

A STUDY INTO THE PERCEIVED ROLE OF FACTORING IN NEW ZEALAND SME CASH MANAGEMENT

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ABSTRACT

Factoring has been described as an “oasis in a cash desert” (Riordan, 1997). In particular it can be useful for small to medium sized businesses (SMEs) that are expanding rapidly and need to convert debtors into cash quickly enough to pay creditors and sustain growth. However, cash-flow problems still exist for New Zealand SMEs, so this promise appears not to have been realised to the extent expected by its advocates.

A literature review confirmed that factoring can benefit SMEs cash-flow and debtor management. Yet arguments that it is underutilised or improperly used may stem from misunderstandings and perceptual blocks held by stakeholders making the cash management decisions (i.e. SME owner/operators, business advisors and factoring companies.)

An inductive research project was undertaken which: (1) investigated factoring utilisation; (2) analysed patterns and themes with respect to perceptions in the marketplace and; (3) developed a factoring perception model.

The study presents an investigation into stakeholder understanding and perceptions. Content analysis was applied to the semi structured interviews undertaken and relationships were identified. Specifically, there was general agreement in the marketplace that factoring is underutilised, poorly understood and suffers from a poor image.

From the findings, a factoring maximisation model was developed, demonstrating how perceptions should be changed in order to boost factoring's effectiveness in the New Zealand marketplace. These findings are useful in guiding factoring companies engaged in promoting factoring in the marketplace, and highlighting the deficiencies in SME owner/operators and business advisors understanding of factoring which is limiting the ability to maximise their cash-flow financing decisions.

INTRODUCTION

When factoring was first introduced to New Zealand more than a decade ago there was great expectation that it would offer a significant solution to the perennial small business problem of cash-flow deficiencies. Factoring has been described as an “oasis in a cash desert” (Riordan, 1997) and “a flexible friend” (Carty, 1995). It is claimed that factoring is useful for rapidly growing New Zealand small to medium sized enterprises (NZ SMEs) that have difficulty converting debtors into cash quickly enough to meet their needs. However, this promise does not seem to have been realised to the extent expected by its proponents. This may be due to the stigma sometimes attached to factoring as a source of last resort financing as well as the lack of understanding in the marketplace of how factoring actually works and the perceived high costs associated with this service.

Cash-flow deficiencies, commonly associated with the ‘finance gap’, are restraining SME performance. It is, therefore, essential that relevant and timely information be made available on all cash-flow funding options. Research on factoring as a NZ SME cash management tool, would address a present void in market knowledge. Research that addresses stakeholder understanding and perception as to the role of factoring in NZ SMEs may advance its overall recognition as a cash management tool and raise the profile of factoring which presently appears to be underutilised.

The aim of this study was to elicit the market’s perceptions of factoring and determine how these perceptions may be influencing the phenomena of its apparent underutilisation in New Zealand.

To this end the study set the following objectives:

1. To ascertain whether factoring fulfils an effective role in NZ SME cash management.
2. To seek market opinion as to whether factoring is underutilised by NZ SMEs.
3. To identify the level to which factoring is understood by the identified stakeholder groups (business advisors, SME owner/operators and factoring companies).
4. To identify where there are the congruencies and variances in perceptions about factoring between the identified stakeholder groups (business advisors, SME owner/operators and factoring companies).
5. To devise a model for factoring maximisation in New Zealand that offers recommendations to address any perception disparities.

FACTORING AS A FUNDING OPTION

Factoring is a term used to describe a range of working capital financing facilities open to business enterprises. These facilities provide avenues by which to (1) release cash which is tied up in trade debtors and (2) enhance debtor ledger management (Henderson, 1996). In simple terms, the factoring process involves a business handing over its invoices to a factoring company and in return receives 80 - 90% of the face value of the invoice immediately and the balance when the debts are paid to the factor – less charges incurred for the service (Hattaway, 1999). In effect, injecting cash into the enterprise and removing the burden of collecting account receivables; a task that many business owner/operators have in the past been unwilling or unable to devote adequate time and effort to (de Vries, 2003).

There are a number of variations to the theme of financing through factoring and it can be tailored to suit differing client needs (Berryman, 2000). This gives credence to its standing as a flexible tool (Carty, 1995), but also muddies the water with respect to the market fully understanding factoring. Traditionally there are three prominent categories of factoring:

- *Full-service recourse factoring* where the factoring company provides complete debtor administration in which they purchase the debts and undertake the collection process with their team of experienced specialist credit controllers; though they do not accept liability for any bad debts.
- *Invoice discounting (Non-disclosed factoring)* is a relationship where the debtors are unaware of the factoring arrangement. In essence the SME retains control of their debtor ledger but have the option to draw funds against debtors, then pay a financial charge for this service.
- *Non-recourse factoring* in which the factoring company offer 100% protection against bad debts, hence, safeguarding businesses against loss of income. Fees tend to be significantly higher and in New Zealand, this mode of factoring has traditionally been limited to export (Hattaway, 1999).

