

Around the Bend...

Will Factoring Come Alive In 2005?

Is that a light we see at the end of the tunnel or warning signs of a derailment? For our last issue of 2004, Thomas Siska of FactorHelp.com assembled a quartet of factoring industry veterans from both coasts to sound off on what they see on the tracks ahead.

By Thomas G. Siska

After a decade of rough waters in the traditional factoring market and a few tough years in the non-traditional niche, what can factors expect in the coming year? Is that a light we see at the end of the tunnel? Or is that just a sign warning of a derailment ahead? Our conductors are industry veterans representing both business segments and both the East and West Coasts (to remove any regional bias). They sound off on what they see on the tracks ahead.

Revenue Generation

Traditional: "The recent wave of consolidation in the major factoring market should soften the intense competitive environment, for a little while anyway", opines David M. Reza, senior vice president of Milberg Factors in Los Angeles. "A couple of newer competitors are being overly aggressive to get noticed, but the more mature players continue to sell with service, structure, relationship and track record." While Reza sees a "bottoming out" effect, he still doesn't anticipate a real recovery any time soon. Neither does Jon Lucas, executive vice president for CIT in New York.

"Competition is constant and we do not expect that to change," says Lucas. "When factoring companies are not competing with each other, they find themselves competing with a host of other competitors like banks, collection agencies, credit agencies, credit insurers and other A/R management providers. There is no shortage of service providers eager to serve our market."

Non-Traditional: "Overall, pricing has leveled out as the industry is quite saturated both with factors and with information. However, we'll (continue to) see spotty price competition", says Tom Smith, vice president for niche leader Riviera Finance. Smith also believes that "...more creative pricing will be used in certain segments."

Our West Coast lookout, Patricia Burns, president of Primary Funding, San Diego, mostly agrees, but sees the landscape continuing to recede on the horizon, not quite leveling off yet. "Downward pressure, caused by new products offered by a variety of lenders and an excess of capital that diverts traditional factoring candidates, won't change much in the coming year," she says.

She, too, sees more "style" changes in pricing than "substance."

"The old discount factoring pricing is now disguised through a canopy of tiered fees," Burns continues. "This is partially due to the application of the software available, but is more likely a defense mechanism. Factors need to look and feel more like a lender for their clients."

Direction: The overall consensus is that both factoring niches continue to chug along the floor of the valley in terms of margins. Neither sees much more decline, which is somewhat encouraging. But the end of the valley is nowhere in sight either.

Structure

Traditional: According to Reza, "The traditional apparel/textile client continues to want/expect over-advances, inventory availability, L/Cs and Ledger Debt. On the debtor side, customer concentrations grow in both absolute terms and percentage." That's the negative side. At least this trip isn't all bad. "However, as part of these dynamics, clients are being asked to retain capital, and/or provide additional collateral, and sign long term contracts", counters Reza.

Lucas observes another version of structural change in the market. "A trend we are seeing is that manufacturers and importers are increasingly asking for the 'a la carte' factoring menu as opposed to the complete dinner. For example, if a housewares company has a large customer exposure with one specific customer (or a few large customers) CIT can offer credit protection on that one (or a few) customer(s)." Lucas notes that the majority of CIT's clients still opt to factor their entire customer base.

Non-Traditional: "Basic deal structure won't change," asserts Smith. "If anything, the average non-traditional factor will be slightly more conservative, reflecting pressures from their capital sources." Balancing this "reality" with the competitive pressures put upon by the "near saturated" marketplace is the real test for factors today. Burns, from her December 2002 article in the *ABF Journal*, described the other side of the tracks. "Factors have been forced to evaluate less tangible collateral in order to keep pace, or perhaps survive in this evolving marketplace. Factors must continue to look under every stone (for collateral)... and rely on the management team of our clients like never before."

Direction: It is evident that our train has reached a switching station with many paths all leading to the same location. Creativity on the structure side is a demand that must and will be met. However, risk can be compromised no further. For everything given a client today, there must be something taken as an offset. Once again, it appears as though things won't be getting any worse in terms of risk taking, but no one sees things getting better either.

