

# Working Without a (Working Capital) Net:

Cash Flow Constraints in the Telecom Industry

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A special report by: THE RECEIVABLES EXCHANGE Working Capital Research Group

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## Cash Flow Constraints in the Telecom Industry

Securing reliable working capital in sufficient quantities is the number one business challenge today for companies with revenues of \$2–200 million, edging out fears of escalating costs and maintaining margins, according to a landmark study conducted by The Receivables Exchange Working Capital Research Group. The Receivables Exchange studied 670 companies across 15 industries to understand their top business challenges and how working capital and cash flow issues are being viewed by decision-makers.

The study found an overwhelming majority of respondents feel they are performing a “high-wire act” when it comes to working capital management.

Viewed from a macro level, working capital constriction for this group of companies is a significant problem for the economy as a whole. Businesses of \$2–200 million in revenue account for roughly two-thirds of private sector workers and 45% of business revenues in the U.S., yet less than 5% of capital markets activity is devoted to funding them, leaving a substantial financing gap.<sup>1</sup> And that gap has only increased during the global financial crisis, which has further restricted access to capital – unsustainably for some businesses.

The Telecom industry faces specific challenges when it comes to working capital, not the least of which is the high incidence of slow-paying customers. To provide insight into the key working capital challenges facing manufacturers, The Receivables Exchange Working Capital Research Group extracted industry-specific intelligence from the study data to aid Telecom company leaders and financial decision-makers.

Nearly 70% of respondents wish they had a more significant “cash cushion” to fall back on in times of need.

### A “Perpetual Challenge”

According to the study, working capital is the number one business challenge for companies in this revenue range, edging out escalating costs and margin maintenance for the top spot. And it's not a new problem. Forty percent of companies in this revenue range state that procuring working capital has been a “perpetual challenge” over time. This number is even higher in Telecom, where 48% of companies say securing sufficient cash flow for ongoing operations is a serial issue.

Exacerbating these working capital issues for Telecom companies is the difficulty of managing growth. In fact, Telecom companies were more likely to be concerned with the perils of managing growth than any of the 15 industries surveyed, which may be warranted given recent trends. According to a report from the International Telecommunications Union, the global Telecom industry expanded at twice the rate of the underlying economy in 2009, and rapid growth is expected to continue. Growth can present substantial opportunity, but equally significant chal-

### What Is The Receivables Exchange?

The Receivables Exchange is a competitive online marketplace where small and midsize businesses sell their outstanding invoices for cash to institutional investors, like banks and hedge funds. Businesses that sell their invoices typically get 98–99 cents on the dollar, and get paid immediately instead of having to wait until their customer sends payment.

Companies that want to sell their receivables go through a one-time approval and verification process, after which they can get funds electronically deposited in their accounts in as little as 2 business days after issuing an invoice to a customer. The competitive online auction process is an effective way to diversify funding sources and to drive down the cost of capital. Sellers can use the Exchange as much or as little as they need, without obligation.

Sellers rave about the results they get from The Receivables Exchange. The owner of a New York-based Telecom services company said The Receivables Exchange helped him grow his business when bank financing provided inadequate. “I can choose what invoices to sell and when, and I can pay my suppliers only a few days after invoicing my customers,” he said.

Minimum qualifications apply, including trailing 12-month annual revenue of at least \$2 million, 2 years of operating history and being registered to do business in the U.S.

