



Making Good Decisions About Collateral

How to avoid 'collateral damage' with a Golden Rule!

by Kenneth P. Walsleben

Ahhhh collateral...

Sounds like a boring topic, right? Not if you've obtained funding and simultaneously pledged all of your corporate collateral to get it. You won't call it boring later on when you need some of it back. Then, you'll call it maddening!

'Many don't even know that collateral is a negotiable item!'

Let's spice up the topic a bit shall we? If you were playing cards against someone, would you show your adversary your hand? Would you hand them your most valuable cards?

Of course not!

Gambling with your collateral?

But, you'd be flat-out amazed at how many borrowers do just that with their collateral "cards." Often they do so unwittingly, and odds are good that I'm describing you.

Allow me another moment to play this analogy further. Let's imagine that one card represents your personal guaranty, another, your accounts receivable, and so on.

Eventually, you're holding cards for:

1. personal guaranty
2. accounts receivable
3. general intangibles
4. inventory
5. production machinery
6. real property/improvements
7. furniture fixtures and equipment

Your job, naturally, is to guard your cards zealously. Unless someone offers the earth, moon and stars, why would you simply hand all of them to the same financier?

Yet, you'd be astounded to learn that many otherwise savvy business owners and managers do just that. Worse, they do it for comparative peanuts! Many don't even know that collateral is a negotiable item!

You mean collateral is negotiable?

Not a week goes by that a prospect of ours doesn't finish our conversation with a long face. Not because we said "no," but because they've just realized that amongst those bank loan papers they signed a while back, they pledged to their lender, a blanket lien on *all* corporate assets.

Now, their only options are to solicit their present lender for subordination against some of their previously pledged collateral, and induce their present lender to do so by agreeing to a large pay down, or leave their present lender for a new, more flexible player.

'A borrower should never allow any party a lock on all of their collateral.... That includes you!'

If only borrowers could know about these problems at the beginning when the loan is made! Well, now you do.

What's the Golden Rule for collateral?

Everything is negotiable.

Here's your golden rule: "No funder should get all of my collateral *unless* they are providing me the offer of a lifetime." I'll bet that virtually every person reading this article expects that their business will grow in coming years.

So, why not plan for that expectation? You need to be judicious about who gets your collateral and what types they get. The absolute last thing you want is to fulfill your growth goals only to find that future opportunities are restrained because your present lender can't or won't grow with you.

Worse yet, what if they have a collateral interest in *all* of your assets? You'll no longer have a lender; you'll then have a *partner* who, by their actions, will control whether or not you are able to further grow your business.

Why grant anyone that much power? Now, when obtaining funding, ask yourself, "Will today's seemingly comfortable loan of \$100K prove equally comfortable in two or three years?"

A factor only requires a lien interest in accounts receivable and general intangibles, and leaves you with the rest of your cards to "play" with additional funding sources.

A borrower should never allow any party to have a lock on all of their collateral.... That includes you!

Discussing this issue up-front with a funder is always easier than trying to negotiate after the fact. After all, why should they give up something after you've already borrowed their money?

When do I have the most advantage?

Remember, you have the most negotiating leverage at the onset of a relationship when that financier is trying to earn your business.

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So, be smart.

Play your collateral cards with vigor, and ensure that no party has a lock on your ability to grow. You'll be thankful down the road when you need to add an additional layer of funding, and you'll have the available collateral to entice a new financier.

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