Opportunity Flow

Traditional: Deal "swapping" was one of the most popular ways to obtain new clients over the last ten years as many of the apparel and textile businesses moved off shore, leaving the traditional factors fighting over an ever shrinking pie. This practice seems to have slowed considerably. "The consolidation wave has certainly inhibited deal movement for two reasons: 1) long term contracts, and 2) factors will do anything to hold onto clients that they obtained as part of an acquisition, otherwise they spent money for nothing," comments Reza. "An additional dynamic is that clients are concerned that even if they do move, that their new factor may be acquired."

Reza further states that while new business continues to come in from traditional industry intermediaries in product categories where demand remains relatively strong, the number of start-up firms has fallen as new apparel entrants prefer to set up off shore.

"At CIT, we are very bullish on factoring," boasts Lucas, obviously a little more upbeat about what the future holds. "We believe that overall, demand for factoring will continue to be strong and the total number of companies using factoring will increase."

Non-Traditional: While globalization has had more to do with sub-par deal flow in the traditional factoring market than has direct competition, non-traditional factors also face adverse circumstances unrelated to their direct competitors. "Competition from outside of factoring has reduced the deal flow," Burns says. "However, I am seeing banks tightening their credit criteria and this is music to our ears."

Smith stresses the need to open up new market channels. When it comes to the standard channels, Smith declares, "the challenge is greater than ever to optimize marketing efficiency to generate the most qualified leads for your business."

Direction: It appears the fuel that drives the engine, new business, is in adequate supply. It just can no longer be found in the same old places in abundance. And, given that building tracks in new areas is usually more costly, it is imperative that these fresh marketing channels be designed to be as efficient as possible. This is positive since new deal flow was in decline the last couple of years. It is less positive to note that the cost of getting this deal flow continues to rise.

Change on the Horizon

Traditional: It will come as no surprise to see that this train is definitely changing direction. New markets, new ways to utilize factoring and extending services globally are all new stops on the trip to survival. In addressing new markets, Reza points out that "consumer electronics and housewares have emerged as prime markets for traditional factoring." Lucas affirms Reza's sentiments. "Growth is likely to come from industries like housewares and electronics as well as from larger companies that are worried about their customer concentration risks, and are using factoring or credit protection as a way to (safeguard) the value of their accounts receivable," Lucas says.

Reza also describes how repackaging their service allows Milberg to market globally: "We can now work in conjunction with the exporter's local bank by providing third-party credit protection and management of the A/R collateral."

CIT also sees expansion beyond the U.S. as a key part of its growth strategy. "Los Angeles is Asia's gateway to America. (Our LA office) spearheads our Pan-Asian sales and marketing efforts," Lucas says. "Our multi-lingual client services teams speak a number of different languages and dialects so they can (communicate effectively) with their Asian clients. We (now) have offices in Hong Kong, Shanghai and Taiwan to market to companies in Asia."

Non-Traditional: Reza's sentiments are clearly echoed in the words of his non-traditional counterparts: "I believe we must constantly look at new industries," says Burns. Smith also sees a continuing evolution process: "We expect to see lots of niche focusing and branding based on value-added services that players can bring to (those niches). It's separating the commodity providers from the service providers." Smith isn't just witnessing this from his window in the passenger car. He's totally on-board with these new directions and is happy to do his part to foster this evolution. "I think there's room for both commodity and service providers, and the ultimate winners are the clients." Through more choices, clients can pick the best fit for them. And as for the factors, "It's happening because technology is making it possible to be profitable by going in either direction."

2005 Forecast

From our perch in the front of the locomotive, the landscape looks only slightly better than 2004, but better none the less. Margins and structures will continue to be under competitive pressures. However, we also believe that with the worst is behind us, factors are better prepared to traverse to new destinations in 2005. The modes of transportation should also look different. Specifically, enhanced services for deeper niche penetration, current applications repackaged, stripped apart and promoted to new users, stretching into the global market and more creative pricing structures are all tactics that will be picking up steam as this train rolls into 2005. The trip ahead promises to be much more interesting, so buckle up! **abfj**

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