

How to Best Position Your Company to Access Credit

Credit is the lifeblood for growing firms and for the economy overall. Three years after the global credit crisis began, small and midsize companies are still feeling the squeeze, partly due to more prudent bank credit guidelines. But the overall willingness to lend has been strengthening, and banks are eager to make loans to creditworthy borrowers. To successfully access that credit, businesses need to position themselves carefully.

This article addresses several key questions:

- How available is credit today?
- How are companies navigating the changing credit landscape?
- How can you best position your company for access to credit in this still-challenging environment?

The credit pendulum is still moving

The relatively easy access to credit that was more typical before 2008 may never return. While the highly restrictive environment of 2008 to 2009 has definitely eased, business owners and chief financial officers may have different perspectives on this swing back to equilibrium based on the size of their business. For example, well-managed midsize companies will see an increased tolerance for leverage compared with the highly cautious approach to credit that dominated 2009, and unsecured debt is just beginning to make a comeback for larger companies.

But small businesses with annual sales in the \$1 million to \$3 million range no longer have access to the easy flow of money that was available with minimal documentation four or five years ago. For these companies, leverage counts—but it can be assessed differently than it is by larger businesses, where creditworthiness is based more on cash flow leverage, expressed as debt to EBITDA (earnings before interest, taxes, depreciation and amortization).

For smaller businesses, the focus is more basic. Having a healthy debt service ratio—the ability to produce annual cash flow in excess of debt obligations—is important, as is a company's ratio of total liabilities to tangible net worth. The lower the leverage ratio, the better. Businesses that are well positioned and have managed their finances appropriately over the last few years have access to core banking options:

- **Lines of credit** — A line of credit provides flexibility; you can access credit as needed quickly and conveniently for any business purpose.
- **Equipment financing** — Whether via traditional term debt or through leasing, equipment financing can be matched to the life of the equipment, allowing you to use it without the risks of ownership.
- **Commercial mortgage financing** — A small business commercial mortgage for owner-occupied space can provide a lengthy amortization period and leverage of up to 80 percent loan-to-value.

Access to credit has tightened, but banks are eager to make loans to small and midsize companies with healthy cash flow, reasonable debt ratios and adequate collateral.

Options for small and midsize businesses

If your business doesn't qualify for traditional forms of finance, plenty of viable products and strategies remain for smaller businesses.

- **SBA: Blended lending**

While Small Business Administration (SBA) loans have existed since 1953, in recent years they have taken on a larger role in helping to stimulate small business growth and financially resuscitating many companies. There are multiple SBA products available in the market, but the majority of loans are made in the SBA 7(a) and SBA 504 loan programs. The benefits of utilizing the SBA programs include longer terms, lower down payments, very competitive interest rates, and the ability to use loan proceeds for multiple purposes.

The SBA 504 loan is typically used to finance fixed assets, such as a building or large piece of equipment or machinery. The SBA 7(a) loan can be used for many purposes: as start-up capital or working capital for a new or young business, to purchase equipment or real estate, to finance accounts receivable or to refinance existing debt.

- **Asset based loans**

For companies that lack strong or consistent cash flow, asset based lending (ABL) could be a good alternative. It can address cash flow timing gaps associated with working capital cycles by providing immediate funds through a revolving line of credit. ABL includes flexible financing solutions that are underwritten primarily on the quality of the working assets of a company, such as inventory and accounts receivable, rather than on cash flow, which is typical of traditional business loans.

Asset based lending also tends to be more tolerant of higher leverage and has greater covenant flexibility. Potential trade-offs include higher costs associated with monitoring the working assets, and more detailed reporting.

- **Supplier financing**

Receiving financing from suppliers may be a good alternative to a bank loan if your business might have difficulty in being approved for traditional financing and to help with tight cash flow. Supplier financing may take less time and be easier to obtain, involving less paperwork and potentially attractive pricing. A key advantage is the ability to defer payment on goods and services until your business has resold them.

In order to benefit fully from potential supplier financing, it's important to pay your bills on time, maintaining good personal and business credit ratings and positive supplier relationships. However, one drawback is that financing may be revoked at any time at the discretion of the supplier.

- **Private equity**

Private equity could open the door to financing in higher-risk scenarios that banks might find less attractive. However, a private equity arrangement may invite potential conflicts over management control, depending on the objectives of the private equity stakeholders.

SBA loans are a compelling option for all types of businesses seeking growth capital and/or funds for recapitalization.

Focus on process, not just product

While the right product could make all the difference to a business in need of maintaining cash flow, good communication between business owner and banker is also important. Be ready to have an open, frank discussion with your banker. Explain your company's challenges and how the firm is positioned to meet its objectives today, in the short term, and in the more distant future.

Commercial credit products can be tailored to meet each company's specific needs. It could be the way the collateral is managed and monitored or the way liens are applied, how the covenant is structured or the way the loan's maturity is established.

That type of customization ideally comes from a relationship built on solid communication. Working closely with a trusted banker, business owners can better identify their banking needs and develop a financing package that can help the company meet its specific goals.

Help your bank to help you

How can business owners help their bank to help them? Be prepared. Start by creating a clear and communicable set of strategic goals and financial objectives. Assemble all of your pertinent financial information and bring your banker into the discussion at an early stage. Fully understanding your situation and your plans will help your bank find the right financing solutions for your business—options you may not have heard of or overlooked.

- Bring a complete set of financial statements and document your decision-making. Provide detailed supporting information. For example, document changes in the firm's revenue mix and cash flow, changes in gross margin by product, and show which products were discontinued or had major margin deterioration.
- Explain what happened, why and how. Be prepared to guide your banker through the business's challenges. Be able to explain how management anticipated and responded to those challenges, and how they are being resolved.

Better yet, be proactive. What could be more effective in preventing potential banking mishaps than to treat your banker as a partner and trusted ally? Let your banker share his or her timely insights with you and help trouble-shoot and guide you with advice and solutions as appropriate.

With the credit environment still tight — but improving — opportunities for financing exist for many small and midsize businesses. Through open communication with your banker, you can further improve access to funds you need to grow your business.

Take your business banking relationship to a higher level. When you make key decisions about the future of your firm, consider including your banker along with your tax advisor and attorney, so that you can hear the best advice on financial solutions.

