FEATURE STORY

Transportation Factoring in a Freight Recession

BY GEORGE A. THORSON

Factoring for trucking companies and brokerages has skyrocketed in the last 10 years. An estimate on factoring company purchases is $90 billion annually. There are about 250,000 active for-hire carriers with 96 percent having six trucks or less. Factoring remains a necessary and viable tool for smaller carriers who have limited access to bank lines of credit or asset-based lenders. The transportation factoring company fills this void through the built-in elasticity of its offering – helping companies expand when the transportation industry is booming and sustain business when the industry is down.

In 2021, our nation's trucking companies had one of the best years, with freight rates (or rates per mile driven) soaring to record highs. The combination of federal government support programs coming out of the pandemic in 2020 with favorable freight rates caused an expansion of new trucking entries and fleet growth. This created overcapacity, as consumers shifted their spending to services, and returned to restaurants and travel.

All the catch-up in the supply chain created overstock, and freight tonnage began to contract.

In the second half of 2022 and so far in 2023, the transportation industry has suffered through a 30-percent reduction in rates per mile, dropping below breakeven for many small trucking companies. Large fleets have reported a severe reduction in earnings and lowered outlooks for the remainder of the year. Through May of this year, the Department of Transportation (DOT) has recorded a net reduction of 15,000 fleet authorities.

Contributing to the current state, during 2021 and 2022, the costs of both used and new tractors and trailers rose dramatically. Those ordering new tractors faced a 12-14-month wait at a 60 percent average higher cost. This pushed up the cost of used equipment as firms held onto their units for longer. Putting more miles on the trucks increased repair costs and a shortage of parts occurred. Driver payroll increased and insurance costs rose.

Even in a dynamic rate market, cash-flow pressures remained, and transportation factors stepped up. Funds advanced had to grow with increased activity, in many cases rapidly with the supply chain problems from the pandemic creating excess freight.

Small and medium-size carriers need factoring due to cash-flow pressures. Diesel fuel and driver pay must be paid every week. The cost of insurance, repairs and payments for tractors and trailers require cash outflow that cannot wait 45 days for payments. Carriers seek the services of their factoring partner on invoicing, credit decisioning and collections. As technology has advanced, invoice and document presentment are now increasingly digitally managed, requiring a savvy partner to facilitate timely acceptance and payment.

Transportation factoring is more of a combination of services and invoice funding than in general factoring. Such offerings may include help in obtaining new motor carrier authority, fuel cards and fuel discounts, access to insurance products, transportation management software, tire discounts and even legal support.

For the factor, the transportation niche features each invoice as a completed transaction with dilution of one percent or less. Most small and mid-size carriers work for about 9,000 freight brokers, who are accustomed to making about 60 percent of their payments to factors. These account debtors are accustomed to receiving notices of assignment and, for the most part, comply and make payments direct to the factor. There are specialized mercantile credit reporting products that focus on tracking the payment patterns and volume of these freight brokers, allowing familiarity and active warnings for the account debtor credit department.

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The business failure of a carrier has minimal impact on the collection of accounts receivable, as a carrier/factor can generally receive payment for each completed freight load. There are no returns and allowances creating dilution as in general factoring, with the biggest offset risk relating to freight claims. Trucking also extends to many verticals, from produce, energy, construction materials, retail goods, etc. In 2022, trucks carried 11.48 billion tons of freight through dry vans, flat beds, refrigerated trailers, tankers and specialized trailers.

Trucking is a low net-margin business. This is amplified in a transportation recession when rates are low and diesel costs are high. Small trucking firms expect a 95-100 percent advance less the discount fee and a non-recourse contract. Medium and larger firms still look for a 90-95 percent advance, but most move towards a recourse contract with a lower rate. Given a rate of dilution of one percent or less, this is not beyond the realm of safe practices, but is another reason that transportation factoring is a niche that other factors may touch lightly.

In addition, factoring has its focus on the financial condition, pay history and solvency of the account debtors, much more than on the carrier itself. Start-ups, net losses, and deficit net worth prospects are not automatically declined by a transportation factor. A bad safety rating by the Federal Motor Carrier Safety Association (FMCSA) may be viewed in underwriting as a higher risk element than a weak balance sheet or income statement, if the latter is even available.

Larger carriers with annual revenue of $50 million or more have stayed with or gravitated to transportation factors from bank commercial lending or asset-based lending. In addition to higher advance rates, factoring is mostly covenant free. There are usually no periodic field exams. With many factors, there is no maximum facility "credit limit" or maximum advance limit in factoring terms. Instead, the factor's credit limits are focused on the account debtors and establishing credit limits for maximum exposure. So, the facility can grow as large as the carrier's fleet grows assuming the account debtors credit supports that growth. This is critical in good times for trucking. Average invoice amount increases with rising freight rates and firms get more trucks on the road to take advantage of higher margins. The flexibility to quickly grow or contract with volume without going through a lengthy approval process is prized by the clients in this industry.

Pricing pressures in the transportation factoring marketplace have allowed large carriers to obtain rates that are equivalent to those offered by asset-based lenders. The industry is dominated by fixed rate products, although variable rate pricing is becoming more common for larger carriers. This is especially true with recent rising cost of funds to factors, whether private or bank owned. Longer terms required by shippers affect the market as well, creating discount rate contracts that price towards the number of days that an invoice is outstanding. Flexibility has been the key to retaining and acquiring clients in the rising prime rate environment. Providing ancillary services to help the trucking client survive and prosper in a challenging market has been of more value to the trucking firm during the current recession.

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Transportation factoring on a large scale has remained a niche service area for an expanded group of factors. It is necessary to structure and plan for changes in the freight industry through both good times and tough times. Knowledge of the particulars of the freight industry are required. An understanding of the changes and innovations in transportation technology including load matching, carrier vetting, electronic logging and GPS tracking, payment networks and auditing, along with technical requirements by the account debtors is needed for the factor to be successful in this space.

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