



Lending relationships

CRITICAL FACTORS FOR BUSINESS SUCCESS

By Uwe Manski

How much time, effort and resources does your company devote to customer relationships? For many manufacturers and exporters, customer acquisition and satisfaction is one of the company's most significant investments.

What about lending relationships?

Despite the fact that the risk of losing a lender may have more serious consequences for the survival of a business than losing a customer, many companies simply aren't investing enough in these crucial relationships.

No matter what the prevailing economic conditions, small and mid-size manufacturers often have difficulty

securing loans at affordable rates. At the same time, they require investment capital in order to be – and stay – competitive.

Many manufacturers face several key challenges when it comes to securing loans: lack of sufficient collateral, inadequate cash flow to service debts, being considered too small or in a risky industry.

So, what's a manufacturer or exporter to do to get the capital needed survive and grow?

Research the lending market

Just as your company conducts research about prospective customers, you should identify prospective lenders who may

meet your current and future needs.

Institutional lenders such as banks and trust companies, usually offer slightly better rates for commercial loans than other types of lenders. The larger banks also offer alternatives to traditional loans such as asset-based loans and mezzanine financing. Institutional lenders, however, are more selective about borrowers, often declining loans to companies that have been in business for a short time and don't have stable earnings. These lenders typically require more collateral, lower debt-to-equity ratios, and more proof of business success than others.

Asset-based lenders will fund businesses that are considered too risky by

traditional banks. They secure loans by taking a first priority security interest in a company's accounts receivables, inventory, equipment, and/or real estate. They generally charge more interest and have higher fees than banks. These lenders also have more stringent reporting requirements since their lending model is based on understanding their collateral – the more comfort they have about a borrower's collateral, the more willing they are to advance higher amounts.

Venture capital lenders invest in early stage fast-growth companies in return for some equity. For start-up businesses, venture capital is often the only type of financing available.

Strategic investors such as suppliers, customers and competitors can be a source of financing, risk sharing and growth opportunities. Often, when a smaller company is struggling, these investors are the best solution because they have a stake in the company and understand the industry.

Know what each lender requires from you as a prospective borrower

Each lender has its own assessment criteria and it's important to know these. If you have ambitious growth plans for your company, for example, you are more likely to persuade an equity investor to provide financing. A bank, on the other hand, is a conservative lender looking for stable growth, earnings, and security.

Eliminate "red flags"

Along with evaluating a company's fit with its lending criteria, prospective lenders will also be alert for "red flags" that may signal high risk.

Accounts receivable

Old receivables signal possible issues related to product quality, customer disputes or other collection problems – none of which lenders wish to deal with. As well, lenders don't like to see complex customer programs and the right to return goods. Thus, it's important for a company to clean up accounts receivable.

Obsolescent inventory

Lenders will assess inventory for obsolescence and will analyze how you value and write off inventory. A perpetual inventory system is a necessity; without one, many lenders may choose to pass on providing financing.

Customer concentration

Lenders don't like to see a company that is highly dependent on a few customers, especially in industries such as automotive. If more than 25 per cent of your sales are concentrated on one account, available advances against these accounts may be capped. Lenders are concerned that suppliers can be replaced and lines may be discontinued.

Low capitalization

Lenders are important stakeholders in the businesses they support and want to see a healthy level of capitalization. Should borrowers experience several slow months, they want to be confident that covenants won't be breached. Owner-managers often have high earnings expectations, and can strip a company of its working capital. Before taking cash from the company, it's important to know how your bank will react and to review your lending covenants.

Move to larger premises

A move is a high-risk venture for any company, as you will operate at a higher level of costs, yet may lose staff and customers and potentially incur significant losses. Before deciding to move, explore other options such as renting additional warehousing, running another shift or evaluating your customer base to determine whether you can eliminate non-profitable accounts. If you require financing to support a move, you will need a strong case before a lender will finance the costs.

Make a good first impression

First impressions are critical; lenders expect timely and comprehensive reporting on how their funds are being used. Thus, when approaching any lender, along with your business plan, be prepared with timely, comprehensive information, including the following:

- five years of financial statements,
- current interim statements,
- description of accounting system,
- tax returns for the previous three years,
- cash flow projections (for more than one year),
- detailed aged accounts receivable and payable listings,
- current inventory listing,
- recent valuations on building or equipment,
- details of key contracts,
- current insurance,
- list of customers with commentary on each dealing with future prospects, programs, payment terms, risks, etc
- current business plan, and
- organization chart with profiles of key executives.

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Plan long term and continually look for financing

Financing should be a regular discussion among the members of your management team. Since it will take many months to get a new banking relationship underway, you need to know your options and the steps needed to ensure that your business qualifies for funding.

Consult with professionals who deal with lenders every day. If there isn't an appropriate person in your company, seek external assistance. An advisor, who is knowledgeable about and has established relationships with lenders, can help you identify the appropriate sources of capital and help you approach them properly.

If you find that you are not being well received by a variety of lenders, it may be time to take more aggressive steps to make your business more attractive. In such cases, it's worthwhile to consult with restructuring professionals who can conduct an objective assessment, identify key problems and advise of optimal solutions, such as strengthening the business, securing bridge financing, or exploring strategic options such as a merger, acquisition, sale of assets, or a formal restructuring.

When it comes to ensuring that your manufacturing or exporting company thrives and grows, it's vital to keep your lending relationships as healthy as your customer relationships.

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