Credit Options for Small Business in Today's Economy

Q: What are the advantages of traditional versus alternative lending?

A: Generally speaking, lending is fairly simple. It's best viewed as a continuum with the components of price, liquidity, control, and sources of repayment. There are trade-offs with each of these components based on the type of traditional or alternative financing.

A traditional bank line or an alternative form, such as an asset-based loan or accounts receivable financing are all effective tools for access to working capital. The tool chosen should be the one most appropriate for a business' needs.

A traditional line of credit will generally give the borrower the lowest rate, if the business has high credit worthiness, a strong cash situation and a reasonable flow of receivables. Traditional financing is typically for small businesses that have short-term cash flow issues, seasonal purchases, or other last-minute financing needs.

Asset-based lending leverages the accounts receivable, inventory, and other assets as collateral to qualify a business for a flexible line of credit. An asset-based loan can make more funds available because it is not based strictly on the anticipated levels of cash flow, and the structure often requires fewer covenants, providing more flexibility. Underwriting is based on the financial strength of the borrower, the quality of the assets, and the credit worthiness of the business' customers.

Accounts receivable financing (also known as factoring) allows a business to gain liquidity through its invoices. Instead of waiting 30 to 90 days for an invoice to be paid, a business uses its accounts receivable (AR) as collateral for a lender to advance funds against.

It's based on the credit worthiness of the client's customer and payment ability. There are generally no financial covenants. AR lenders take on much of the debt collection, reducing the burden and expense of collecting from no-pay or slow-pay clients.

Q: Explain disadvantages of both traditional and alternative lending.

A: Companies that rely on traditional financing can be subject to a finite amount of liquidity and more constraints and risk. Traditional underwriting is typically based solely on the borrower's credit worthiness. Traditional lenders control through financial statements and audits and primarily rely on the company and owners for repayment.

Asset-based lending (ABL) interest rates are slightly higher. The fact that ABL is based on a company's current assets may not provide concessions for asset depreciation.

Accounts receivable financing is the highest priced product. The fees and discount a company must pay should be weighed against the cost to collect and loss when customers aren't paying in a timely fashion.

Q: What businesses are ideal for alternative lending?

A: Asset-based lending helps businesses that have a high percentage of current assets, have seasonal or cyclical natures, and are looking to expand their business, or need more flexible financing.

Start-up businesses, fast growth companies, businesses with minimal assets, and businesses with either bad credit or poor sales history are particularly suited for accounts receivable financing.

Q: Is there still a credit crunch and restrictive lending impacted businesses?

A: Small businesses still suffer due to tight credit markets and the stagnated economic recovery. Without sufficient financing or liquidity, many small companies haven't expanded operations, invested in new equipment, funded new research and development, hired new employees, and in many cases have laid off existing staff.

For more information regarding these types of lending programs, contact a local commercial lender, the Commercial Finance Association (**www.cfa.com**), or the International Factoring Association (**www.factoring.org**).

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