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Our Bank Said No. Now, What?

By: Mark Borkowski

Options exist outside of the traditional financial institutions.

Asset-based lending and other alternative finance products like purchase order financing and factoring are available when conventional financing is unattainable.

If you own a small to medium-sized business and have a need for a line of credit from $250,000 to $15 million and the bank says no, it is not the end of the journey. If your company has assets to leverage, such as accounts receivables, inventory, equipment, and real estate, an asset-based lender typically can help access capital.

Conventional sources of finance rely on the borrower's history (how long it has been in business), its overall financial health including profitability, positive cash flow, and debt service coverage. If anyone of these items does not meet the bank's criteria, then conventional financing will most likely be unavailable.

Business Cycles

All businesses go through positive and negative cycles. During a positive cycle when the business is growing, the demand for the product is overwhelming. You will have the assets, receivables, and inventory, but the bank still may not increase your line of credit because your equity base is insufficient to keep your leverage ratio within the bank covenant. Leverage is not an issue with an asset-based lender, however.

If the assets are adequate and can be appraised to determine value, an asset-based lender can provide the needed working capital. It will advance money against the value of the assets taken as collateral, thus providing the working capital needed to grow.

Now let's examine a negative business cycle. During these times your business may have just lost a major customer and your infrastructure, staffing costs, and other overhead are in place for the higher volume. You cannot shrink overhead and downsize headcount fast enough before operating losses pile up.

You now have negative EBITDA and are outside the bank's covenants. You are in what is called "special credit." Regardless of all the positive years with the bank, the relationship has soured and you are told to find financing elsewhere. Your first approach may be to seek out another bank for support.

An asset-based lender looks at your financing needs differently. More due diligence on asset values is determined before it enters into a commitment, and the liquidation values of assets are determined and an in-depth understanding of the financial position of your company is completed to understand the present circumstances. Losses and red ink are tolerated as long as the asset values cover the outstanding loans.

A great deal of emphasis is also placed on management's ability to overcome the present financial crisis and work their way back to profitability.

When financing with an asset-based lender, reporting requirements usually are more stringent than with conventional lending. Industry standards on working capital advances require a borrowing base certificate to be completed on a weekly basis as a minimum to include margin advances up to 85 percent of eligible account receivables under 90 days and up to 85 percent of eligible net orderly liquidation value (NOLV) of inventory.

In managing the cash cycle, as the borrower, you deposit all daily accounts receivables in a blocked bank account at any chartered bank in Canada. The account is controlled by the asset-based lender that sweeps this account daily and applies proceeds to your loan to keep the daily balance at its minimum.

As new invoices are generated and inventory is received, a borrowing base certificate is completed for the asset-based lender to provide cashback to you. The more rigorous reporting actually disciplines borrowers into managing their cash requirements more effectively. This most often creates a better-managed company.

The Bottom Line

In many cases, the borrower even prefers to stay with the asset-based lender at the end of the contract because the financial strength of their company is increased and the disciplined reporting allows for a more fluent business model.

About the Author

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Mark Borkowski, MBA has been helping clients in acquiring and divesting privately owned mid-market companies for more than a quarter of a century.

Mark's career as entrepreneur began when he was 29 years old with the co-founding of a manufacturing automation company based in Oakville Ontario.

Mr. Borkowski is an accomplished public speaker and author.

Mark has published over 750 articles for various industrial trade publications, newspapers and blogs in respect to mergers & acquisitions, private equity, and many other management topics.

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