The Hidden Truth: Financing Options for Canadian SMEs

While the lending market is changing—and financing options are more plentiful for Canadian SMEs in need of capital—finding the right option can be challenging. Many solutions require a mix-and-match approach. Glenn Bowman explains how with a little creativity, and knowledge of the market, virtually anything is possible.

Every lender wants to help their small and medium-sized business clients access the financing they need. Too often, however, this is easier said than done. Over 80,000 creditworthy small and medium enterprises (SMEs) in Canada face a shortage of efficient debt capital. In a BDC survey* on financing and growth, businesses cite that the main challenges facing them are financial. Further, their biggest opportunities are growth, innovation, and international expansion, however lack of access to working capital, capital for growth, tangible and intangible assets are preventing them.

Fortunately, a wide range of new lending options have become available, significantly expanding on the more conventional financing options. Over the last decade, capital markets have seen a tremendous boost in liquidity with investment capital looking for greater returns than those offered by conventional equity and bond markets. This has resulted in an influx of alternative lenders who seek higher returns for their investors by lending to commercial businesses. These lending products are typically more flexible than those offered by traditional lenders. Because of this, there’s now a financing solution for a multitude of SMEs with viable business propositions, albeit finding them is not always an easy task and the solution is frequently more expensive. The challenge for lenders, accountants, and advisors is to educate themselves on this swiftly-evolving landscape, so they can help their clients find the financing solution that best fits their situation.

Places to turn

While financing obstacles still exist, the good news is that—with a little creativity—they can often be resolved. Given that lenders are introducing new, and frequently more flexible options all the time, chances are that financing is available to suit many commercial businesses.

Banks, for instance, have specialty lending programs with criteria that are more than their mainstream commercial lending programs. These programs can be innovative and include cash flow lending without tangible collateral coverage, knowledge-based industry financing, retail financing, and specialty services financing.

If credit can't be found through a traditional bank, Federal government-sponsored lenders also have unique specialty programs that finance everything from growth companies and innovators, to food and beverage companies, to small entrepreneurs with higher risk profiles—to provide a few examples.

Beyond these options lies an alternative lending space which is comprised of non-traditional lenders—including privately-owned independent finance companies, investment limited partnerships, investment funds with private debt mandates, and subsidiaries of foreign financial institutions. Because these entities aren't confined by the Office of the Superintendent of Financial Institutions (OSFI) regulatory requirements, they have freer rein to define their unique risk parameters and create very targeted lending solutions for SMEs in need of capital.

Navigating the alternatives

Given the pace at which the non-traditional lending landscape is expanding, it can be challenging to stay on top of all the different types of lenders and products that may be suitable for a company. Fortunately, the market has reached a point where, if you need a specific financing option, it likely exists.

The key is to think outside the box and not rely solely on one type of loan or provider. By combining the capabilities of various lenders, it's possible to structure customized financing for companies at every stage of the cycle—from start-up to growth to those facing a business slump. Consider these examples:

- **asset-based financing –** this type of financing uses virtually any type of asset as collateral—including accounts receivable, inventory, equipment, and real estate.

  example: A business client needed access to additional capital and wanted to refinance its properties to get it. Its assets included three urban residential properties and one rural commercial property. The problem? The client required a very high loan-to-value, which made the company a problematic candidate for even non-traditional real estate lenders. Fortunately, an asset-based lender with expertise in rural and urban properties, and plant equipment was willing to finance the client's properties, along with the commercial property's associated equipment to get the deal done.

- **working capital financing –** this type of financing is short-term and is used to fund a company's day-to-day operational needs, rather than long-term investments or assets. It typically includes factoring, purchase order financing, and supplier financing.

example: A law firm was looking for a larger-than-average stretch loan and wanted to temporarily finance its receivables to get it. Traditional working capital financing couldn't accommodate the firm's need. However, the law firm handled insurance claims for clients—so when the insurance company made a settlement offer to the firm's clients, a settlement receivable became an eventuality. A lender was willing to margin against the insurance company's offer to the client (i.e., pre-settlement and pre-receivable)—knowing that, when the settlement was complete, the loan advance would be repaid.

- **real estate financing –** providing a mortgage financing that falls outside of a traditional lender's ideal parameters. This can include rural properties, vacant land, or commercial-residential properties.

  example: A client needed a mortgage for a property that included three different specialty retail businesses, vacant development land, and a commercial strip plaza—in a smaller suburban setting. Typically, each of these businesses would require its own type of financing and would not be considered straightforward. But a non-schedule 'A' lender was willing to look at each of these asymmetrical elements as a package and provide financing at greater than 70% loan-to-value.

- **venture financing –** venture financing is provided to help early-stage companies achieve rapid growth. It can include financing for contracts, innovation and intellectual property, and turnaround.

  example: A business client had negative earnings before interest, tax, depreciation, and amortization (EBITDA) and had been losing money for two years. On the plus side, they were on the cusp of signing a big client for a new product. While there was still almost six months of product development to go, the client order was virtually inevitable. Revenues would increase exponentially. Ultimately, a lender was willing to look past the company's recent losses and see the near-term future potential and get comfortable with the company's ability to deliver on its new product.

The future is bright

While the lending market is changing—and financing options are more plentiful for Canadian SMEs in need of capital—finding the right option is still very challenging. Many solutions require a mix-and-match approach, and lenders' appetites and product offerings constantly evolve. That said, with a little creativity, and knowledge of the market, virtually anything is possible.

Source: BDC
2015 SMEs and Growth: Challenges and Winning Strategies
2018 Needs and Potential Solutions Survey

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