[www.receivablesXchange.com/seller](http://www.receivablesXchange.com/seller)  
or call 877-392-4952

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<sup>1</sup> Morgan Stanley BtoB Finance Report for Small and Medium Business, March 2010 via U.S. Census Bureau 2002 County Business Patterns and 2002 Economic Census

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Fig 1: Top Business Challenges for Telecom

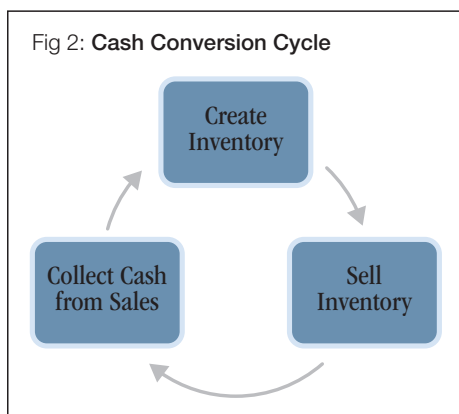
Working capital	66%
Escalating costs	59%
Margin maintenance	39%
Ability to forecast results	38%
Managing growth	36%*
Liquidity	33%
Maintaining morale/productivity	29%

\* Highest rating among the 15 industries studied

Source: The Receivables Exchange Working Capital Research Group, 2010

surveyed, Telecom had one of the highest desires for significant strategic cash reserves and yet had one of the lowest overall satisfaction ratings, with only 21% of respondents satisfied with their current cash reserves. Top uses for a cash cushion included coping with disruptive events, being in a position to take advantage of business opportunities, dealing with seasonality and slow-paying customers or customers extending terms.

Big customers are at the root of many of the working capital woes of Telecom. Telecom companies have the highest incidence of slow-paying customers of any industry studied, with a full 43% of companies citing this as a key working capital issue. Telecom also gets hit hard by customers extending payment



terms, with 41% of companies citing it as a significant cash constraint. Because Telecom generally has high cost of equipment and overhead, extended payment terms put a great strain on a company's cash conversion cycles. The mismatch between upfront investment and a collections cycle that can reach six or even 12 weeks means Telecom companies are left to bridge the gap, sometimes painfully.

These problems are likely the cause of Telecom's high desire to have a "cash cushion" as an insurance policy against future events. In fact, half of all Telecom companies – more than any of other industry – said that if their company experiences some type of disruptive event, working capital will be a problem.

Of course, disruption is not necessarily negative, provided a company is prepared. "A sudden shift in the marketplace due to unforeseen events can be a boon to businesses," said Bill Siegel, SVP and

head of the Liquidity Desk at The Receivables Exchange, "but only if they have the working capital on hand to take advantage." New technology, regulatory changes and even competitors' business issues can create opportunity. But Telecom companies must have resources on hand to seize that opportunity. This is easier said than done.

## Working Capital is a Distraction

All of these working capital pressures add up to a major distraction for a large proportion of companies in this revenue range. One in four respondents said working capital challenges create excessive anxiety at their companies and 68% indicate they do not feel a sense of control

lenges. For examples, the high overhead costs associated with running a Telecom business can take a substantial bite out of profits when revenues decline. "Operators have to pay to run their networks whether they are loaded with revenue-generating traffic or not," the report states.<sup>2</sup> Unfortunately, the capital required to manage cash flow during expansion can be difficult to secure, especially for smaller companies.

## The Value of a Cash Cushion

Restricted access to capital can stand in the way of growth or force an adjustment to day-to-day operations. Perhaps that is why a full 69% of the companies surveyed ranked having a strategic "cash cushion" as very important to their business. Telecom is particularly hard hit in this area: Of the 15 industries

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<sup>2</sup> International Telecommunications Union, Confronting the Financial Crisis, Feb. 2009: [http://www.itu.int/osg/csd/emerging\\_trends/crisis/fc11.html](http://www.itu.int/osg/csd/emerging_trends/crisis/fc11.html)

