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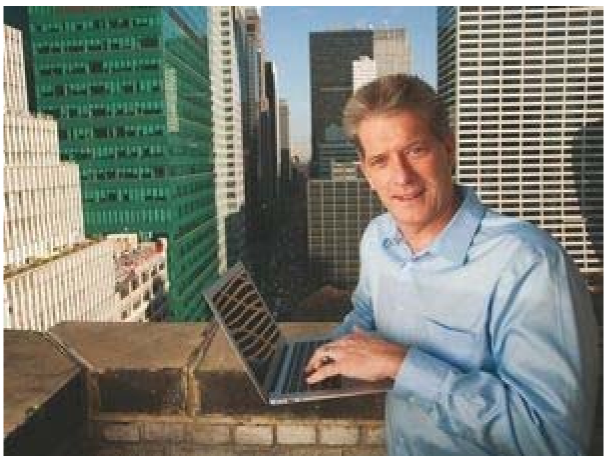
Startups that can't get financing try old trick

Selling receivables to raise cash isn't just for old-line industries.

Judith Messina



Buck Ennis

Tom O'Flaherty of CaféX Communications turned to factoring to balance out "lump" revenues.

Published: December 9, 2014 - 11:34 am

After raising $10.5 million from investors last year, real-time Web and mobile conferencing firm CaféX Communications wouldn't seem to be the typical candidate for factoring. The financing approach—where firms sell their accounts receivable to a financial-services firm to get cash into their coffers more quickly—is much more common in the garment trade and other old-line industries.

But last January, CaféX joined a small but growing number of Silicon Alley tech firms that are using factoring to improve their cash flow—in lieu of harder-to-get financing like bank loans. Tom O'Flaherty, chief financial officer of the year-old communications company, wanted insurance against "lumpy" revenues. He turned to Prestige Capital Corp., a Fort Lee, N.J.-based factoring firm.

"It's expensive money, but it's simpler to use," Mr. O'Flaherty said.

At a time when many tech firms are investing in growth, traditional factoring firms say they are serving more of them for a simple reason: "They can access capital without our having ownership in the company," said Rachel Hersh, the Northeast regional sales director for Prestige.

Bridging the gap

89%
Percentage of privately held U.S. firms eager to implement growth strategies

52%
U.S. firms with access to growth capital

Source: 2015 Pepperdine Private Capital Markets Project

Niche players are getting in on the action. Among them is FastPay, a Beverly Hills, Calif.-based firm that last year established an office in New York City. Viewing itself as a payment company, not a factor, FastPay buys receivables from ad-tech and other digital-media businesses that need to bridge the often months-long gap between delivering services and getting paid for them.

Over the past three years, said founder and Chief Executive Jed Simon, FastPay has financed $500 million in receivables. In doing so, it has attracted powerful backing. FastPay announced a $15 million funding round from venture firm Oak HC/FT in Greenwich, Conn., in November.

"Generally speaking, investors are finding invoicing economics very interesting," said Mr. Simon.

That said, factoring and similar forms of financing aren't ideal for every tech firm. A company's customers—the source of the receivables—have to be creditworthy, and it helps if they have valuable brands.

And factoring comes with financial trade-offs. The tech firms must be willing and able to sell a healthy chunk of receivables. Prestige starts at $100,000, while FastPay on average finances $200,000 in invoices. These short-term deals are pricey. Typically, factors charge an upfront fee and discount the receivables based on risk and volume, from 1% to 4% over 30 days and more the longer the receivables are outstanding.

"If you live on it all the time, it can get expensive, like living on credit cards," said small-business consultant Marilyn Landis, president of Pittsburgh-based Basic Business Concepts, which serves clients nationally.

But for some tech firms, factoring makes more financial sense than other options.

"You're doing what you can to get your business going," said Brian Whelan, a C.P.A. with accounting firm Presti & Naegele who has clients that have used factoring. "For short-term financing, you probably don't want to go the equity route. You've already given up so much in the first rounds, why give up the golden ticket at the other end?"

And for some firms, bank financing isn't practical at the moment. One of FastPay's clients is Manhattan-based Heavy, a digital news and information service, whose co-founder Simon Assaad learned about factoring in the early 2000s from other tenants in his garment district building.

Growing trend

"We'll probably soon be ready for bank financing to grow the business, but it's easier right now with factors," said Mr. Assaad.

Given the demand from tech entrepreneurs like Mr. Assaad, financing experts expect to see more factors courting them in the future.

"Old-line receivable lenders and factors really need to reach out to them because these are attractive companies," said Barry Sloane, president of small-business lender Newtek Business Services.

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