Like most other forms of financing factoring companies require security. It is common for factor financing to be secured by (1) a debenture that is first ranking over the debtor's assets and (2) personal guarantees of the shareholders (Berryman, 2000; Walters, 2000). However, the level of security underpinning a borrowing facility is viewed as being well below the expectations of banks.

Effectiveness of Factoring

Within the financial marketplace there is considerable debate between business advisors (as stakeholders in a client firms cash management decisions) and finance companies as to the role of factoring. Robinson (1993) suggests that factoring should not be considered as an advance of money by a financier in the traditional sense. He argues that factoring is not a lending facility in the true sense where funds are borrowed for a specific capital outlay or other short-to-medium term need and require repayment (with interest) over a prescribed term. Furthermore it cannot be considered as an equity-based approach as it does not require that SME owner/operators to relinquish ownership or control of part of the existing company to the external fund provider (e.g. selling shares). Factoring in effect releases a firm's own cash which would otherwise be tied up in accounts receivable. Hence, it can be claimed that it does not directly compete with, but complements other forms of business finance as the circumstance in which it could be used may be quite different. Never-the-less, commonalities between the various market offerings do exist.

Internationally factoring has gained some notoriety. Soufani (2001) contends that factoring is a financing option that supports the working capital of firms, while Summers and Wilson (2000) note that a factor's credit management is more efficient than that of smaller firms because they are able to invest in specialised personnel and procedures. Factoring's effectiveness is often a function of the stage of development and growth of the business, where the role of factoring is particularly evident in the early developmental stage of a business life cycle and that the respective roles of other forms of financing (e.g. overdraft, term loans) come into play at later stages of growth (Soufani, 2001; Perrin, 1998). There are high-profile areas where factoring has become a key tool and that the demography of the businesses that use factoring are broadening and deepening in the UK (Perrin, 1998). With 80% of the UK corporate business transactions based on credit (Summers & Wilson,

2000) this potential market for factoring is not to be underestimated. Worldwide, in fact, factoring volume is estimated at US\$600 billion (McNabb, 2002).

The significant variances in factoring costs both historically and between countries (e.g. Soufani, 2001; Robinson, 1993) may be limiting its overall acceptance and effectiveness. Spragins (1990) argues that in some cases the accumulative cost of US factoring fees could be five times as much as interest charges, but does concede that factors provide services banks don't. This argument may be rather extreme, but the cost of factoring is customarily comparable or higher than bank overdraft rates. In addition there are setup costs and the debtor ledger administration fee - a percentage which is based on variables such as average invoice number and size. A further drawback of most full factoring arrangements is that if debts are unpaid after 90 days the factor asks for its money back. Jarvis and Gillie (1998) contend that SMEs and their business advisors (predominantly accountants and bankers) perceive the cost of factoring as too high, thus, will traditionally not consider it as an option. Therefore, customarily the popularity of factoring tends to have a direct correlation with availability of overdraft facilities offered by banks. As overdraft finance terms toughen the use of factoring increases and vice versa (Miller, 1995).

Factoring companies contend that it is a facility that avails itself to large or small businesses, yet Summers and Wilson (2000) suggest that smaller firms are more likely to use factoring companies. They argue that factors may not specifically find smaller firms more attractive as factoring clients, but these firms are less attractive for other forms of finance such as bank loans. A common denominator is that factoring suits SMEs growing so fast that their banks can't keep pace (Goldman, 1979). In essence factoring can be viewed as a financing option that suits young undercapitalised businesses that have high profit margins so that they can absorb the factoring fees (Parks & Gallop, 1999). Robinson (1993) claims that the characteristics of businesses which suit factoring as a finance option are those that have: (1) sales on credit and not cash, (2) manufacturers or wholesalers with continuous trading with established customers, (3) no unusual selling terms or conditions, (4) no unusual purchasing terms and (5) businesses that demonstrate sound management and profitable trading. Cooper (1998) in contrast, outlines unsuitable businesses as: (1) those that sell on consignment or with the right of return, (2) high technology companies, (3) certain types of service industries, (4) professional corporations, (5) companies like building contractors and (6) industries in which the gross profit percentage is very narrow and turnover is very slow.

