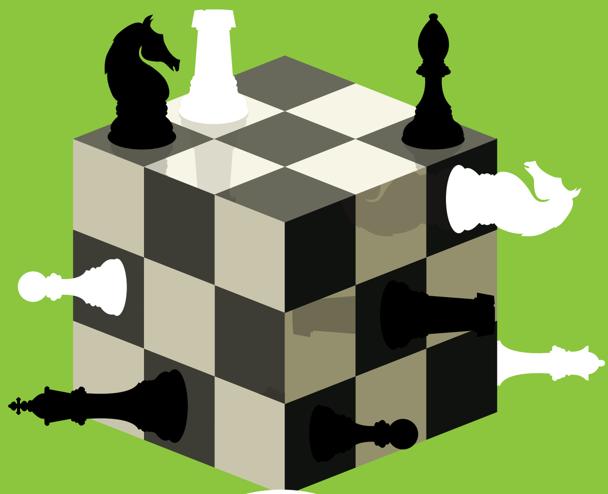
How Commercial Lenders Can Use Strategic Alliances to Better Serve their Clients



Many lenders are able to fully satisfy a client's domestic needs on their own, but this may change when a client enters the international market. A partnership between lenders with differing specialties can provide the greatest value for a client with international needs, and ensure a successful long-term relationship for all involved.

By Sami Altaher

THE BASICS

A family-owned business turns to an entrepreneurial asset-based lender to acquire the funding needed to fill increasing orders.

The company realizes that it is missing an opportunity to sell its products internationally and decides to open a European subsidiary.

The lender is unable to lend against foreign A/R and to finance purchase orders. Meanwhile, larger financial competitors are approaching the borrower.

To retain the client, the domestic lender realizes it must introduce partner lenders. The domestic lender contacts a foreign-receivable finance company and a purchase-order lender.

Supreme Scan, a family-owned business started by two brothers from Rhode Island, is celebrating its third successful year in business. Like most young companies, this one went through its share of issues to achieve its current success. Supreme continues to experience growing pains in its quest to evolve from a local company to becoming a global brand.

The company develops two consumer products. One is a scanner designed for home offices and the other is a scanner designed for portable use. Early on, Supreme encountered challenges that most start-up companies face when vying for shelf space with the big-box retailers. Marketing its superior products to consumers and retailers alike proved difficult due to the simple scanners that large household brands offered in the market. Luckily, the company caught a big break when a magazine featured its product as an "innovative solution" and a "top ten gadget" for businesspeople. A large volume of orders started coming in. And that is also when Supreme Scan ran into its first major hurdle.

The brothers realized that they needed additional capital to meet the increase in demand. They reached out to the lending community; however, commercial banks could not accommodate Supreme Scan's working capital needs due to the company's insufficient credit history and minimal equity capital. The brothers turned instead to an entrepreneurial asset-based lender (ABL) that helped them acquire the funding to fill the increasing orders and continue to service retailers.

Today, Supreme Scan's sales continue to thrive. However, the company realizes that it is missing an opportunity to sell its products internationally. Although the sales manager believes Supreme Scan can tap into that market, management is split between exporting out of the U.S. or opening foreign subsidiaries to compete better locally.

Deciding that a local presence will give Supreme Scan more clout with the retailers in Europe, the brothers opt to open a subsidiary. Supreme's concern is that this new subsidiary could create a cash crunch for the parent company. Additionally, the company will face similar start-up issues if it chooses to finance the business locally. European banks tend to take a more traditional approach, and entrepreneurial ABLs such as Supreme Scan's domestic partner are harder to come by in Europe. Without the additional working capital, Supreme Scan cannot offer the competitive terms needed to break into the European market. Supreme recognizes that this is especially damaging overseas where longer terms are expected and considered the norm.

Additionally, in order to be competitive with local players, Supreme Scan's foreign subsidiaries must be able to sell products and collect payment in foreign currency. This presents additional challenges with collection accounts, foreign-exchange exposure, wire tracking and reporting. Although Supreme Scan executives recognize the challenges the company faces in successfully running a foreign subsidiary, they also recognize the potential upside.

As sales continue to increase, Supreme Scan realizes that it can begin sourcing its product through contract manufacturers in China. This will allow Supreme to service large retailers, take advantage of economies of scale and improve gross profit margin. It also comes with the challenge of having to prepay Chinese vendors that often do not give terms. Thus, all of a sudden another issue surfaces on the purchase-order side of the business.

The domestic lender continues to service Supreme Scan aggressively. It offers competitive advance rates against domestic receivables, a large overadvance and letter-of-credit financing. Despite these accommodations, the lender faces a challenge with maintaining its client due to an inability to lend against foreign A/R and an inability to finance purchase orders. Meanwhile, larger financial competitors are approaching Supreme Scan and claiming they can satisfy all of Supreme's international financing needs.

