What Credit Crunch? Financing Alternatives in Today's Tough Credit Environment

By Tom Klausen

With the credit crunch in full force, many small businesses are finding it harder and harder to land a business loan. Even business lines of credit are being squeezed tighter-often yanked right out from under companies that have long established histories with financial institutions.

Fast-growth companies are especially vulnerable in the current credit environment. Those with 20 percent or higher annual growth rates can make banks nervous even during the best of times, since fast growth can knock their ratios out of whack and result in temporary periods of unprofitability.

There is hope, however, for companies in this predicament. A creative financing alternative known as asset-based lending (ABL) can be a virtual lifeline for these types of businesses. ABL is ideal for companies that can't qualify for traditional business loans due to fast growth or other extenuating (and often temporary) circumstances. Start-up firms and those with heavy seasonal inventory needs are good examples, but any company with a solid foundation and a history of success that's facing temporary financial challenges could benefit from ABL.

How It Works

ABL generally takes one of two primary forms: factoring services or accounts receivable financing.

With *factoring services*, companies sell their outstanding receivables to a commercial finance company (sometimes referred to as a "factor") at a discount that's typically between 2-5%. The amount of the discount depends on such variables as the collection risk, number of days the funds are in use, and how much of the receivable is advanced (80% is common). There are two key benefits of factoring:

***Drastically improved cash flow*—Instead of waiting 30, 60 or even 90 days or longer to receive payment, the business gets most of the accounts receivable when the invoice is generated. This reduction in the receivables lag can mean the difference between success and failure for companies operating on long cash flow cycles.**

***No more credit analysis, risk or collections*—The finance company performs credit checks on customers and analyzes credit reports to uncover bad risks and set appropriate credit limits—essentially becoming the business's full-time credit manager. It also performs all**

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the services of a full-fledged A/R department, including folding, stuffing, mailing and documenting invoices and payments in a ledgering system.

With *accounts receivable financing*, companies borrow against the value of their accounts receivable, instead of selling them to a finance company outright. Their receivables, in effect, become collateral for the business loan, with the finance company advancing funds based on a calculation of the outstanding receivables. The best candidates for accounts receivable financing are companies that can demonstrate a history of strong financial planning, that have solid financial reporting capabilities, and that don't have high customer concentrations (e.g., no more than 60% of sales to one customer).

Finding a Commercial Finance Company

When searching for an ABL lender, talk to your bank first. However, since ABL is a specialized type of lending, many banks don't do it in-house, instead referring their customers to commercial finance companies.

Be sure to check out any potential commercial finance company carefully. Find out how long they've been in business and how well capitalized they are. How many local businesses have used (or are using) them? Does the commercial finance company itself qualify for commercial banking services? Professional experience and adequate capitalization are especially crucial.

***Important*: A commercial finance company will become an integral part of your business team. Therefore, take the time for careful due diligence when selecting your partner, and enter into the relationship carefully and thoughtfully.**

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