Factoring is generally perceived as having had a history of bad press, thus often being relegated to the financing option of last resort for SMEs. Many of the detractors (including accountants, business commentators, bankers, and business operators) have inferred that factoring is, in fact, the desperate effort of certain firms to get a cash injection into their failing businesses when other avenues have been exhausted (Berryman, 2000; Kennedy, 2000; Hattaway, 1999; Cooper, 1998; Jarvis & Gillie, 1998). During the 1980s factoring gained a 'cowboy' image internationally (Cooper, 1998) because many factors lacked professionalism or appropriate financial structures. As a consequence, SME owner/operators felt that employing a factor exposed them to unfavourable reactions from their customers (Jarvis & Gillie, 1998). They perceived that the message factoring sent (as a last ditch financing option) and the manner in which some accounts receivable were handled were detrimental to their customer relationships.

The negative view held towards factoring by the marketplace may be rather unfortunate as there are numerous international and local cases supporting factoring as the favoured

financing option (e.g. McNabb, 2000; Perrin, 1998). But perception often overshadows reality. Viewing factoring pragmatically from a cash management perspective, factoring can increase SME liquidity - especially in the early years of business operation (Robinson, 1993). The business can expand as sales grow because of the release of the debtor funds that factoring allows. Factoring is arguably the only form of working capital designed to grow with the business needs (Kennedy, 2000). Borrowing is against a SMEs growing turnover rather than against bricks and mortar assets which stay very static in value (Berryman, 2000). McNabb (2002) would suggest that one of biggest benefits is the ability to pay creditors immediately, which can earn considerable discount for early settlement.

From a debtor management perspective, there is evidence linking weak credit control with poor collection (de Vries, 2003) and poor businesses performance (e.g. Jarvis & Gillie, 1998). Customarily SME owner/operators do not consider debt collecting to be a part of their core business (Hattaway, 1999) and hence do not give it due attention. With late payment being cited as a major contributor to the high SME failure rates (Howie, 2003; Kennedy, 2002; Mian & Smith, 1992), their inability to manage debtors is problematic. Benefits therefore exist in contracting this task to factoring companies with professional credit management systems.

METHODOLOGY

In attempting to isolate factors influencing the identified phenomena: under-utilisation of factoring in New Zealand, this study identified the two following constructs:

When stakeholders poorly understand a form of financing then it is less likely to be considered as a cash management tool. Conversely forms of finance that are well understood are more likely to be considered.

When stakeholders hold negative or differing perceptions with respect to a particular form of financing then it is less likely to be considered as a SME cash management tool. Conversely if stakeholders hold congruent and positive perceptions about a form of financing then it is more likely to be considered with greater frequency.

It has been the objective of this study to explore the understanding of factoring and the areas of congruence and variance between stakeholder perceptions with respect to the role of factoring as a cash management tool. Of special interest will be variances that may limit its appropriate use within the SME sector in New Zealand and hence reinforcing a belief that it is the least desirable option of financing.

The triangulation approach was employed (e.g. Taylor & Bogdan, 1998) in which similar data was collected from the three New Zealand stakeholders groups involved in cash management decisions. Views were solicited which gave an insight into factoring knowledge and attitudes. Of specific relevance were misunderstandings, negative views or variance in stakeholder perceptions of factoring as a SME cash management tool. The sample consisted of: three SME owner/operators using factoring, three factoring companies and eleven business advisors (accountants and bankers).

The inductive research design utilised in-depth, semi-structured interviews as the means of data collection. The advantages of this method (Ticehurst & Veal, 1999) included: The ability to understand and explain the personal experiences of individuals associated with

factoring; that tacit knowledge or hunches can play a role in understanding the attitudes towards factoring; the research allowed a focus on people's understanding and interpretations; and that it allowed the researcher to experience factoring issues from a perspective of participants involved with the cash management decisions.

The factoring companies and business advisors were randomly selected from the metropolitan regions of Auckland, Christchurch and Wellington using the New Zealand Yellow Pages directory. The SME users of factoring were identified through: existing business contacts and introductions from business advisors previously contacted during the study.

The collected data was evaluated in a manner that met the needs of quantifying the constructs that (1) understanding and (2) congruencies and variances in stakeholder perceptions influence the level of utilisation of factoring as a SME cash management tool. Interviews were recorded on audio tape and thereafter transcribed word-for-word by the researcher. Content analysis was used as the textual investigation method (e.g. Silverman, 1993). Four sections were established in applying the content analysis approach to analysing the collected data; understanding of the factoring process, perceptions of factoring as a cash management tool, perceptions of the situations under which factoring would be used and perceptions of the role of factoring in NZ SMEs. Each section was then further divided into a number of categories in which data could be classified and organised (responses, words and phrases) into recognisable patterns for each stakeholder group.

Limitations

The study was not without limitations regarding to methodology and size. Firstly, the aim of this study was to uncover *patterns* in stakeholders' understanding and perceptions of factoring as a cash management tool. Thus the study does not offer direct observation of the phenomena that can be statistically evaluated and reported. Secondly, the sampling frame encompasses businesses and professional organisations that have an involvement (directly or indirectly) with SME financing decisions at some level. However it was not an all-inclusive sample. For example, it did not include SMEs that have had no contact with factoring services, thus limiting any discussion of the SME sector as a whole. Furthermore, the study does not attempt to be 'all encompassing' with a total sample size of 17 informants from the Auckland, Wellington and Christchurch regions only. Finally, the methodology does not account for the existence of other constructs which may influence the results, e.g. varying level of influence of different stakeholders on the cash management decisions.