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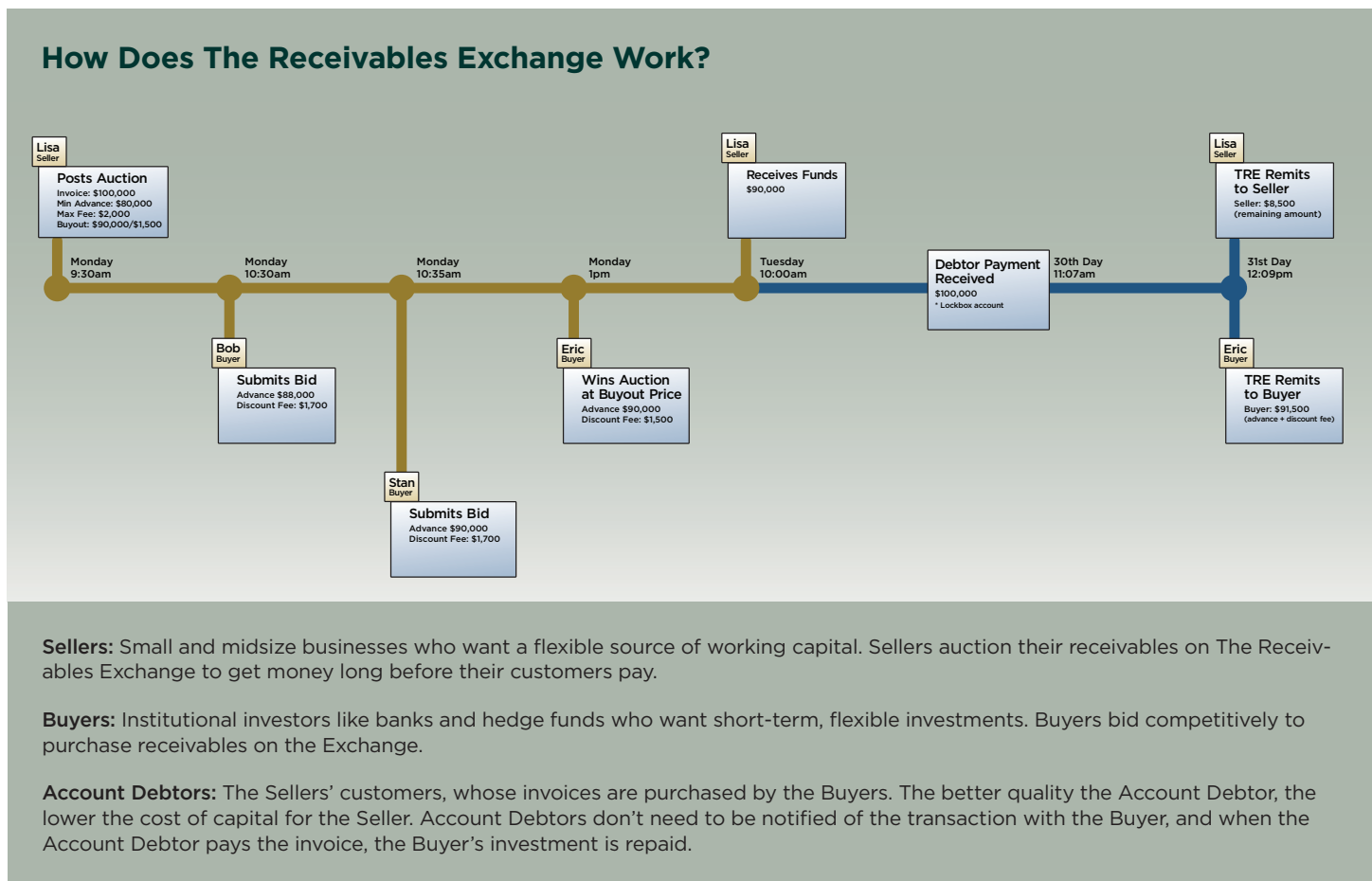
### Cash Flow Constraints in the Telecom Industry

when it comes to their company's finances. Only 1 in 4 are happy with their company's current strategic cash reserves. Even making payroll is a frequent concern for 15% of companies. In Telecom, these sentiments were even worse, with a full 20% of respondents citing making payroll as a frequent concern. While some of this is reflective of structural issues unique to Telecom, this number is startlingly high compared to industries like Transportation and Media that cited this concern at single-digit levels.

