The Move Towards Asset Based Lending –

is the UK going the way of the States?

Global Analysis

Martin Fagan evaluates the US asset based lending market and contrasts it with the UK domestic market. Is there an argument for lenders to go towards asset based lending in the UK?

"The cheque's in the post" is one of the three universal false promises made by scoundrels to optimists ("Of course I love you" being the second; the third is unprintable). When he was President of the Board of Trade in the early 1990s, Michael Heseltine caused a furore when he let slip that, as a young businessman, he only ever paid his suppliers and creditors when the red bill landed on his desk, even when he had the cash in the bank to pay them earlier. It was, he maintained, sound business practice to keep hold of your own cash, but be ferocious and unforgiving when it came to collecting cash you were owed.

For the business awaiting the payment of an outstanding invoice, popular myth has it that you can swan around your debtor's premises and hit them repeatedly with a fence post until they cough up the dough they owe you. This may have worked for the Kray Twins, but is unlikely to work for you. These days, more modern - and more financially sophisticated - options are available to businesses looking to increase their cash flow.

The obvious option is factoring but businesses looking for not only advance payment on invoices but also more flexibility on how they engineer their cash flow-based finances are looking to the USA and Asset Backed Lending, or ABL for short.

The Asset Based Lending industry in the United States is a $500 billion a year business, in terms of aggregate loans outstanding (based on data for the year ended 2006). According to the Commercial Finance Association (CFA), the US trade association, in 2006, the asset based lending industry grew 16.5 per cent.

"In the USA, the ABL industry is much larger than the factoring industry," says Mark Mandula, Principal at United Capital Funding Corp, which currently provides only factoring. "In the United States, ABL constitutes $500 billion of loans outstanding, compared to the factoring industry, which had a total of $127 billion in volume for the year 2006. ABL is a huge industry; the Northeast United States is the largest region in terms of ABL outstandings, with 27 per cent of the total, but what we call the 'rust belt states' such as Illinois, Ohio and Pennsylvania were among the largest asset based lending markets. In 2006, the retailing, steel, food, finance and automotive industries represented nearly 30 per cent of the total ABL outstanding."

David M. DiPiero, chairman and chief executive officer of FGI Finance, a leading global commercial finance company, believes that the most readily identifiable advantage of asset-based lending over factoring is that asset-based lending facilities typically include inventory and equipment - in addition to accounts receivable - as part of the eligible collateral base of a financing facility or loan. "In theory, therefore, an organization can access a greater amount of capital given the same level of assets - inventory, equipment, accounts receivable - if they were offered a typical asset-based loan versus a typical factoring facility," says DiPiero. "It must be noted, however, that it is not entirely uncommon for a factor to also offer over-advances or ancillary facilities to include assets other than accounts receivable."

As with many things that start in the USA, we eventually get them over here in the UK and ABL is no different. Richard Whitehouse, head of operations at Davenham Trade Finance, believes ABL offers UK businesses a real alternative to factoring. "Comparing the two, I don't think you're comparing like with like," says Whitehouse. "Factoring and invoice discounting are cash advances on advanced receivables like invoices. What ABL enables you to do is to leverage capital on all the assets on a balance sheet. Ten years ago, a company would have used a combination of factoring, loans and overdrafts; ABL gives a company the opportunity to plan ahead."

Whitehouse says ABL gives a business the ability to raise more cash in a more flexible way for what he calls "a negligible uplift in cost." It also has advantages for the lender, too. "It gives the lender far greater capability to help the company it's lending to develop, so it can work in partnership with the management to further the business."

David M. DiPiero, believes companies in the UK should consider accessing asset-based loans for much of the same reasons that some organizations in the US desire such facilities – to maximize liquidity based on available assets. "And the more assets that are eligible for inclusion in an asset-based facility, the greater the liquidity available," **says DiPiero.** "With that said, however, the relevant legal structure must be in place to facilitate a lender's ability to secure the assets that are to be considered for eligibility or inclusion in an asset-based loan."

According to John Jenkins, CEO of GE Commercial Finance, the legal structure is in place in the UK. "The only legal aspect that is deemed problematic is something called Retention of Title over Inventory, which is not something they have in the US," says Jenkins. "This covers who actually owns the physical assets in a company's inventory that has been used as collateral. But the law is clear on this aspect. It's less clear in the rest of Europe where ABL is more problematic because the legislative framework isn't there to support it. But there are no legal problems in the UK."

And, legal framework notwithstanding, there's the rub: ABL does have advantages over factoring, but might not be suitable for every company. "Factoring is a purchase of valid Commercial Accounts Receivables, not a loan; an Asset Based loan is just that - a loan," says Mark Mandula. "The obvious advantages of an ABL loan over factoring would be that the cost is usually lower; as it's based on assets on the balance sheet on not invoices, more collateral is available for leverage and more of the larger financial institutions are involved in it. The disadvantages are that it is a loan, not a purchase; extensive monitoring is usually required from the lender and there could be significant up front costs in the shape of fees and so on."

John Jenkins says the ABL industry in the UK has "grown significantly over the last two to three years" with larger businesses turning to ABL to raise finance. "We've definitely followed the US, although the deals aren't yet as big. In the US it's not unusual to see ABL deals of the $1 billion mark."

Mark Mandula says all the major Bank and non-bank firms are in the Asset Based Lending industry in the United States, but that the factoring industry is made up of primarily independent, non-bank firms. The UK is mainly specialist ABL firms, but the big banks are taking a definite interest in the market.

As someone who, for 15 years worked at the commercial finance arm of Lloyds TSB, GE Commercial Finance's John Jenkins has seen other UK banks enter the ABL arena. "Over the last 12 months, we've seen RBS and Barclays set up specialist divisions to handle ABL deals," says Jenkins. "Even though it's competition for GE, I think it's good to see this happening as it grows the market for ABL in the UK and also grows the debate on why business should consider this method of financing."

Although factoring and ABL are talked about in the same breath in the UK, Davenham Trade Finance's Richard Whitehouse feels there are compelling reasons why ABL should be taken seriously, not only by companies looking to leverage capital by using assets on their balance sheet, but by financial organisations looking to meet a growing demand from their clients. "I think the UK will have little choice but to follow the US model of ABL," says Whitehouse. "The big lenders define how the market works and, ultimately, more players will have a structured finance unit. Lloyds TSB has its commercial finance arm, which has a degree of separation from the actual bank and I think that's how the UK ABL market will develop."

John Jenkins also feels the ABL market will grow. "Even though there's a current concern and uncertainty about global liquidity and many financial institutions are cautious, as part of a lender's portfolio of services, ABL performs well and is a good product for banks to offer. As it embraces other areas of business, I don't think, over the next five years, ABL can fail to grow exponentially."