Within these limitations, the study may be viewed as a fact finding mission that reveals issues that will then require further in depth empirical investigation as opposed to offering definitive answers to the questions of under-utilisation of factoring by NZ SMEs.

RESULTS

Understanding of Factoring

1. *The workings of factoring:* All stakeholders interviewed had an appreciation that factoring offered an immediacy of cash, but understanding of how it worked varied. When

asked to explain the service, factoring companies descriptions were clear and concise whilst accountants appeared to be familiar with the factoring concept but only had a basic understanding of how it worked. Accountants used broad explanations such as “selling receivables at a discount to factoring agents, whose job is to recover the debt,” and “Buying invoices off clients at a discount.” to describe factoring. Account managers for banks had slightly more detailed explanations but still did not have a clear or complete understanding. SME users of factoring appeared to understand their particular arrangement only.

2. Costs of factoring: Factoring companies were again clear and concise in explaining the setup, borrowing and administration fees associated with various factoring services. They acknowledged that costs can vary considerably but down-played the argument that it is an overly expensive form of financing. Accountants and bankers were unsure of the costs associated with factoring, but were in general agreement that the costs are high, “Lender of last resort because costs are too high” was a typical comment. Few business advisors could recall an example of specific factoring costs and eight out of the eleven respondents did not know whether there is considerable variation in factoring costs within the market. SME users of factoring were quite clear on what their particular costs were and understood that fee structures could change over time. One respondent stated, “Once you have built up a relationship then figures alter (reduce) and different product ranges can be advanced which are more customised to the individual.”

Perceptions of Factoring

1. Reputation of factoring: When asked whether factoring had a respectable or cowboy image, the factoring companies contended that there are mixed views in the marketplace. With New Zealand being a small and new factoring market, a respondent suggested that it suffers from the ‘small community syndrome’, which infers a reluctance to accept something new or different. However, factoring companies did concede that 10 - 20 years ago factoring companies did not do their job well and hence the service gained a poor reputation. They argue that the industry is now driven by reputable and well run organisations. That some of the largest finance companies in the world are now involved with factoring and would not be interested in offering such a service if it were not a legitimate and viable financing option. Hence, they believe that it is now better received; especially with increased education of the market. As one respondent stated, “Maybe we are finally seeing the end of the doubters.”

SMEs using factoring stated that they have no concerns over its reputation believing it is very professional, though they concede that few businesses understand how it works. Accountants were unsure as to the reputation of factoring - offering varying comments such as “People look at factoring from time to time but shy away from it,” and “tool of desperation;” through to “there are professional organisations out there,” and “a tool for growth.” Two of the three bankers suggested that the market views factoring as a inferior financing option. One such banker commenting, “From a banker’s perspective there is a stigma attached to it - rightly or wrongly.” Both accountants and bankers suggested that there may be two tiers of factoring companies in the marketplace. “Some may be dodgy,” stated an accountant. Evidence from accountants and bankers would suggest that the accretion of factoring companies that we are “seeing the end of the doubters” might be far from the reality.

2. *Image of factoring:* All stakeholder groups were of the opinion that factoring was considered to be the last choice finance. Factoring companies argued that “people don’t know it exists or don’t understand it”. They do admit that they are in the business of relieving cash-flow problems and therefore get some last resort desperation calls; but stress that factoring will not ‘stave off the wolves’ for companies in extreme difficulty or fundamentally unsound. Instead they prefer to do business with growing firms – stating, “We are after clients with quality products and services who have got potential to grow the business.” Bankers and the majority of accountants were adamant that it was finance of last choice and were unequivocal in that view.

Factoring companies believed that there was sometimes confusion among their client’s customers as to why an organisation would use factoring. One commented, “There can be a perception that they are in trouble.” However, they argued that a competently managed transition of the debtor ledger from the client to the factor, with full and clear explanations to customers, presented few problems. They commented that the worst payers are generally the ones that react badly. Accountants were generally not sure about customer reaction to a factor collecting accounts receivable, while bankers believe it may send a message to the market that a company may not be as strong as they perceived. Furthermore it was suggested that it creates another burden for a customer’s accounts clerk. “Processing an invoice from one firm and having to pay another is perceived as a burden they can do without,” and “it’s open to more mistakes.”

