FINANCING – A RECOVERY TOOLKIT FOR BUSINESSES

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Ontario Small Business Series

The CPA Financial Literacy Program makes resources available to Ontario's small-business owner-operators to help them manage their finances. This free, comprehensive series will enable the province's small businesses to navigate through today's uncertainty and plan for the future. These resources are made possible by the generous support of the Government of Ontario. For more information, please visit www.cpacanada.ca/ontariosmallbusiness.

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> Business is like a man rowing a boat upstream.
> He has no choice; he must go ahead or he will go back.
>
> Lewis A. Pierson, Chair of Irving Trust, 1937

Recovering Together

All businesses have been challenged by the pandemic, but the challenges for smaller businesses have been particularly severe. In fact, survival is not enough; it is important to be ready for the challenges once the economy becomes "normal" again. This concise guide will give you advice on financing techniques as well as guidance geared to the pandemic to help you recover from the disruption and to prosper afterwards.

> This publication is directed at financing a business. Two other *Toolkits* in this series should help you as well: *Cash Management – A Recovery Toolkit for Businesses,* and *Strategy and Planning – A Recovery Toolkit for Businesses*. They are available as a free download at www.cpacanada.ca/ontariosmallbusiness.

Overview of Financing

Financing refers to the types of funding that a business uses to operate and to grow. The financial structure refers to the mix of debt, equity, and sometimes things that are a blend of both, that provides the funds to support the business.

Many small and medium businesses do not think of their financial structure in strategic terms. They may leave in the business as little equity as their lenders allow and not do a great deal of planning. Or conversely, they avoid debt and try to repay it quickly to have as little exposure to lenders as possible. But, particularly in challenging times, it can be helpful to have a more in-depth understanding as to the best financial structure for your business.

Many entrepreneurs view a bank as the first place to go for financing. Indeed, the bank is the most common source of financing for small and medium businesses. Banks provide a variety of financing options, such as short- and long-term loans, lines of credit, loans against inventory or accounts receivable, as well as more innovative types of financing. In fact, the banks have frequently taken the initiative in creating services for small and medium businesses. We will examine bank financing and other sources of debt, as well as equity financing and other financing options that do not fall neatly into either category.

Planning for a Successful Financing

Your financing is successful if it lets you acquire the funds required for a cost, terms and conditions that meet the needs of your business. As with any negotiation, you will be in a stronger position if you are able to see things from the perspective of the other party.

The key to successful financing is planning and preparation. There are four preliminary steps to understanding and obtaining financing. They all require you to see your business from the point of view of a prospective lender.

1. Understand the "five Cs" of credit: Character, Capacity, Collateral, Conditions and Capital.
2. Define and analyze your market.
3. Prepare reasonable forecasts outlining the required financing and the projected cash flow available for debt servicing.
4. Develop a written business plan.

These are discussed below.

1. The five Cs of credit

The basic criteria for being willing to grant credit have not changed in more than a century. Lenders review these in detail, through checklists and also implicitly as they analyze a prospective borrower.

Character:

- character of the owner and management and their willingness to observe the terms and conditions of the financing
- lender's confidence in the management of the business
- lender's confidence in the judicious use of the funds based on previous experience with the principals
- confidence demonstrated by outside creditors

Capacity:

- ability of the business to meet the terms and conditions of the financing based on its profits and cash flows

  For example, a $2,000,000 five-year loan may require blended interest and principal payments monthly so that it is fully paid off at the end of its term or, at the other extreme, interest only for five years and the full amount of the loan due at maturity.

Collateral:

- realizable value and enforceability of any security, together with its nature and compatibility with the purpose and term of the financing.

  For example, assets that are pledged as security for a particular loan will not be available for a later financing unless the first loan is repaid or the creditor agrees to subordinate its position. Similarly, a lender may wish a personal guarantee or mortgage from the owner, which may or may not be acceptable depending on the circumstances.

Conditions:

- current economic conditions and outlook for the country, province, and municipality
- current conditions and outlook for the particular industry

Capital:

- amount, composition and adequacy of funds invested by the owners in relation to
  - business risks
  - profitability
  - risk to be assumed by the lender

2. Your market

Before approaching potential sources of debt or equity, you need to ensure that you thoroughly understand your market. The business plan will include a great deal of this information, but your knowledge must be deep and comprehensive.

Ensure that you can articulate who your potential customers are, where they are located, why they buy, when they buy, and their expectations in terms of price, quality and service. Explain the current size of the market and its growth potential in the short, medium and long terms (one to 10 or more years). Support the growth estimates with data such as industry trends, new technological developments and changing customer needs. Clearly state the sources of your data and the assumptions used. Be realistic in your estimates. Make sure your forecasts are clearly correlated with your data and assumptions. Do not overstate the size of the market or your potential share; if you do, it may cast doubt on the credibility of the entire business plan.

Describe your competitors by name, size and location, and how their product or service compares with yours with respect to price and other factors. Where possible, assess their strengths and weaknesses in such areas as management, marketing and finance.

