Growing Pains: How to Get Cash When Banks are Tapped Out

There are plenty of financing options available for businesses looking for working capital growth—it just requires knowing where to look. **Barbara Cowper** dives into some of the more promising financing alternatives, including selective factoring, PO financing, supply chain financing and secured term loans.

It's every business's greatest fear—not being able to capitalize on opportunities due to a lack of working capital. We've all heard the stories; not enough cash for raw materials or inventory, large back orders along with anxious vendors and customers. If you're a rapidly growing company, how do you get over these hurdles when you don't have the capital to support your growth?

Fast growing businesses pose a dilemma for institutional lenders like banks. Growth signals commercial success and banks value the opportunity to partner with businesses that show real promise. However, fast growth comes with greater risks to banks as well—particularly where the need to finance working capital requirements expands rapidly. That can leave the company short on the funding needed to build inventory or source product from suppliers.

The answer? Supplement borrowing with less traditional sources of capital that allow the borrower to realize its full potential, while still maintaining the bank relationship.

There are plenty of options available—it just requires knowing where to look. Some of the more promising alternatives include selective factoring, PO financing, supply chain financing and secured term loans. Let's diver deeper into each option.

1. Selective factoring:

Sometimes banks will allow a young business to carve out a specific large customer, especially if that customer is new for the business, from the bank’s working capital facility. By factoring that one customer, immediate payment of most of the invoiced amount due (usually 85% – 90%) can be funded. With immediate payment, working capital is available to buy more raw materials or products, to supply other customers.

A recent client had a small janitorial business that was well supported by their bank with a line of credit. When the company had the good fortune to secure a large national chain customer, the bank allowed the new customer to be carved out of the company’s receivables so that the invoices could be factored and the company was able to obtain the needed funds on an immediate basis to meet its larger payroll on a weekly basis.

2. PO financing:

There are lenders who will provide up to 100% of the funds required to pay your suppliers directly for finished products. Once paid by the lender, suppliers will release and ship the finished product so that the borrower can ship directly to its customers or to its own warehouse for re-packing and shipping to customers. The PO lender is paid when the customer is invoiced for the product: either using the margined line of credit or through a factoring facility.

Another client was a distributor of bedding to large national home product retailers. The challenge came when the client secured large orders from a US retailer which, in turn, required substantial additional purchases from their suppliers. A PO lender was able to provide the required financing to buy the product, recognizing that our client would be shipping to their warehouse for immediate re-packaging and shipment out to the US retailer. The lender gained comfort from the fact that our client had non-cancellable PO’s from their customer and was shipping immediately to that customer.

3. Supply chain financing:

Lenders who provide supply chain financing will pay suppliers on a company’s behalf so that it has the raw materials needed to manufacture its products. Typically supply chain financing is unsecured by the company’s assets, relying instead on the strength of the supplier to provide assurances to the lender.

Our client was a high fashion dress designer and manufacturer with retail customers across North America. They needed more financing to purchase material and sewing notions as they gave their customers long payment terms because of the custom-made nature of the dresses. A supply chain lender was able to provide them an unsecured line of credit with funds paid directly to their suppliers upon our client’s request and approval. Suppliers were happy as they were paid within the required terms and our client was able to purchase the required materials to reduce their back orders significantly.

4. Secured term loans:

If the company or owner has tangible assets that are unencumbered or partially encumbered, there are often non-traditional lenders that will take a first or second security position on the assets and provide an interest-only short-term loan (one to two years) that can be paid off when the company has more available cash.

Our client was a distributor and the owner had a recreational property with a small mortgage on it. A second mortgage was obtained from a non-traditional lender, secured by the property, which provided the necessary funds to make a large purchase of inventory so that our client could support their customers' seasonal demands.

Mix and match financing

Each of these solutions can stand on its own, but it can also work in conjunction with traditional financing, enabling the fast growing company to maintain a valued relationship with its bank. And banks are often pleased to have a partner in financing young companies, providing additional support until the business is sufficiently established to access traditional lending sources for all of its needs.

The growth phase is an exciting time for business owners and opportunities for expansion need to be bolstered with the necessary funding. The trick is to tap supplemental financing sources that can facilitate growth and get young businesses over the hump, while preserving valuable long-term relationships with traditional lenders.

Recommended for you:

Financing options for Canadian SMEs are more abundant than you think. Learn more.