3. *Professional debtor management:* Factoring companies all concurred that debtor management was a very useful aspect of the factoring service and suggested that the bulk of factoring in the New Zealand market is ‘full factoring’. They viewed this as beneficial for SMEs who are generally considered to be hesitant, ineffective or too busy to collect money. The SME operators themselves believed that factors were much more professional than they could be and that they could focus on building client relationships rather than money issues. Accountants were evenly split as to whether it was a useful tool, suggesting that there are more effective ways of collecting accounts receivable. One accountant raised concerns about factors operating from outside New Zealand, commenting “All the management has been done from Australia and it has been difficult to get responses and information from them.” Bankers were generally not in favour of factors managing the debtor ledger, arguing their lack of commitment. “The trouble is that they don’t manage it – they wipe their hands of bad debts which come back to the client.”

4. *Difference between factoring and loan finance:* Factoring companies stated that loans and overdrafts are not true forms of cash-flow finance because they do not ensure that borrowing facilities keep pace with growing turnover. They argue that factoring is the true dynamic growth tool. “With factoring the more turnover - the more money you can borrow,” and go on to suggest “With factoring you can’t overtrade.” Accountants, on the other hand, were less clear about the differences. Some suggesting little difference, while others stated the main distinction as the higher costs associated with factoring. Comments were made with regard to different risk criteria, suggesting banks are more conservative than factors.

Bankers viewed factoring as an opposition product in some respects, but not a serious threat. They saw it more as a means of reducing short-term cash-flow problems and as a product that needed less security from the lender. One bank confirmed that it had recently introduced a form of factoring service for some of its larger business clients, while another bank stated that some of the financial products they already had worked in similar ways to

factoring in any case. SME users of factoring commented on its ability to grow with sales. They also believed that overdraft criteria were far more difficult to meet.

5. Drawbacks of factoring: Factoring companies understandably believe there are no real drawbacks to factoring as long as it is used correctly and clients' understand that accounts receivable are still their debt. Accountants reiterated that high costs are a major drawback and that the practice of factors operating client accounts from off shore was impractical. Bankers suggested that a danger exists if clients spend the cash generated from the improved cash-flow on non-revenue generating expenditure; believing that some business owners "can't help themselves" in spending business funds. They also see factoring as a double edged sword (immediate cash versus charge-backs) and argue that once you are trapped in the factoring cycle it is hard to get out later. In contrast, the SME users saw few drawbacks. However, this may be a situational response, as once an SME owner/operator is committed to using a particular financial service they will generally be positive about that decision.

6. Factoring's value: Factoring companies contend that factoring should be used to reduce the SME finance gap in growth situations. One account manager stated "We are after clients with quality products and services who have got potential to grow the business," though the manager did qualify this statement by saying "I'm not going to turn away companies with cash-flow problems – that's what we do." SME users also saw it as useful growth tool. One owner/operator commented on the perennial SME cash-flow problem "You can double your turnover and find you've got no cash," suggesting factoring was viewed as a tool that avoided such situations. Accountants were unsure as to when factoring should be used. With only two of the eight have experience with clients using factoring and in one case a bad experience, this is perhaps not unexpected. Generally accountants did see it as a tool for bridging the finance gap and fostering growth, though they were somewhat cautious in their endorsement. They suggested that growing firms can fall over if not managed carefully and responsibly and that firms need to give care and thought to the process of matching borrowing with the level of business activity. Three accountants saw it as simply a last resort means of dealing with cash-flow problems. Bankers also considered it to be simply a tool for cash-flow problems and in most cases a 'last ditch resort'. One banker commented that it could be helpful for firms dealing with seasonal cash-flow issues.

7. Appropriate industry sector: Factoring companies were ferriferous in arguing that most industries could use factoring; as long as they did not involve progress claims or stage payments as commonly found in the construction and software industries. Accountants had no clear opinion, while bankers believed most industries could use factoring, especially when undercapitalisation was common. SME users could see the merits for factoring in their particular industry and went on to propose that most invoice based businesses could use factoring. Stakeholders generally agreed that irrespective of the type of industry; users of factoring would need simple, well maintained and provable debtor ledgers with as few troublesome payers as possible.

8. Factoring's 'fit' for small or big business: There was considerable variance in opinion between stakeholders as to whether factoring was more suited to large businesses or SMEs. Factoring companies suggested the majority of their clients are SMEs, but were careful not to dismiss the potential for large clients. One manager stated that "The bulk of our clients have less than 20 staff." Accountants had no clear view on the appropriate fit, as their opinions were evenly spread between small businesses, medium businesses, large businesses and no opinion at all. Bankers suggested it was a tool for larger

businesses, while SME users believed both large and small businesses could benefit from factoring.

