

eNBUSINESS *New Brunswick's Business News*

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Finding the money to fuel a fast growing business

Feb 9, 2007



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Business is booming in New Brunswick and times are great. While this is much better than having a poor economy, it can bring a whole new set of problems for business.

The natural inclination of a business owner or manager is to go out and sell more goods and services. The idea being that the more you sell, the more profit will end up on the bottom line. Pursuing sales increases can bring challenges. If you don't plan carefully, you could end up in a cash crisis. Let me explain: say you're a big player in the widget business. You buy them at a great price from out west and sell them to good customers here in Atlantic Canada. As a matter of course, you extend 30 days to pay your invoices. Some of your customers like to stretch you a bit and pay in 45 to 60 days.

Here's the problem, you need to pay your supplier and then wait to be paid by your customers. You are, in fact, financing the operation of your clients. The more you sell, the more money you have tied up in your clients' businesses. If you were to double your sales, you would have to double your operating capital. If you're not careful and you don't have this extra money, your improved sales (which you're very proud of) could cause you to come up short on payday.

Traditional solutions usually involve trying to borrow more operating capital or putting more equity into the business. If you borrow more, your debt to equity ratio will start to weaken. If you inject more equity, you may dilute your ownership position by bringing on partners. What you really need is a way to shorten the time it takes for

customers to pay. Let's talk about factoring.

Factoring is a way to sell something you own: accounts receivable. This lets you get your money today instead of waiting for your customers to pay. Here's an example: Customer A orders \$100 worth of widgets and you ship them today. Normally, this guy pays in 45 days. If you had a factoring arrangement, the factor would pay you \$80 the next day. They now own the receivable and customer A must pay the bill to them. After 45 days, when the customer pays, the factor then gives you the remaining funds less the fee. This back end payment to you could be \$17 meaning a fee of \$3.

Let's examine this scenario further. What you've done is traded \$100 in 45 days for \$80 tomorrow and \$17 in 45 days. This means that you're now only financing 20% of what you used to finance. You're using other people's money more efficiently now. If you do the math, you realize that you can now increase your sales fivefold without increasing your operating capital. As an aside, this is almost identical to what happens if you accept credit cards, you give up a small fee in order to get the sale and the money today.

The other nice thing is that factoring will strengthen your balance sheet. Instead of taking on more debt, you will convert accounts receivable (an asset) into cash (an asset). This does not change your debt to equity ratio at all. Additionally, you can now use this cash to pay short term liabilities. This will strengthen your balance sheet and move the debt to equity ratio in your favour, thus putting your company in a better position to borrow in the more traditional way in the future.

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