To overcome these challenges and retain the client, the domestic lender realizes that it needs to introduce partner lenders. The domestic lender contacts a foreign-receivable finance company and a purchase-order lender in order to fill those gaps.

Working with a foreign A/R lender complements the services that the domestic lender can provide Supreme Scan, and it enables the company to replicate its domestic success internationally. Supreme can now borrow against its foreign receivables and meet its increased liquidity needs. This lender also has the ability to provide export funding outside of the United States as well as offer local funding for Supreme's subsidiaries, support the company's capital needs and enable it to offer aggressive open terms internationally. The foreign A/R lender has established relationships with foreign banks to cost-effectively transfer money across borders, as well as manage the collection and conversion of foreign currencies.

Supreme must conduct business within multiple jurisdictions, but multi-jurisdictional invoicing and distribution present their own legal challenges for the company and the lender. Sales contracts and purchase orders all vary by jurisdiction, and unique jurisdictional differences are further complicated when a foreign language is added into the mix. For example, a purchase order in Germany may have certain restrictions that limit the lender's rights on a receivable. Supreme Scan's domestic lender may not be familiar with these specific challenges. Additionally, it may not have the experience in hedging against foreign credit risk and political risk. Partnering with a foreign A/R lender that understands foreign-buyer behavior and has a multilingual staff to communicate with these buyers minimizes the risk for Supreme Scan as well as the domestic lender.

Generally, for a company growing its international business, upward of 10 jurisdictions may be involved. An aggressive domestic lender will service its client best domestically. In order to retain a client with global needs, a domestic lender needs to partner with a finance company that can complement its services on the international side and in multiple jurisdictions.

The lender's partnership allows Supreme Scan to cater to the European market and increase its market exposure. Borrowing against foreign receivables is a critical component of allowing that growth. The foreign A/R lender is able to reduce Supreme's average international cash-conversion cycle from over 90 days to fewer than 60 days, which also increases Supreme's ability to fill orders. As a result of partnering with a foreign A/R lender, Supreme Scan's gross annual sales nearly double. Furthermore, international accounts and the ability to move money across borders cheaply allow Supreme to maximize its profit from international sales. Lower risk and additional availability to the company enables the domestic lender to offer Supreme better rates and structure. Most important, it allows the lender to retain a happier client.

Similar issues arise when a client such as Supreme Scan has purchase-order financing needs. Sourcing inventory from foreign suppliers presents additional financial and operational challenges. Though importing will improve gross margin by reducing labor and material costs, the company is faced with longer lead times due to longer transportation and a lack of open credit.

In addition to providing additional availability for Supreme Scan, a PO lender is able to provide financing options for Supreme's suppliers. This lender issues letters of credit, providing the Chinese factory with advance rates of 100% of cost and enabling the factory to fill Supreme's orders quickly. Issuing letters of credit to the supplier has the added benefit of placing pressure on the supplier to adhere to delivery time frames and quality-control expectations. This contributes to a healthy business relationship with Supreme Scan and improves transaction turnaround time. The PO lender also plays a major role in supplier quality control. It is able to monitor inspections at the factory level and ensure that the supplier is following government requirements. This mitigates the risks for all parties involved in sourcing supply overseas, including for the lenders and Supreme Scan.

Although a domestic lender may have limited experience with importing, a PO lender has the expertise to specify proper procedures for cash flow, shipping logistics and quality control in the underwriting. It also has relationships with foreign suppliers that are able to produce, monitor and ship products in accordance with its specifications. These relationships allow for the diversification of suppliers so that Supreme Scan does not solely depend on one foreign supplier. This helps Supreme fill orders on time, which also increases success rates and minimizes risk to the lenders.

For the deal and alliance to remain successful, all lenders involved must work together to support the growth of their client. This involves setting clear expectations in the intercreditor agreement (such as defining what qualifies international versus domestic assets). The partners should also engage in open and frequent dialogue to leverage one another's expertise in predicting problems before they arise. In a strategic partnership, each specialized lender's procedures add value. This value is the key for how commercial lenders can better serve their clients.

Some lenders are able to satisfy most of a client's needs on their own. The case of Supreme Scan demonstrates that, although having one lender that is okay at everything could satisfy an immediate need, having three lenders with expertise in their respective roles will ultimately provide the most value for the client. More important, it ensures a successful long-term relationship for all involved. **TSL**

Sami Altaher is the executive director for FGI Finance, New York, NY. He earned his undergraduate degree in accounting from the University of Jordan and his graduate degree in finance from Drexel University. In addition to his MS in finance, Altaher is also a licensed CPA.