Considering the level of angst over working capital issues, it is not surprising that 57% of respondents consider cash flow a key driver of their business success and 35% of respondents spend "a lot of time" researching and educating themselves about how to best manage working capital issues. What may come as a surprise is that 40% of respondents state they do not proactively manage cash flow "in good times" and that 26% "only deal with cash flow issues when they become a problem." Harried Telecom leaders were particularly troubled in this area, with 25% stating they did not have time to "manage working capital issues in the best possible way" and 46% admitting that they did not proactively manage cash flow when times were good. Telecom companies also had the smallest number of respondents claim that they were "strategic in their approach to working capital issues."

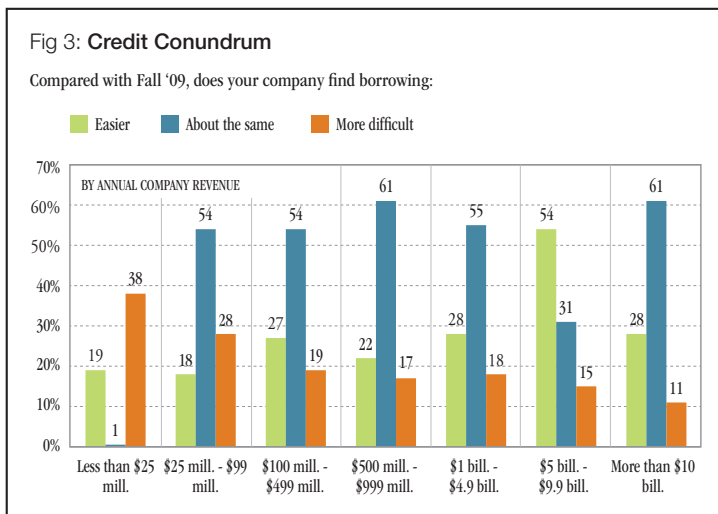
## Seeking Financial Alternatives

This desire to manage cash flow more effectively may be warranted. Until recently, most companies comfortably relied on traditional financing sources such as bank lines, asset-based lending or factoring to source working capital. But small and midsize companies are losing confidence in traditional financing



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Source: CFO Magazine, July/August 2010

pieces of business, dwarfing all other potential triggers, including balance sheet “dressing” and taking advantage of more sophisticated working capital management techniques. This is not surprising given that Telecom companies were much more likely to be growth-oriented and have a larger-than-average proportion of customers larger than themselves.

Funding overall growth was cited by a full 52% of companies in the \$2–200 million revenue range, which would seem to indicate a deeper, more systemic issue with working capital access for this group. This is in line with a recent survey by the Pepperdine Private Capital Markets Project, in which 71% of private companies said they believed they could grow their revenues, if only they had access to additional growth capital.<sup>3</sup>

The trend towards alternative financing may be driven by more than just restricted availability of traditional financing. Diversification of funding sources has traditionally not been a major issue for companies in this size range, and yet about 40% of respondents indicate they are now concerned about “putting all their eggs in one basket” with a single financing source, and a similar percentage stated that diversification of funding sources was of strategic importance to their companies. This is particularly true of Telecom, where 43% of companies indicated explicitly that diversification of funding sources was of significant importance.

However, despite tightened credit and the newfound desire for diversification, banks are still very much part of the picture. In fact, 70% of the companies surveyed had access to a bank line of credit. This number was highest in industries like Transportation and Logistics (81%), Manufacturing (78%) and Energy (76%) and lowest in Healthcare and Education (both 61%). Banks were reported as fast, efficient and reputable sources of working capital, and industries that had a high affinity for lines of credit cited strong ongoing personal relationships with their banks. Telecom in particular had the highest affinity for bank lines of credit, with one of every two companies indicating it was the single best source of working capital. But Telecom companies also cited friction with obtaining lines of credit because of a fairly high incidence of customer concentration. In fact, 20% of Telecom companies said it was difficult to get financing because they had a small number of large customers.

as access to capital has become more restricted (Fig. 3). In fact, 1 in 3 companies studied believe small and midsize companies are increasingly blocked out of traditional financing sources that are now open only to very large companies. One in three also state that they themselves have been forced by the current economic situation to consider alternative forms of financing they had not previously considered. Telecom in particular has been driven to find alternative forms of financing, with 43% indicating traditional sources had proved inadequate.

