

Why asset-based lending could be the key to unlocking business growth

Paul Stephens, Close Brothers, explains the potential of asset based lending.



Paul Stephens is Head of Sales, Asset Based Lending & Invoice Finance at Close Brothers Commercial Finance. The FTSE 250 company is the principle provider in Ireland of Asset Based Lending (ABL) facilities.

The year ahead may be fraught with uncertainty, with so many political and economic storm clouds gathering, but many Irish businesses are optimistic about their prospects. Almost half expect their business to grow over the next 12 months. We conduct a quarterly survey, Close Brothers Business Barometer, which questions Irish SME owners and senior management across a range of sectors and regions. Data from the survey reveals that 48% of SMEs expect to be larger in a year's time than they are today.

However, there is a problem. Businesses need solid financial foundations on which to construct their future growth plans – funding for day-to-day operational needs, but often also capital to help them move forward. Research suggests many SMEs aren't aware of all the funding options open to them – 61% of SMEs in our survey are not aware of any alternatives to traditional loan and overdraft facilities from the high-street banks. That may mean they miss out on funding solutions that are much better suited to their business needs than traditional financing arrangements

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– products that deliver larger amounts of capital, for example, as well as flexibility, scalability and speed of access.

Asset-based lending is an excellent option for businesses looking to finance a management buyout/buy-in, a merger or an acquisition. Alternatively, the extra funds can be used as a contingency, providing additional working capital as and when required. The story of Bodel Distributors provides a good example of what is possible with asset-based lending. The business, which distributes household appliances and kitchen equipment was acquired last year by its sales director John Leckey in a management buy-out with funding provided by Close Brothers Commercial Finance. An asset-based lending facility was the best way for Bodel Distributors to release the additional capital required for the transaction, which was tied up in the stock of the company. They needed to find a lender who saw the strategy, supported the vision, and could put enough funding in place to enable the buy-out to progress.

Many companies see the potential of asset-based lending. Around one in six Irish firms in our survey intend to take on additional funding over the next 12 months; of these, 25% are intending to use asset finance of one variety or another. However, too few businesses don't know what their options are. Almost two-thirds of firms in the research haven't heard of asset finance; amongst the remainder, almost half say they have only a limited understanding of how asset finance products work. Similarly, almost three quarters of SMEs confess they wouldn't know where to turn to finance if they had to find funding for a strategic event such as an acquisition.

The good news is that awareness is growing. In the immediate aftermath of the financial crisis, when banks largely withdrew from the market for lending to SMEs, ambitious businesses were forced to look further afield for funding solutions that would facilitate their growth plans. Even today, banks constrained by increasing regulation on the capital they must hold against loans, have not been able to return to the lending practices of the pre-crisis era. Indeed, 11% of SMEs in the survey have been turned down for finance by a high-street bank. This is not to suggest, however, that asset finance is a solution only suitable for companies that have not been



able to secure funding elsewhere. While asset finance certainly has helped plug the funding gap left by the banks' retreat, it's not a last resort – for many growing businesses it has clear advantages over other types of arrangement.

The idea is that the lender buys an unencumbered asset from the owner for its current value and then sells it back via a hire-purchase agreement that runs over an agreed period. The business can go on using the asset in exactly the same way as it did before, but the value tied up in it is released as a valuable boost to working capital – it's a really innovative funding solution.

The asset in question might be receivables, inventory, property or plant and machinery. Asset finance transactions are bespoke arrangements that will depend on the circumstances of the individual business. But as the credit risk to the lender is lower with the finance secured against the company's assets, the cost is very competitive with other forms of business finance.

Asset finance is also a flexible and scalable way to fund a business as it expands. As the business grows and its assets increase in value, its asset finance facilities naturally grow too – by contrast, for example, to a bank loan or overdraft of a fixed size. The options will include an asset-based lending arrangement, which is often used by businesses keen to expand, restructure or refinance, and is typically based on a

combination of assets, often including receivables in the form of invoice finance.

As asset-based lending releases relatively large amounts of working capital, typically between €2m and €40m, it is ideal for a business thinking about how it is going to fund a one-off corporate transaction such as an M&A deal. Equally, however, many SMEs opt for an asset-based lending arrangement that provides them with additional cash flow resources on an ongoing basis.

The current state of business confidence amongst Irish SMEs suggests there will be no shortage of firms with such requirements; many businesses are sanguine about the UK's vote in last year's referendum to leave the European Union. Hiring intentions, for example, are positive, with 72% of firms saying their plans have not been affected by the Brexit decision; significant numbers are not concerned that the UK's two-year negotiation with the EU over the terms of its exit will get in the way of their plans.

Such optimism amongst Irish businesses is to be welcomed. But it is crucial that firms have access to the financing solutions they need to realise their ambition – and that they explore the full range of possible options for funding their future growth. Asset based lending will not be the most appropriate solution for every business, but it is an attractive option for many – it could just be the key to unlocking their potential.