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For CIT Customers, An Uncertain Future Looms

By EMILY MALTBY

CIT Group Inc. began its final attempt to restructure this week, leaving many small-business customers with unanswered questions about their obligations and future relationship with the century-old commercial lender.

The New York company, which anticipates exiting bankruptcy before the end of year, has reassured customers that it will operate as usual while its holding company goes through reorganization. Bankruptcy experts agree that customers who have contracts or debts owed to CIT likely won't see any changes in coming months. But the real test is yet to come, when CIT emerges from Chapter 11.

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"For CIT to open the spigot again, it needs to be well-capitalized and supposedly [bankruptcy] will help the capital side," says Joseph Baldiga, a partner and head of the reorganization group at Mirick O'Connell LLP in Westborough, Mass. "We will have to wait and see if [CIT] lends or preserves the capital in order to make itself look better in terms of survivability."

CIT's pre-packaged plan is to be considered at a Dec. 8 hearing, and until then, the company says it will operate under the status quo. "We remain in constant communication with our clients," the company said in a statement. "Credit is being approved, invoices are being collected and funds are being remitted."

Still, CIT continues to turn away loan seekers and scale back its small-business lending initiatives. According the Small Business Administration, CIT's lending to small businesses plummeted 82% in fiscal 2009, which ended in September. During that period, CIT lent only $105 million in SBA-guaranteed loans to 142 businesses, compared to $575 million to 1,195 small businesses a year earlier.

As a result of CIT's pullback, former small-business customers have searched elsewhere for alternative financing for start-up and growth capital. But CIT offers another service to small businesses that can't be easily substituted: Factoring.

CIT's factoring volume fell 19% – to $8.2 billion from $10.1 billion – in the twelve months following the company's 2008 second quarter. The drop, the company said, was due to the weakened retail sector, as many CIT factoring customers are small or mid-sized vendors who sell to the retail industry.

Factoring allows vendors to collect on invoices quickly.

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Instead of sending retailers an invoice and waiting for payment, vendors can sell the invoice to a factoring company such as CIT, which will immediately pay the vendor a large percentage of the invoice and – for a fee – assume the task of collecting the owed amount. Once the retailer pays, the factoring company will send the balance to the vendor.

The retailers are often small-business owners themselves who rely heavily on the factoring system. For instance, Mickey Gee, owner of the Taylor Company Inc, has four retail stores in the Birmingham area. "Our vendors have factored accounts for 25 to 30 years through CIT," he says. Mr. Gee was not surprised to read the headlines of CIT's bankruptcy. On Monday he contacted some of his vendors to gauge their reaction. "Vendors weren't as concerned as I thought they would be, though some have set up second and third choices, like GMAC," he says. "Others think [CIT] will just get tough on who they give credit to."

Bankruptcy experts predict that if any disruption transpires, it will happen after the bankruptcy, not during. For example, if too many customers flee to competitors, CIT could re-emerge with shaky footing in the small business market, without enough business to sustain a quick recovery.

One vendor who is staying put is Howard Li, chief executive of Waitex International Inc., a New York firm with $110 million in annual revenues that manufactures, imports and distributes clothing to department stores. He started factoring with CIT 25 years ago and calls it "the best system in the world."

Mr. Li has been following CIT's financial plight for months and while he was uneasy at times, he's supportive of the bankruptcy. "I'm not nervous," he says. "I don't know the details, but I think they will come to a good solution. Otherwise, a lot of mid- and small-sized companies will have big problems."

James Beshears, a private-practice bankruptcy attorney in San Diego, says Chapter 11 is designed to make a company stronger because it demonstrates how it will pay its creditors back. CIT's bankruptcy likely won't impact existing borrowers, but the company's ability to generate new loans, during and after the bankruptcy, is still unknown, he says.

"I could see a disruption in their ability to have money long-term to lend, but I don't see it affecting existing borrowers at all," he says "Where it could hurt existing customers is ongoing factoring every month, because they may not have the funds to buy the new accounts. Cash flow is the greatest challenge in bankruptcy."

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