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How to improve a subcontractor's cash flow: Factoring becoming the alternative financing choice

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Quantum
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Funding

In the construction business, one of the worst things that can happen is for a project that's in the works to stop in its tracks. The result is delays, even greater costs – and very dissatisfied customers.

While borrowing from banks may appear to be one possible solution for contractors and subcontractors, the reality is that this option has severe restrictions. The most obvious problem is that banks generally insist on securing assets equal to a minimum of three times the amount of the loan. Another is that a borrower cannot secure additional funds without renegotiating the loan – or even starting the process all over again with a different lender. A third is that a borrower is required to meet monthly payment obligations, which may be difficult or even impossible. Then there's the fact that banks are often reluctant to help finance contractors and subcontractors. In short, borrowing from banks limits flexibility so severely that it is rarely a realistic option.

Given these realities, the need for alternative methods of financing construction deals is tremendous. And there's no better method than factoring. Factoring is quickly becoming the alternative financing method of choice in the construction industry. More and more frequently, bankers and ac-

countants are referring contractors and subcontractors to qualified, experienced factors like Quantum Corporate Funding, Ltd. – the nation's largest construction factor. As an experienced factor, Quantum can help a contractor or subcontractor survive financial setbacks and bankruptcies quickly and simply by financing their receivables.

Factors like Quantum are also valuable resources to contractors and subcontractors because we can help improve their cash flow so they can pay their suppliers, their payroll, and their taxes. This enables businesses in construction to purchase supplies and equipment and increase their labor force in order to keep their businesses afloat in times of economic difficulty.

There are numerous advantages. With factoring, a contractor or subcontractor does not have to borrow money, he makes no monthly payments, and he can control his cash flow by exercising total control over how much he factors and how often. Perhaps most important is the fact that the money can be available in as little as 24 hours.

As an example of just how effectively factoring can work, Quantum recently factored receivables for a carpenter in California who was working on a large residential development. The carpenter was able to increase his cash flow, which in turn allowed him to buy supplies, pay his laborers, and purchase the equipment necessary to finish what has turned out to be his largest

job ever. Without the help of Quantum, the carpenter would have been forced to limit the size and scope of his projects – and forgo the opportunity to grow.

Another example is a subcontractor in the midwest. He was working on a large commercial development project, and he desperately needed an infusion of cash. Because he'd never worked with a factor before, he anxiously asked us about points, the percentage he would be charged to factor, and how soon he would be able to receive the monies that were critical to keeping his business running.

Quantum determined that the subcontractor would be able to receive an advance, under a no term contract and with no credit risk, equivalent to 70% of a single invoice totalling \$100,000, or a sum of \$70,000 in cash that would be wired directly to his bank account.

The subcontractor agreed to pay 3% of the total for the first 30 days as a fee on the \$100,000. In other words, he would pay \$3,000 to factor a \$100,000 invoice for one month. He would receive the balance of the money — \$27,000, or \$30,000 minus the \$3,000 fee – upon receipt of the funds due toward payment of the invoice. He therefore received \$70,000 plus \$27,000, or a total of \$97,000 for his \$100,000 invoice.

Because this particular subcontractor had no experience with factoring, he was reluctant at first. Yet he realized that he was operat-

ing in an extremely competitive market, as are most contractors and subcontractors. Further analysis of his financial situation revealed that his gross margin was 18% and that his annual overhead was \$150,000. The subcontractor commented that if he had access to "unlimited funds," he could double his business from \$2 million in annual sales to \$4 million. He admitted that he was turning away business because he simply did not have the cash flow to handle it.

At Quantum, we recognized that his situation was all too familiar. We asked him if doubling his sales would mean doubling his overhead. His answer, as we expected, was "no." In fact, he calculated that the extra \$2 million in sales would only cost him an additional \$50,000 in overhead expenses.

This situation is hardly uncommon. In most businesses, doubling sales does not mean a concurrent doubling of overhead. A business that doubles its sales does not need twice the office space or twice the number of employees. In fact, the economy of scale generally allows for a dramatic increase in net profit.

Once the subcontractor looked at the numbers, he understood how he could benefit from factoring. Without factoring, he made \$360,000 gross profit on \$2 million in sales. But by factoring 100% of his receivables, he only had to factor \$2 million out of a projected \$4 million in sales in order to generate a gross profit of \$720,000. His annual cost

for factoring was \$60,000.

Factoring with Quantum helped this subcontractor grow his business by taking advantage of work opportunities he would have otherwise been forced to say no to. He was also able to receive volume discounts offered by suppliers, which resulted in even greater financial benefit.

For businesses involved in construction, factoring can be the ideal way to stay in the race – or to grow dramatically. Factors like Quantum do not buy retention, meaning monies are withheld by the owner until a project meets the owner's satisfaction. What we do is supply cash – cash that can help contractors and subcontractors meet their payroll, tax, and insurance needs, pay their suppliers, and receive greater discounts from them. As a construction "specialist," Quantum offers other services that are valuable to contractors and subcontractors. We provide bank-to-bank wire transfers, we require no long-term contracts, we factor as many invoices as required, we cut paperwork by not requiring financial statements, and in some cases, we can provide funding in 24 hours.

When your banker says "no" and you've fallen below the radar screen, an alternative financing company who thinks outside the box will often say "yes."

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