Retail: How Lenders are Overcoming the Fear

Article | October 16, 2018

The world of retail can be scary—especially from a lender's perspective. Recently, many well-known retailers have closed-up shop and many more continue to struggle. Even before the current environment, lenders have historically struggled to finance retailers. However, a surprising number of financing options have become available from both traditional and non-traditional lenders.

Canadian lenders have traditionally had a tough time financing retail businesses, and with good reason. From a macro perspective, business failure rates are higher than average and generally rank amongst the five highest by industry sector (source: Office of the Superintendent of Bankruptcy Canada, 2014). The industry is prone to ever-changing consumer trends and competitors that can emerge rapidly.

AUTHOR

Glenn Bowman
Senior Managing Director

In terms of assets to lend against, retailers typically have cash orders (i.e., no receivables), high inventory turnover that is prone to customer returns, and little in the way of tangible assets (e.g., equipment, property, etc.) to pledge as collateral. Not appealing parameters through the lens of a typical lender.

For these reasons and historical experience, few industries have historically spooked lenders more than retail.

However, times are changing, and a surprising number of options have become available. To properly advise businesses, finance professionals need to be aware that retail customers have many more options when facing a challenging financing need.

In recent years, there has been a shift in the lending marketplace. Traditional and non-traditional lenders are making a concerted effort to better understand the retail industry, and more specifically, find ways to provide working capital financing.

Favouring revenues and earnings over balance sheet assets

Several non-traditional lenders have stepped into the market to focus on retail. The solutions are creative, but also somewhat expensive. Typically, interest rates are in excess of 20% per annum, but can provide critical working capital to a growing business and therefore make a viable solution. This type of financing can be tied to prior months sales levels, with loans repaid daily over a three to 12-month period.

The advantage of going the non-traditional route is that there is less emphasis on the company's historical profitability and instead focuses on the monthly sales volumes. This means that early-stage businesses can qualify more readily than with traditional financing. These solutions can work with a traditional operating loan facility and offer flexibility for a growing retailer.

Likewise, many traditional banks have set up teams that specialize in the retail space and have a greater understanding of their customer's financing requirements. In the past, a government guaranteed term loan was one of the few options that traditional banks could offer.

A recent client situation provides an excellent example. A rapidly expanding independent retailer with online and bricks and mortar sales, required working capital to purchase inventory to keep up with demand. In the past, the client had used high-interest rate (i.e., sub-prime) term loans together with shareholder injections to support business growth. With a history of strong cash flow and profitability, the client was looking for a long-term lending solution at a traditional bank that could also meet the growing needs of the business.

As part of management's growth plan, they established an online store to sell products offered in only a handful of physical stores. As the online business rapidly outstripped the combined sales from their existing bricks and mortar stores, the business simply couldn't keep up with demand. Outside of the inventory on hand, there were no traditionally lendable assets that could be provided as security to the bank.

A common issue throughout the retail industry, management was faced with the option of borrowing funds at a high-interest rate or delaying growth until the company retained the necessary working capital to support expansion.

Traditional banks were approached, and the client received mixed feedback. Five lenders believed that additional financing was warranted, but only two could propose a structure acceptable to the client. The initial client request was a $750,000 line of credit. Offers from the banks ranged from $200,000 to $850,000. Lenders with dedicated retail industry teams were able to understand the need and provide the best offer(s). The approved facilities were a $500,000 operating line of credit (LOC) and a $350,000 term loan.

In the end, the traditional lender was able to meet the client's two primary objectives:

- a facility that can support future growth and expansion opportunities

- saving the client in excess of $50,000 in interest costs in the first year

The key takeaway for financing professionals and business owners is that there are more financing options available than retailers may realize, and the focus criteria of these options are different than has been the case historically. There are creative working capital loans available with non-traditional lenders, but there are also traditional lenders that are dedicating resources to understand, and lend, working capital to small and medium-sized businesses in the retail industry. Increasingly, these lenders are willing to consider a broad range of factors, other than traditional balance sheet assets, to provide loans for businesses.

Want to free up cash flow?

You should start with your debt structure. Learn more.