Funding Growth for Staffing Firms | A Paychex® Company

THE ESSENTIAL GUIDE

TO FINANCING YOUR STAFFING FIRM

The **Essential Guide** to Financing Your Staffing Firm

In an industry where volume can fluctuate wildly from week to week, healthy cash flow can be the difference between staying afloat and going under.

Undercapitalization is one of the main reasons that 45% of service firms like staffing agencies fail by year four. The reason that working capital is a particular challenge in staffing, is that firms are expected to cover payroll while waiting 4-6 weeks for client payment. Staffing businesses need a stable and flexible source for working capital, and many turn to outside financing for help.

Sometimes, owners can rely on friends and family to cover costs in low periods, or max out their credit cards to keep afloat. Small Business Loans and Merchant Cash Advances are another option, but they require great credit and collateral, which you may or may not have.

For most staffing firms considering financing solutions, there are a few viable options available. In this whitepaper, we will discuss the merits and drawbacks of each option.

Bank Financing

The first place staffing owners turn for outside financing is typically a bank. You might have an existing relationship with a banking partner, so it is a natural first step. A bank line of credit usually has attractive rates, as well as reputational benefits. If your firm has a few years of operating history and solid profitability, a bank may offer you a line of credit if you pledge your personal collateral. Problems come in for staffing firms even getting a LOC in the first place due to lack of collateral or hard assets. The credit limits of bank financing also do not grow with your firm, meaning borrowing is capped at a certain point. For growing firms, that is a big issue.

QUICK BANK FACTS:

- One of the cheapest ways to finance
- Turnaround time to get funds is 60-120 days
- Commit yearly
- How much you borrow depends on your assets

FACTORS THAT DETERMINE LOAN ELIGIBILITY:

- **Industry.** How risky is the staffing industry as a whole?
- **Risk analysis.** Are your financials sound? How many years have you been in business?
- **Business plan and model.** Will you be able to overcome changes in the economy?
- **Your personal equity.** If the business fails, will you be able to make good on the loan?
- **Credit score.** A credit score of above 650-700 is okay, but most lenders will look for a credit score that is at least in the 700-800 range.

ADVANTAGES OF A BANK LOAN:

- Relatively low interest rates
- Typically no dilution of ownership
- May help establish credit and reporting discipline
- Reputational benefits

DISADVANTAGES OF A BANK LOAN:

- Scrutiny and reporting can be difficult
- Collateral is typically encumbered
- Limited capital and growth opportunities
- Credit line increases difficult to obtain
- Not focused on the staffing industry
- Not startup friendly
- Based on personal credit

Accounts Receivable Financing

Accounts receivable financing goes by many names in the industry. Invoice factoring, payroll funding, working capital financing – it is all referring to the same process, where a third-party company purchases your accounts receivable in exchange for weekly cash advances. This process allows staffing companies to convert invoices into immediate working capital, without having to wait for customers to pay. The reason this method is popular is because of the unique pay structure of temporary staffing, where you need to pay your staff weekly but your customers are on 30 to-90 day payment terms. Accounts receivable financing can be on the pricier side in terms of financing options, but also has advantages like unlimited growth potential.

WHEN YOU SHOULD USE IT:

- **Good customers.** Approval is based on the credit of your customers, not your credit. Your personal credit is not taken into account.
- **Trying to grow**. If you are looking to expand business, more working capital means being able to say yes to new business opportunities.
- **Running up against bank or credit card limits.** If you are consistently pushing up against your credit limits, consider a funding source without them.
- **Need flexibility.** Even if you don't meet the requirements of a bank, you can still be approved for funding.
- **Need working capital fast.** Cash emergencies happen, and you can be funded within a few days. Once you are set up, you can expect same day payment on verified invoices.

ADVANTAGES

- Flexible contract terms and pricing structures
- Fast access to working capital
- Unlimited growth potential
- Partner may bring strategic support and expertise
- No dilution of ownership
- Less scrutiny and controls compared bank financing
- Optional back office solutions like In-house collections, credit, and payroll processing
- No debt on the balance sheet
- Weekly electronic funds transfers
- 24/7 access to detailed online reporting

DISADVANTAGES

- Can be more costly than other options
- May have service fees
- Borrowing depends on the quality of receivables
- Late payments may reduce borrowing limits

Equity Infusion

Another path that you can go to raise capital as a staffing owner is equity infusion. You can seek outside funding by issuing stock in your company. By selling shares of your company to outside investors, you inject your business with cash. Investors are looking to make a high return with an eye towards mid-to long-term growth.

SOURCES OF EQUITY FINANCING

- Venture capitalists. Venture capital funds are professional investment organizations that invest in growing industries in order to make a profit. VC firms know several of their investment choices may not pan out but are willing to take that risk in return for an occasional windfall. Securing a venture capital firm that specializes in your industry means you'll be bringing in owners who can offer experienced opinions on running the company but may also seek to exert significant control.
- Angel investors. These are individuals who have a personal stake in seeing a business proposition succeed. Angel investors tend to focus their investments on sectors in which they have a personal interest. The equity arrangement with an angel investor is similar to that of a venture capitalist.
- Initial public offerings. Depending on the nature and stage of development of the company, it may be possible to raise funds by offering shares in the company to the public. This activity is highly regulated and expert advice should be sought prior to embarking on this route.
- Corporate venture capital. This is capital provided by established companies in return for a stake in your business.

ADVANTAGES

- Typically no current cost of interest
- Allows you to cut out the bank as a business partner
- Instead of spending cash on loan repayments, use cash infusion to grow your business
- Equity investors help reduce your personal risk in the business
- Lighter reporting requirements
- Do not need perfect credit
- Partner/investor may bring strategic support
- In the event your business fails, not required to return the original investment

DISADVANTAGES

- Relinquishing ownership is expensive
- Ability to grow may be capped
- Not a good short-term cash solution
- Have to cede some control over your company's operations if you offer stock to investors
- Some private equity firms are not interested in staffing because of the cyclicality of the industry
- Investors most likely only focused on high growth segments like IT, engineering, etc.
- Not startup friendly

There is no right or wrong answer when it comes to financing your staffing firm, it all depends on your current situation and your ultimate goals. We hope this guide was helpful to you in making your decision about financing. If you have any questions or want to know more about our payroll funding services, contact us at advancepartners.com or 866-653-1810.

YOU MIGHT ALSO BE INTERESTED IN:

- Why It's Worth Switching Funders
- Understanding Financial Documents
- The Essential Guide for Business Owners

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ABOUT ADVANCE PARTNERS

Advance Partners is the #1 provider of financial, operational and strategic support to independent staffing firms in the country. Advance Partners serves as a business partner with a simple mission: To help staffing firms grow. Over the past twenty years in business, we have accomplished that mission by helping our clients grow 20% on average, which is 5x the industry standard. Advance's customizable solutions include payroll funding, back office support and a variety of strategic services to help staffing firms from entrepreneur to enterprise.