Alternative and Non-Bank Financing: Don't Be Afraid!

By Tom Klausen

The good news is that, despite the tight credit environment, there are many alternative and non-bank financing options available to companies that need a cash infusion, whether it's to beef up working capital or help facilitate growth.

However, the bad news is that business owners often shy away from non-bank financing because they don't understand it. Most owners simply rely on their banker for financial information and many bankers (not surprisingly) have only limited experience with options beyond those offered by the bank.

To help ease some of the fear that owners often have of alternative financing, here is a description of the most common types of non-bank financing. There are many struggling businesses out there today that could benefit from one of these alternative financing options:

Full-Service Factoring: If a business has financial challenges, full-service factoring is a good solution. The business sells its outstanding receivables on an ongoing basis to a commercial finance company (also referred to as a factoring company) at a discount—typically between 2-4 percent—and then the factoring company manages the receivable until it is paid. It is a great alternative when a traditional line of credit is simply not available. There are a number of variables to a program, including full recourse, non-recourse, notification and non-notification.

Spot Factoring: Here, a business can sell just one of its invoices to a factoring company without any commitment to minimum volumes or terms. It sounds like a good solution but it should be used sparingly. Spot factoring is typically more expensive than full-service factoring (in the 5-8 percent discount range) and usually requires extensive controls. In most cases, it does not solve the underlying lack of working capital issue.

Accounts Receivable (A/R) Financing: A/R financing is an ideal solution for companies that are not yet bankable but have good financial statements and need more money than a traditional lender will provide. The business must submit all of its invoices through to the A/R finance company and pay a collateral management fee of about 1-2 percent to have them professionally managed. A borrowing base is calculated daily and when funds are requested an interest rate of Prime plus 1 to 5 points is applied. If and when the company becomes bankable, it is a fairly easy transition to a traditional bank line of credit.

Asset-Based Lending (ABL): This is a facility secured by all the assets of a company, including A/R, equipment, real estate and inventory. It's a good alternative for companies with the right mix of assets and a need for at least $1 million. The business continues to manage and collect

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its own receivables but submits an aging report each month to the ABL company, which will review and periodically audit the reports. Fees and interest make this product more expensive than traditional bank financing, but in many cases it provides access to more capital. In the right situation, this can be a very fair trade-off.

Purchase Order (PO) Financing: Ideal for a business that has a purchase order(s) but lacks the supplier credit needed to fill it. The business must be able to demonstrate a history of completing orders, and the account debtor placing the order must be financially strong. In most cases, a PO finance company requires the involvement of a factor or asset-based lender in the transaction. PO financing is a high-risk kind of financing, so the costs are usually very high and the due diligence required is quite intense.

The message I am trying to convey is simply that "financially challenged" business owners should not be afraid to consider alternative or non-bank financing options. It's a fairly simple matter to learn what they are, how much they cost and how they work. Alternative financing is a much better option than facing the challenges of growth or turnaround alone. It is a known fact that the vast majority of business failures are due to a lack of working capital- but it doesn't have to be that way.

With a better understanding of these different types of non-bank financing, you'll be in a better position to decide if they might be the answer to your financing challenges.

Tom Klausen is the Senior Vice President of First Vancouver Finance (FVF), which has offices in Vancouver, BC and Toronto, ON. FVF provides creative financing solutions to small and medium-sized businesses all across Canada. Tom has worked in the alternative lending industry for more than 25 years and consults with businesses struggling to obtain traditional financing. You can reach him at TKlausen@FVF.ca or visit http://www.FVF.ca.

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