9. Factoring utilisation by NZ SMEs: All stakeholders interviewed were of the view that factoring is underutilised by NZ SMEs. Factoring companies suggested that there is huge scope to grow factoring - if the negative image can be removed. Interestingly, even though business advisors were sceptical about many aspects of factoring they still believed it was under-utilised. One banker did argue that market forces would suggest "If people felt that there were real benefits they would use it more," but still conceded "If anything, it is under-utilised". SME users of factoring contended that it is underutilised mainly because it is poorly understood and that people think it is a debt recovery tool. All stakeholders were adamant that banks, with their traditional overdraft facilities and term loans, were the first port of call for SME owner/operators needing cash injections.

10. SMEs understanding of factoring: All respondents conceded that SME owner/operators had little knowledge of factoring. Factoring companies argued that New Zealand is an immature market and people don't know it exists or can't grasp the concept of factoring. Business advisors maintain that SMEs adhere to the tried and proven (i.e. overdrafts and loans) and are by and large poorly informed of differing financial options. SME users concur that there is simply a lack of understanding 'out there' in the market place.

There is also a belief among the SME users and factoring companies sampled that business advisors have limited knowledge on factoring. A factoring accounts manager was quite frank, "Banks don't understand it and accountants don't understand it." SME users commented that they felt that business advisors did not make an effort to understand factoring. The business advisors themselves had mixed views about their knowledge levels. Half of the accountants interviewed suggested that advisors know little about factoring but would find out if required; two stated that advisors know the basics and two were not sure on the level of understanding in the marketplace. The bankers admitted to having limited understanding of factoring and suggested other business advisors would be the same.

Discussion

The study indicates that marketplace understanding of factoring is limited among business advisors and SME operators. Business advisors negative views appear to reflect this lack of understanding (further in depth research would be required to validate this relationship), but a further issue is the poor image associated with the early years of factoring's introduction into New Zealand.

Whilst factoring companies, who wish to promote factoring, argue the benefits of cash releasing capability, synergies with growth companies, prevention of overtrading and professional debtor management, the market has been very slow to embrace these claims. Business advisors argue that it is a finance option of last choice as there are significant drawbacks, particularly that cost structures are too high. Interestingly, however, even with the divergence in perception over factoring's role, all stakeholders believed that factoring was underutilised; which would suggest that there is potential for greater use of factoring services if negative perceptions can be altered.

CONCLUSIONS AND RECOMMENDATIONS

The introduction contended that factoring offered a solution to the perennial SME problem of cash-flow deficiencies, yet has met with limited support in New Zealand. Therefore this study set out to investigate how market knowledge of factoring and perceptions influenced its use in New Zealand by identifying factoring's role in NZ SME cash management, the level of understanding within the marketplace and the perceptions held by stakeholders. To this end the study reports on the five objectives identified in the research aims.

Objective 1: To ascertain whether factoring fulfils an effective role in NZ SME cash management. The findings of the literature review acknowledged that the inherent cash management weaknesses within the SME sector can be, in certain cases, lessened through factoring. Growing SMEs suffer from cash-flow deficiencies which are compounded by under capitalisation, gearing, overtrading and poor debtor management practices. At best these businesses under perform and at worst face failure. Factoring in effect releases cash that is otherwise tied up in debtors, which can then be used to generate further revenue under appropriate business conditions. With increasing revenue, cash streams will grow as the business grows thus avoiding overtrading. Secondly, factoring offers a professional debtor management service, which relieves SME owner/operators of the often vaunted accounts administration burden. The indications are that factoring has a role to play in SME cash management. As to whether it is as good as factoring companies claim cannot be substantiated by this research, thus the whole area of how factoring can most effectively benefit SMEs requires greater research.

Objective 2: To seek market opinion as to whether factoring is underutilised by NZ SMEs. When factoring was introduced into New Zealand it was described as an "oasis in the desert"; yet this promise has not been realised to the extent that proponents of the service expected. In fact all stakeholder groups questioned, believed that factoring was underutilised, which would suggest that there is untapped potential for factoring services in New Zealand. Factoring companies believe there is huge scope to grow in New Zealand if perceptions can be changed. Certainly factoring is not suited to all enterprises or all situations but the perception is that there is a market for this service.

Objective 3: To identify the level to which factoring is understood by the identified stakeholder groups. The stakeholder analysis indicated that marketplace understanding of factoring was limited. Factoring companies understood their product implicitly (naturally enough) but were conscious of the poor market penetration of knowledge on factoring. A basic understanding of the factoring concept was evident in discussions with business advisors, but SME owner/operators only became aware of factoring and what it offered as a financial tool when it was introduced – typically as a last choice option. The study further indicated that there was little knowledge of the factoring's cost structures in the marketplace, with business advisors only being aware that costs were high. Whilst factoring companies affirmed benefits such as instant cash, prevention of overtrading and professional debtor management; business advisors' negative views appear to reflect the lack of understanding and the poor image that surrounds factoring, arguing factoring is the finance of last choice as it has significant drawbacks and high cost. These findings support the construct 'When stakeholders poorly understand a form of financing then it is less likely to be considered as a cash management tool.' Therefore, it is argued that the disparity in knowledge among stakeholder groups requires addressing.

