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In a cash crunch?

Venture merchant banks help bridge the capital gap by financing a variety of trade activities

EACH NEW REQUEST that Katalin Posztos received for her company's activewear in 2004 was bittersweet. In some respects, things could not have been better for Borneo Fitness International. The four-year-old Miami-based business was on track to generate $1 million in sales that year, and Posztos had recently won the International Brand New Sports Award.

Still, as increasingly bigger orders poured in, Borneo's cash flow dried up, making it difficult to finance production. Posztos tried to land a bank loan, only to be turned down because of her short track record. Even factoring companies, which pay businesses up front for outstanding bills, were put off by the risk. By January 2005, the situation had become dire. "We had a bunch of big orders and nowhere to go," Posztos says.

Then an investment banker friend suggested that Posztos try venture merchant financing. The next week, she packed a suitcase with sample garments and her business plan for a meeting at Capstone Business Credit, a venture merchant bank based in New York City. A month later, she had landed a two-year financing deal worth $3 million.

"Most clients have a backlog of orders and no way to fill them," says banker Joseph Ingrassia.

Venture merchant banking isn't a new concept. Indeed, similar banks funded the voyages of Dutch ships in the 17th century. Today, venture merchant banks fund clients' trade activities such as importing and distribution. Unlike traditional merchant banks, they cater to small and midsize businesses, offering financing backed by assets, such as accounts receivable. Unlike factors, they also float loans backed by purchase orders. During the past few years, the niche has experienced a resurgence. For one thing, consolidation in the commercial banking industry has made it more difficult for early-stage businesses to land traditional loans. At the same time, more companies are doing business overseas, where vendors often require them to finance orders up front, creating a cash crunch. "Most of our clients have a backlog of orders and no way to fill them," says Joseph Ingrassia, Capstone's managing member. "It's the chicken-and-the-egg problem."

The banks fund a wide array of businesses—Capstone, for instance, counts an environmental services firm and a manufacturer of airplane engine parts among its clients. Most companies that tap venture merchant financing are thriving but lack the cash flow necessary to fund significant growth. Ideal candidates have between $5 million and $50 million in annual sales, solid growth potential, strong management teams, and profit margins between 20 percent and 30 percent. Relationships last two or three years, at which point businesses are usually solid enough to qualify for other forms of financing. In exchange for taking on all that risk, venture merchant bankers generally charge fees equal to 30 percent of the profits generated during the course of the deal, including interest charges and fines for late-paying clients.

Posztos was willing to pay that price. During her initial meeting with Ingrassia, Posztos—who runs Borneo with her boyfriend and business partner, Shawn Boyer—presented her business plan and some samples from her clothing line. After five weeks spent poring over tax forms and public records to make sure Borneo had no outstanding liens or litigation, Ingrassia offered the company a deal.

Then the real work began. First, Ingrassia guaranteed Borneo's payments to its fabric suppliers and its factory in Hungary, which enabled the company to start producing goods and generate receivables. Next, Capstone's factoring arm bought the rights to those receivables, advancing funds against the invoices, charging 2.5 percent interest, and collecting payments from customers. To streamline operations, Ingrassia helped Posztos establish Jet Set Style, a U.S.-based parent for Borneo, which was legally based in Nice, France, where Posztos had founded it.

With the basics in place, Ingrassia helped Posztos plot her next move: the launch of a new, upscale activewear line to complement Borneo's mass-market offerings. To cut costs, Ingrassia used his contacts to find a Chinese factory to produce the lower-end line; the new line, called Anatomie, would be produced in the higher-quality Hungarian factory. Thanks to her relationship with Capstone, Posztos receives discounted rates from a shipping firm used by some of the bank's other clients.

Some of the help has been less tangible. "Every time they see a potential new customer or vendor, they keep me in mind," Posztos says. And Ingrassia hasn't been shy about giving advice. During one meeting, Posztos mentioned she planned to build a $100 million company by 2010. He encouraged her to start building a staff. Since then, she's hired seven employees, including several salespeople.

Within a year, Capstone's handholding began to pay off. In July 2005, the Anatomie line became available on the company's website and in New York City's Reebok Sports Club. The clothes, which are sporty yet stylish, are due to hit select Nordstrom department stores this spring. The Borneo line is still being sold in Europe. In addition, Posztos signed a private-label deal with Club Med. In 2005, sales increased three-fold, to $3.5 million. Posztos expects revenue to reach $8 million this year.

The good fortune hasn't come cheap: One year into the two-year deal with Capstone, Posztos has plunked down $100,000 in fees. Still, she says, the relationship has been invaluable. Now that the company is back on track, Ingrassia is helping Posztos get ready for the next step—venture capital. "I went to Capstone with a dream and a great product," she says. "Now I have a $4 million company." —*Catherine Curan*

Working your assets

Venture merchant financing can save cash-strapped companies.

How it works

Banks offer financing backed by purchase orders, accounts receivable, and inventory. Relationships usually last two or three years, during which the bank also manages the client's trade activities.

Who qualifies

Companies with strong managers, growth potential, $5 million to $50 million in sales, and margins of 20 to 30 percent. Most have weak balance sheets.

What it costs

Financing fees typically amount to 30 percent of the profits generated during the course of the relationship.

What happens next

By the end of the deal, many companies qualify for more traditional forms of financing.

Resources For more information about Capstone and similar financing companies, visit the ABF Journal, which includes profiles of various asset-based lenders, including contact information (abfjournal.com/abl_svs.asp).