When asked specifically what events would be most likely to trigger their company to seek new financing, project finance (i.e., funding a major piece of new business) and disruptive events (examples cited included bank cutting line of credit, sudden expense and major customer extending terms) were at the top of the list (Fig. 4). Telecom companies were especially concerned about funding both overall growth and specific new



Source: The Receivables Exchange Working Capital Research Group, 2010

<sup>3</sup> Pepperdine Capital Markets Project, July 2010: <http://bschool.pepperdine.edu/newsroom/index.php/2010/07/private-business-owners-have-solid-growth-strategy/>

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“Banks are a key source of working capital for a large number of companies, but tightening in credit markets has led many companies to augment their lines with complimentary sources of liquidity.”

In addition to their line of credit. As Siegel puts it, “Banks are a key source of working capital for a large number of companies, but tightening in credit markets has led many companies to augment their lines with complimentary sources of liquidity.”

Given these widespread trends in the marketplace and the accompanying credit climate, both Telecom companies and the market as a whole are turning to alternate financing sources in record numbers. In fact, nearly half of Telecom companies were willing to try forms of financing they'd never used before. Alternatives that are commonly considered include:

- Widespread use of credit card float (e.g., for T&E or other business expenses)
- Directly incenting earlier payment using techniques like invoice discounting
- Taking advantage of Supply Chain Finance opportunities offered by large customers
- Sale or auction of receivables to a third party

Each of these alternatives has pros and cons based on the unique business situation of an individual company. For companies in the Telecom industry, the key factors in selecting new forms of financing were flexibility of terms (51%) and cost of capital (49%). Personal recommendations and how quickly the cash would be received were of less importance. Telecom companies also put the highest premium of any of the 15 industries on ease of use and simplicity to deploy.

## Looking to the Future

Despite persistent working capital challenges, Telecom is actually faring better than other industries during the economic downturn. This is due in large part to emerging technologies that are fueling demand for new products and services, according to a report from IT Business Edge.<sup>4</sup> “The expected turnaround is no doubt well deserved after 2009's abysmal performance due to tough macroeconomic conditions,” the report states.

However, as the industry recovers from the financial collapse, ensuring sufficient access to capital at a reasonable cost will remain a significant challenge. The prospect for these broader working capital issues resolving themselves is low. In the study, 62% of Telecom companies anticipate their working capital needs will actually increase in 2011 versus 2010. As Telecom companies continue to recover from the economic crisis, they will need to manage risk more effectively.

Even though 70% of companies surveyed had lines of credit, less than half of those companies indicated that their bank lines of credit were sufficient to cover their working capital needs, and 1 in 3 stated that they needed a financing option in

### How Has The Receivables Exchange Helped Telecom Companies?

Do you have the cash on hand to handle slow-paying customers and manage growth? The Receivables Exchange offers a flexible, affordable and fast way for Telecom businesses to secure financing almost instantly, and on their terms. It is a financial solution perfectly suited to the varied working capital challenges Telecom companies face.

Pegasus Network Services, a network communications systems provider serving Fortune 1000 companies and the world's largest hoteliers, approached The Receivables Exchange when customers began extending payment terms well beyond 30 days. Pegasus' bank was unwilling to increase the company's line of credit to compensate for the late payments, and cash flow was severely hampered as a result. On the Exchange, Pegasus was able to turn its receivables into a flexible, affordable source of capital. “We have refocused our energies on our core business, bolstering efficiencies and operations throughout and planned for future growth,” said Pegasus' owner, Brendan Cuff.