Objective 4: To identify where there are the congruencies and variances in perceptions about factoring between the identified stakeholder groups. Where there were congruencies in stakeholder perceptions of factoring, they tended to be beliefs that held factoring in an unfavourable light, i.e. last choice option whilst banks were first choice finance, image problems and being poorly understood by both SMEs and their business advisors. With respect to issues espousing the benefits of factoring, i.e. assistance to growth, debtor management, and overall effectiveness, there were significant variances with factoring company's naturally positive whilst business advisors and to a lesser extent SME users were more critical.

The overall mix of perceptions tended to marginalise factoring as a financing option and reinforce the strong traditional culture of SMEs supporting bank financing as the 'natural' first preference. This supports the construct 'When stakeholders hold negative or differing perceptions with respect to a particular form of financing then it is less likely to be considered as a SME cash management tool'.

The study argues that underutilisation appears to be linked to the market's lack of knowledge about factoring which consequently reflects in poor perceptions of its image, business value and cost structures. Perceptions that will need changing through behaviour modification, education, an informed market and relationship building; in essence, creating a cultural shift with greater knowledge in the marketplace to make informed cash management decisions which maximise factoring effectiveness but minimise its inappropriate application.

Objective 5: To devise a model for factoring maximisation in New Zealand that offers recommendations to address any perception disparities. A model of stakeholder perceptions has been developed to explain the perception disparities and identify possible remedies (figure 1). The model delineates a theory that perceptual blocks underpin the underutilisation of factoring (dark shading), identifies the perceptual shifts required and stakeholder action needed to achieve perceptual change (light shading); thereby maximising the benefits factoring can offer NZ SME cash management.

The factoring maximisation model identifies factoring as a finance option of last choice, as SMEs prefer visiting their banks for overdraft and loans. Therefore, if factoring is to increase in prominence a shift is needed in 'financial culture' which encourages the market to consider all financial options. This would require a willingness of business advisors to accept and understand a greater range of financing alternatives and for SMEs to be far more rigorous in investigating all financing options. The fledgling factoring industry will need to take a prominent role in facilitating any attitude and behaviour modification in the market place; specifically marketing activities which create greater awareness and build relationships with all stakeholder groups. There is an argument to suggest that New Zealand suffers from the 'small town syndrome' where firms may be innovative in designing new products and services but hold steadfastly to conservative financing practices; none-the-less the study identified that all interviewees accept that factoring is underutilised in this country. This anomaly needs to be seized upon, as it would suggest that the market may be receptive to positive promotion of factoring and disposed to shifting from traditional financing habits if the benefits can be proven through independent in-depth research.

The factoring maximisation model identifies that factoring, as a financing option, is not well understood by SME owner/operators or their business advisors. However, factoring company's tradition of writing articles on factoring and distributing brochures alone will not

create the knowledge levels required to achieve a cultural shift in financing habits. To this end factoring companies need stronger ties with the business advisors that support SME owner/operators. Even though they argue that they promote factoring to the market place - a far more pro-active approach is required. Resources must be directed at educating accountants, who presently lack knowledge on factoring and consequently do not suggest it to SME clients. In fact, accountants quite likely dismiss any client interest in factoring out-of-hand, without clearly evaluating its suitability. As one manager of a factoring company stated, "Accountants can be our best friends or worst enemies," so the challenge is to make them their best friends. Business schools, at the coal face of education, also need to be encouraged to include learning outcomes on factoring in the finance papers they deliver to accounting and business students. (e.g. provision for factoring in course literature or availability of guest speakers). Finally, factoring companies require working relationships with a sceptical banking industry. If factoring companies can build some kind of reciprocal relationships (e.g. linking the benefits of factoring and banking services) this may remove the stigma of bankers viewing them as fringe finance providers, to whom they should only send troublesome clients.

A further concern is the belief that the factoring industry image is damaged by 'second tier' factoring companies that may not have adequate systems or controls to scrutinise and manage clients effectively. The factoring industry as a whole could benefit from monitoring and managing the activities of all firms through a professional body which promotes ethical and professional guidelines. Also with the significant variance in opinion between stakeholder groups as to the drawbacks of factoring and the circumstances in which factoring should be used, the industry require greater critical analysis that a professional body could provide. Certainly factoring is not for everyone or suitable in all business situations and this study does not argue that it should. However, a well informed and educated market, which operates with reputable factoring companies, will ensure informed decisions are made regarding cash-flow and debtor management. Therefore the factoring industry must be proactive with strategies that position themselves favourably in main stream financing.

