problem this state legislation creates and hope more education about how things work for factoring clients in the real world will prevail.

SCHULDINER: We are concerned as the legislation needs much more attention to the onerous requirements that will be placed on factoring companies that lend into the small to low middle-market business community.

(Editor's Note: For updates on this and other advocacy issues, please visit SFNet.com or reach out to Michele Ocejo at mocejo@sfnet.com)

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