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Two Things to Consider When Your Bank Wants Out and You Are Considering Refinancing Options

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Over the past few years, I have met with a number of businesses that were experiencing cash flow issues. This is a tough reality that almost all businesses face at some point in their life cycle.

In the majority of cases, while their core business was viable, their traditional bank was looking to exit the relationship. Many of these businesses were going through a turnaround, reorganization, or informal restructuring and their banks were experiencing a certain level of lender fatigue.

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For many of the businesses I visited, there were alternative refinancing options available albeit they were more expensive. These non-traditional lending options (ABL, factoring, bridge financing, etc.) are designed to be used as a short-term (12 to 18 months) solution a bridge to help the business through its journey to being ready to graduate back to traditional banking.

A few of the businesses with whom I met believed the costs of non-traditional financing were too onerous and some did not want to incur the cost of using an advisor (notwithstanding many are success-fee based). Others were exploring equity options.

For some of the businesses, things did not end well. A few went into receivership, others into bankruptcy protection, and a few simply closed their doors.

These experiences brought me to the following realization. If the need for refinancing is so pressing, then there are really two primary questions to be addressed:

1. Do business owners have availability or access to new financing?
2. How do the incremental costs of refinancing compare to the costs of not refinancing?

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Availability or access to financing

Many business owners were completely tapped out personally and could not invest any additional shareholder advances. Those looking for an equity partner, which in concept seemed feasible, were faced with the difficulty of trying to source a suitable investor within the available timelines, one that was comfortable with the turnaround plan being executed and that would be the right fit culturally all at a time when the business was under stress.

On the other hand, non-traditional lenders generally have the capital ready to deploy. If the company "ticks the boxes" (see my article: 3 Key Things All Asset-based Lenders Look for When Approving a Loan), the business can be funded 8 to 12 weeks from application.

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Incremental costs of refinancing versus cost of not refinancing

While business owners often experience sticker shock when they consider the costs of refinancing, they often forget to consider the costs of not refinancing and the negative impact of having very limited availability of cash flow to operate their business. One should compare the incremental cost (i.e., the difference between the cost of non-traditional versus traditional bank financing) of a non-traditional solution to the costs or impact on the business of not having access to the required financing. These costs can include:

- Supplier delays - inability to pay for goods can result in production delays or suppliers adding on late payment fees;
- Customer losses - lack of inventory to fulfill sales orders can result in customers charging penalties for late shipments or failure to ship or even in some circumstance the loss of the customer;
- Landlord - some may fall behind with their rent thereby exposing their business to either a landlord lease termination or distraint;
- Government obligations (HST, payroll taxes) - many let their government obligations (for which there could be personal liability as directors and officers) get into arrears which also triggers interest and penalty charges; and,
- Loss of key employees - some key employees may see the writing on the wall and decide to move on if they perceive the business is not going to survive.

And while there are often additional out-of-pocket costs associated with sourcing a non-traditional financing solution, such as advisors, legal, appraisal, and other ancillary costs, there are also a number of costs to bringing on an equity partner, such as advisors, legal fees for shareholder agreements, tax advice, and business valuation costs. Not to mention, the cost of any equity given up by the owner to a new investor.

One should also remember that it does not have to be an "either or scenario." Non-traditional bridge financing can be used to buy time so that the business owner can find the right partner instead of "getting married" under duress.

In conclusion, if the need for cash is immediate and the impact of not refinancing would result in material costs being incurred or even the bank pushing the company into receivership or bankruptcy, then considering a non-traditional refinancing option (while expensive in the short run), could help the business survive and live to fight another day!

Isaacs Advisory are experts at sourcing financing solutions for small to medium-sized businesses with financing needs of $100K to $1Million. We work with a wide array of traditional and non-traditional lenders across Canada to source and structure financing solutions to meet our clients unique financing. For more information, please contact Adrian Isaacs at (416) 835-4511 or aisaacs@isaacsadvisory.ca.