

Six Key Factors When Considering Alternative Financing

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Every small to medium-sized business (SMEs) requires financing at some point—but what happens when traditional lenders aren't in the position to help? This article discusses alternative financing solutions and offers up six key factors to consider. Factors that can save your business both time and money.

When the bank says *no*, many business owners or CFO's turn to non-traditional lenders to source their financing needs. There are many benefits to working with non-traditional lenders such as the speed of approval and funding, bespoke solutions, increased flexibility and, in many situations, consistency—meaning the individual you deal with is also the person that approves and manages the loan.

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However, it can also be a very time-consuming exercise and is often needed when the business needs are more pressing. With this in mind, here are six key factors to be aware of when considering alternative financing solutions:

1. Their cost of capital is higher which means their interest rates are higher

Non-traditional lenders don't have customer deposits to deploy as loans. Instead, they use investor capital on which they can pay between five to 15 percent or more. This cost of capital—plus operating costs and profit margin—results in non-traditional lenders interest rates being in the 12-25 percent (or more) range. So, focusing on lenders with the cheapest cost of capital is a good way to source cost-effective financing solutions.

2. Raising and lending capital is a delicate balance

Given non-traditional lenders need to raise capital from investors in order to lend, there is a delicate balance for non-traditional lenders to consider when raising capital.

If they have a surplus, they are then paying interest to investors on capital which they have not yet deployed. Conversely, they may have clients with financing needs greater than what they have raised, resulting in them needing to raise additional capital to meet demand or not close on some of the financings they have committed to already.

Therefore, having visibility on a lenders portfolio size and available capital is important when considering these types of solutions.

3. More liquidity equals more competition and new products

While the interest rates and fees being charged by non-traditional lenders are not necessarily reducing (as their cost of capital is largely fixed) the influx of non-traditional lenders into the marketplace has resulted in more competitive loan structuring and the creation of new financing solutions.

For example, in the factoring segment, many non-traditional lenders are now offering non-notification solutions with no personal guarantees, extended recourse periods and adding in other asset classes (i.e., equipment or real estate) to increase the amounts they can lend.

As you can see, options are available, it's just a matter of taking the time to meet the various lenders and identify which ones will be optimal to finance your business by asking the right questions.

4. Transaction type, sizes, and asset appetites can vary widely

Unlike traditional banks, which primarily offer term loans amortized over several years and revolving lines of credit, non-traditional lenders tend to predominately offer short term, interest only solutions. Repayment terms can range from three to 12 months. And for non-traditional lenders, the exit is a critical question to be addressed—while your business may qualify today, how are you going to repay the loan at the end of the term?

Traditional banks also generally do not have limits on how much financing they can provide, whereas non-traditional lenders could have limits on both the minimum amount and the maximum amount they will lend.

Traditional lenders generally need to be in first place with respect to their liens or charges, whereas depending on the underlying collateral values, non-traditional lenders can sit behind a traditional bank in a second lien or charge position.

5. They typically lend against the orderly or forced liquidation values of assets

The majority (but not all) of non-traditional lenders are asset-based lenders (ABL), meaning they typically lend against hard collateral. This can include assets such as accounts receivable, inventory, machinery & equipment, real estate, and more.

Unlike more traditional lenders that lend against the market value of assets, ABL lenders lend against either the orderly or forced liquidation value of these asset classes.

It is also important to note that while the business may have lots of collateral to support a loan, the business must be able to cover the costs of the higher interest rates and related costs.

6. Credit approvals and transaction appetite can still be quite varied

As with traditional banks, there can be a wide range of risk appetite amongst the various non-traditional lenders. This can also segment between transaction size, industry type or asset class.

For example, we have shown an identical transaction to five different non-traditional lenders and the feedback ranged from the most conservative saying the business was not viable in its current state to the most aggressive willing to provide more financing than was initially requested.

Therefore, it's important to flush out early in the discussion their appetite for your industry, asset mix, credit scores and other factors to enable you to quickly establish if you are a *fit*.

As with many things in life knowledge is power, and having a deep understanding of the non-traditional marketplace can save significant time as well as generate real savings for your business—by knowing what costs are negotiable, who has the most competitive rates or the right financing structure for your financing needs.

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