



What Options Do Business Owners Have When Banks Tighten the Screws?

"A recent Federal Reserve survey found that about two-thirds of banks' loan officers reported that they tightened terms for business loans in recent months." (2009, April 4. Credit Woes Hit Home. *Wall Street Journal*) Tightening terms may include one or more the following: increasing interest rates, requiring personal guarantees if not already provided, decreasing advance rates, adding or tightening loan covenants, requesting additional collateral, demanding pay downs, or demanding pay offs. This tightening is most commonly driven by a client's eroded financial performance and/or modifications to bank policies. Often the tightening begins fairly painlessly, but as it progresses many business owners are finding themselves under so much pressure they can barely run their business. When an owner finds him or herself in this situation, what options to they have?

Move to another bank

Historically the first direction a business owner would turn to remedy the situation was to find another lender. A little more than 9 months ago, banks were lending and competition was fierce, therefore it was almost guaranteed that another bank that would offer more favorable terms, pricing, and covenants than the incumbent bank had in place. Although this was an option for many business owners in the past, this option has virtually ceased to exist. Unless a business is in the top tier of a bank's risk rating system, it can be virtually impossible to switch institutions in this lending environment.

Given that switching financial institutions is no longer a realistic option, business owners have three additional choices.

Leverage personal assets

Banks have consistently wanted to know that an owner stands behind his or her business; this is even more prevalent today. If owners do not provide personal guarantees, chances are the bank will be requesting them in the near future. In some instances a personal guarantee will not be enough and lenders will require liens on personal assets such as cash, marketable securities, real estate, and other valued assets.

Many owners will be unwilling to provide personal guarantees and/or further leverage their personal assets, thus leaving themselves with two options – give the bank the keys or sell equity.

Sell equity

Hopefully owners do not initially consider handing the keys to their lender a valid option, specifically when there is an alternative that will provide current and future financial benefits to the owner, retain jobs of their employees, continue the legacy of their business, and keep commitments to customers, suppliers, and creditors among other situation specific benefits. There are many financial and strategic buyers who are interested in acquiring a majority or minority equity stake in businesses with strong fundamentals, but who have struggled as a result of the economy, excess financial leverage, or other reasons. These acquirers generally prefer to retain the existing owners, management team, and employees. Moreover, they often allow the owner to retain equity and participate in the future growth.

Owners do have options when banks are tightening the screws. The keys to reaching successful resolution include taking quick action, communicating openly, and involving professional advisors in the process.