Exploratory Note 12

Commercial Banks and Other Asset-Based Lenders

**INTRODUCTION**

For aggressive entrepreneurs who want to grow their businesses while holding onto as much ownership and control as possible, debt sources are critical. Commercial banks and other asset-based lenders provide an array of financing options which can oftentimes be tailored to the unique needs, timeframes, and balance sheets of entrepreneurial ventures.

**COMMERCIAL BANKS**

Commercial banks are a significant source of debt financing for firms both public and private; however, whether due to regulation, other factors, or some combination, banks tend to be quite conservative in their lending habits—this having been said, banks do lend to startups and fast-growing private businesses.

***Commercial Bank Loan Types***

Commercial banks offer a wide range of financing arrangements, but most qualify as either a line of credit or a term loan.

What is a line of credit?

What is a term loan?

What does a bank look for to support a loan? What roles do cash flow and collateral play?

What types of collateral are oftentimes preferred by banks? In the event of default, how much protection does collateral offer to the lender?

***Personal Guarantees***

Banks typically require personal guarantees on loans. Who can tell me about these? Why do banks demand them?

Even if unavoidable, can personal guarantees be structured so as to be less wide-reaching? If so, how?

How strong are personal guarantees in general?

***Banking Relationships***

Banking is a relationship-centric business for all parties. What do banks look for in prospective borrowers?

What should be of particular concern to borrowers?

Of course, banking operations are not carried out in a static environment. What are the implications for the entrepreneur? Should new banking relationships be constantly cultivated?

**ALTERNATIVE ASSET-BASED OPTIONS**

Commercial banks do not have a stranglehold over small business lending. In fact, an array of asset-based financial services firms exist to supply entrepreneurs with both working and investment capital through different asset-backed options (some of which are offered by commercial banks as well).

***Accounts Receivable and Inventory Financing***

In traditional accounts receivable (A/R) financing, the lender, which may be an asset-based lender, commercial finance company, or commercial bank, advances funds to a client against a line of credit (LOC) based on a percentage of eligible outstanding receivables. How is the eligibility of A/R determined?

Factoring of accounts receivable is similar, but works a little differently. What is it and how does it work? Is factoring a cheap financing source?

What is the difference between recourse and non-recourse factoring?

Inventory is not as liquid as accounts receivable; however, it also serves as a fairly solid source of collateral for asset-backed lines of credit.

***Purchase Order (PO) Financing***

For firms that produce products, purchase order financing can be very useful as a source of capital. How does purchase order financing work?

***CAPEX Lines of Credit***

Some businesses require more capital expenditure (CAPEX) than others. What are some examples of CAPEX?

Preapproved CAPEX lines of credit are common for CAPEX-heavy firms. How do they work?

***Sale and Leaseback Financing***

What is a sale and leaseback? What are the benefits?

What are the potential pitfalls?

**CONCLUSIONS**

Many individuals are scared of taking on debt. To an extent, this is understandable; however, in a business environment, debt is critically important—especially as a firm begins to scale.