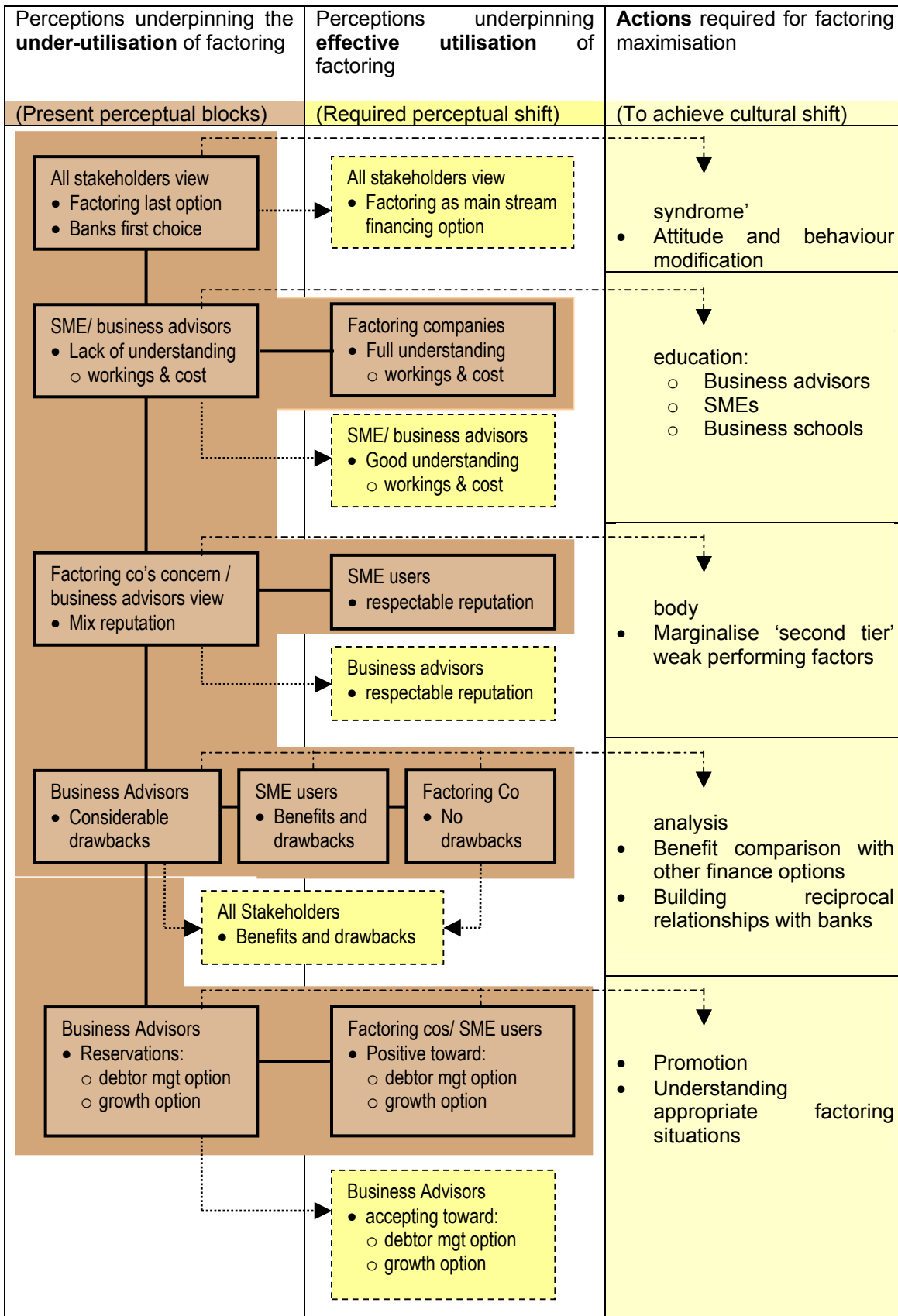


Figure 1: Factoring Maximisation Model

This study adds to the body of knowledge on NZ SME cash management, nevertheless, this study creates more questions and highlights that the area of factoring remains relatively bereft of empirical research. The study did not identify the level of influence of each stakeholder group in cash management decisions and argues that the implied relationship between understanding and positive perception requires further investigation. Research could also be undertaken with a wider sample frame including: SME non-users of factoring, other financial institutions and accountants specifically identified as having experience with factoring. Furthermore, to examine claims of factoring companies, as to how good factoring really is, longitudinal studies of SMEs using factoring should also be carried out with cost-benefit comparisons between the various financing options.

Factoring is a useful tool among the many available for NZ SME cash management, but this study has identified anomalies which have created a perceived environment of underutilisation. The challenge for stakeholders in the SME sector is to understand and embrace all financial services to maximise cash management decisions. Research into factoring is a step in that direction.

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