Another company, a New York based VOIP service provider that routes calls from overseas markets, uses The Receivables Exchange to pay suppliers quickly - taking advantage of discounts and boosting profit margins. The company's bank would not extend the credit it needed to cover day-to-day operations, and factoring was too expensive and restrictive. By selling on the Exchange, the company is able to shorten its cash conversion cycle, and maintain good relationships with its smaller suppliers and large Fortune 500 clients.

Whatever your company's challenges, The Receivables Exchange can help you secure the working capital you need to cover day-to-day operations and fuel growth.

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<sup>4</sup> ITBusinessEdge, February 2010: <http://www.itbusinessedge.com/cm/community/features/guestopinions/blog/telecom-companies-grab-at-two-bright-spots-after-the-onslaught-of-last-years-bad-figures/?cs=39135>

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### What They're Saying About The Receivables Exchange

"The Smartest Financing Opportunity You've Never Heard of" – *Bizmore*

"Turn unpaid invoices into cash – quickly." – *Crain's New York*

"The Receivables Exchange is an online workaround for slow-paying customers." – *Forbes*

"The Internet...has enabled the creation of a digital receivables auction in which borrowers set their terms and lenders compete to meet them." – *Crain's Chicago*

"The Receivables Exchange enables small- and medium-size companies to finance accounts receivable at...21st-century velocity." – *Institutional Investor*

"For sellers, The Receivables Exchange offers faster access to working capital, which is often critical for small businesses that have much of their cash tied up in receivables." – *American Banker*

"Suppliers Find Fast Relief in Auctions on The Receivables Exchange." – *Treasury & Risk*

"A winning online business-to-business idea." – *Institutional Investor*

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While Telecom businesses will continue to feel the impact of the crisis, they will press forward with cautious optimism and a renewed focus on risk mitigation. This means optimizing working capital efficiencies, improving cash conversion and diversifying funding sources. Managing these risks is vital, not only to short-term profitability, but also to overall financial health and long-term sustainability for small and midsize suppliers in the Telecom industry. Financing alternatives abound, including many innovative options, and smart companies have more opportunities than ever to create competitive advantage using an optimal working capital structure. ■

Fig 5: What Telecom Companies are Looking for in New Forms of Financing

Flexibility of terms	51%
Low cost	49%
Ease of use/simplicity	44%*
Reputation	44%
Speed	34%
Recommended by peers	28%

\* Second-highest rating among the 15 industries studied

Source: The Receivables Exchange Working Capital Research Group, 2010

### About The Receivables Exchange

The Receivables Exchange is a flexible, fast and affordable solution that helps companies overcome working capital challenges and take control of cash flow. Named the most innovative e-commerce company in the world for 2010 by *The Wall Street Journal*, The Exchange lets businesses sell their B2B receivables online to institutional investors in a real-time auction, and competition among Buyers lowers their cost of capital.

The Receivables Exchange is a tailor-made solution for many of the working capital challenges Telecom companies face. With the Exchange, businesses can shorten their days sales outstanding (DSO), helping them cope with extended payment terms from their customers. The Exchange lets businesses leverage the value of their receivables, where 60% of a company's annual working capital usually lies, so companies without many tangible assets can still get financing. The speed and flexibility of the Exchange can also help businesses stay nimble when disruptions occur. They can access capital in a matter of days, not weeks or months, and can use the Exchange when they want, selling as many or as few receivables as they choose.

Make an appointment today for a free cash flow consultation with an Exchange Associate and find out how The Receivables Exchange can help your business. Learn more at [www.receivablesXchange.com/seller](http://www.receivablesXchange.com/seller) or call 877-392-4952.

<sup>5</sup> American Staffing Association, July 2010: <http://www.americanstaffing.net/statistics/economic2010.cfm>