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[RAISING MONEY] Stock Exchange

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SHORT ON CAPITAL? IF YOU'VE GOT A PROVEN PLAN FOR CONVERTING INVENTORY INTO CASH, INVENTORY FINANCING COULD BE THE OPTION FOR YOU.

BY CRYSTAL DETAMORE-RODMAN

JUST OVER a year ago, National Direct, a sports collectibles business in Toronto, needed the funds to acquire inventory for a major sales campaign. While the $5 million company had an established track record, conventional lenders weren't convinced of its ability to turn over the inventory. When a business's need for a loan is not based on a purchase order, banks and factoring companies are often tough to deal with.

For National Direct, the solution was finding a firm specializing in inventory financing—Los Angeles-based Inventory Capital Group LLC. The financing company initially provided $400,000 to fund the sale of a pin collection licensed by World Wrestling Entertainment. Shortly thereafter, National Direct obtained an additional $1.2 million to roll out a commemorative pin collection featuring the Boston Red Sox.

As a result of the financing partnership, National Direct's sales have more than doubled, says company president Kevin Johnstone, 44, and its distribution network now includes more than 2,000 U.S. and Canadian retailers. Says Johnstone, "It certainly allowed us to make a very large footprint in the market that a traditional banking avenue would not have given us."

Significant Sales

Inventory financing fills a unique business-funding niche. It's geared toward companies that have major sales opportunities but lack fund-raising clout with traditional lenders. Here's how it works, generally speaking: A financing firm purchases inventory stock directly from manufacturers on the borrower's behalf, holding those items until that borrower has a firm buyer, usually a customer with a credit card. Those funds are then deposited into a lender-controlled account to pay down the inventory loan.

National Direct's lender, Inventory Capital Group, makes its money by marking up the inventory it purchases on the client's behalf, usually by 5 percent to 14 percent. While this is not the cheapest type of financing you can find, it can be a good option if you need to buy inventory but don't have a purchase order (provided, of course, you have a good

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plan for getting the inventory out into the marketplace.)

While the firm has financed deals as small as $13,000 and as large as $2.2 million, its preferred financing range is $200,000 to $500,000. And as a general rule, it prefers not to extend funding to companies concentrating solely on any one client. "It's difficult when a person comes in and says, 'I've got the Costco order that I've been working on for two years. It's 10 times my annual sales volume last year, and by the way, they can return it if it doesn't sell.' Those are hard for me to fund because there's so much risk concentrated in whether or not that inventory sells through at the store level," says Inventory Capital Group CEO Todd Kesselman.

He's also reluctant to fund inventory used in heavy-labor production processes, such as sheet-metal fabrication, because the "majority of value comes from input from labor into the item after it's purchased," Kesselman explains. "The item is in the middle of transformation, and I can't take the risk that the company [will] operate long enough to continue transforming the item."

Proven Plan

To qualify for inventory financing, businesses need a proven process for converting inventory into cash. "We perform a strict viability analysis on the business," says Jeffrey

Koslowsky, executive vice president of Gerber Trade Finance in New York City, who finances deals as large as $3 million. "Are they doing the right things to stay successful? Do they hold too much inventory? When they are stuck with too much inventory, do they know how to liquidate and move the product quickly through closeout channels? Do they know how to collect receivables? We focus on the trade cycle, how well they turn money and how well they run their business. The track record is vital."

Borrowers must also be able to comply with their lender's rigorous reporting demands, such as providing accurate and timely information on shipments, returns and accounts receivable. That may entail significant procedural changes for some companies, though inventory lenders argue that businesses should already have those monitoring mechanisms in place. "It actually ends up being good because [the lender] will go back and crunch [the company's] model and see if there are some bad signs coming up. They'll be able to analyze it and call you up and say, 'We have a couple of concerns,'" says Steven Friedlander, 36, founder of SKF Global Inc., a distributor of household items in Hackensack, New Jersey. For instance, the lender may warn that the business is "sitting heavy on inventory" or that cash flow has stalled, he observes.

Friedlander, who initially struggled to find regular funding for his 9-year-old company and had to borrow from friends, appreciates the flexibility that inventory financing offers. "When you bring goods from [Asia], it takes, from the date the goods ship, a good 30 to 40 days to get them into your warehouse," says Friedlander. He notes that it can then take companies up to 90 days to complete the transaction and get paid, making the typical 120-day terms reasonable.

In addition to providing working capital, inventory financing allows the funding recipient to obtain discounted pricing because it gives the business the funds to purchase in larger quantities. What's more, an inventory-financing arrangement often gives entrepreneurs the leverage to negotiate more favorable payment terms with vendors, enabling them to wait longer to pay without incurring late fees and interest charges. "They've been running so thin that their vendors are used to a whole litany of excuses, because every time they've had to pay a bill, they've been short money," Kesselman says of companies that typically turn to inventory financing. "When we step in as a third party and say [to vendors], 'The good news is, now they've arranged financing, and when you give them 30-day terms, we'll pay on the 30th day,' that credibility can sometimes open up terms."

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