Identify the target market in detail, provide sales and market-share projections, and show how the market should be segmented. Demonstrate that your company has the capability to manufacture, sell and deliver the product, or to otherwise service the market, so that the marketing plan will achieve the projections.

3. Forecasts

A forecast is a prediction of what is expected to happen if events unfold as expected. It is intended to be a realistic estimate of the future. An integral part of a financing request is a cash flow forecast, which also requires forecasting future balance sheets and income (or operating) statements. In order to have a reasonable forecast, you need to have reasonable assumptions underlying the numbers.

You likely already have a budget and forecasting process in place. Now is the time to analyze "what went wrong" with previous forecasts. You should be able to identify the specific assumptions that did not come to fruition. For example, the pandemic has resulted in the sales volumes of many businesses being severely curtailed, while fixed costs (such as rent and property taxes) and payrolls changed by relatively little.

4. Business plan

The business plan is a concise but comprehensive written description of a business and its overall activities, including products and production techniques, markets and marketing strategies, management and personnel, sources and uses of funds, and financing needs.

It should highlight in some detail the past, present and future of the enterprise. When well conceived and well prepared, the business plan becomes a blueprint for financing and a crucial component of your application to any funding source. It should therefore be complete, organized and factual. The business plan will force management to plan, monitor and assess the company's progress. It compels management to think ahead, anticipate and deal with change, and chart the optimum course for the business.

Your business plan will include details as to your target market and the forecasts referred to above.

> A companion publication to this one, *Strategy and Planning – A Recovery Toolkit for Businesses*, available free at **www.cpacanada.ca/ontariosmallbusiness**, provides more information and resources on how to prepare a business plan.

Working With Your Professional Advisors

Professional advisors – your chartered professional accountant, banker, lawyer, financial consultant, and others – may all play important roles in helping you achieve your financing objectives.

Advisors may have various roles, including:

- determining what type of financing is appropriate
- defining or developing your business plan and financial model
- identifying any potential obstacles to obtaining financing from lenders or investors
- helping you assess the terms and conditions of the financing
- negotiating repayment, security, terms, prepayment and other conditions
- liaising with the company or institution that provides funding to businesses
- helping you satisfy any legal requirements, provide insurance documentation, or meet other conditions set out in the offer to finance

If you already have trusted advisors, excellent. Otherwise, many owners seek recommendations from knowledgeable friends or from their accountants and lawyers. The role of the professional advisor may range from just putting you in contact with sources of financing to drafting the budget and business plan, and sourcing, negotiating and helping close the financing.

Measuring Success

How do you measure success in financing? It is certainly more than the quantity of dollars obtained. The financing needs to be considered in its totality. Factors to be considered include:

- raising the correct type of funding for the specific requirements; for example, long-term assets financed with longer-term funding
- cost of financing: not just interest but front-end fees, legal and other costs, and any bonus or equity payments
- achieving manageable cash flow related to the specific needs of the business
- obtaining flexibility in refinancing and in the ability to repay as requirements change
- undertaking covenants, both positive and negative, that the borrower can meet
- not encumbering more assets than necessary as security so the business can raise new funds at a later date
- confirming that it has workable terms and conditions
- obtaining funds on a timely basis, as required
- ensuring an efficient and timely disbursement of financing proceeds
- establishing an open working relationship with the lender as a new "partner" of the business.

2. Your Financial Structure

> A live dog is better than a dead lion.
>
> *Ecclesiastes* 9:4

Capital Structure

Financial structure, also called "capital structure," refers to the mix of debt and equity on your balance sheet. (In this context, current liabilities such as accounts payable are considered a reduction of working capital, and are not directly part of this discussion. However, the greater your current liabilities, the lower your net working capital, so the less you need to finance through debt or equity.)

Debt refers to loans and borrowings. Its characteristics include:

- repayment is required by particular date or when requested ("on demand")
- requires payment of interest
- carries various terms and conditions
- interest on debt is deductible from taxable income
- must be repaid before equity if there is bankruptcy or insolvency
- adds financial risk to the business (also called "leverage")

The debt may be repaid during its term or based on an amortization period that extends beyond its term, or it may all be due at the end of its term (otherwise known as a "balloon payment").

Equity refers to investment by owners or investors. Its characteristics include:

- represents ownership in the business
- no interest payable, but it may pay dividends
- no maturity date
- last to be repaid if there is bankruptcy or insolvency
- reduction of financial risk to the business

There are exceptions to many of the general definitions above. For example, particularly outside North America, the world has entered the realm of some debt carrying zero or near-zero interest rates, or even negative interest. Some shares – "special" or "preferred" shares – may have a maturity date or otherwise be retractable (at the option of the investor) or redeemable (at the option of the corporation).

In theory, the amount of debt and equity on your company's balance sheet results from a careful analysis based upon minimizing the total cost of debt and equity, called the "weighted average cost of capital." If debt accounts for a small proportion of the total funding, then it is much cheaper than equity because it represents a more secure claim on the assets of the company and because the cost of debt (i.e., interest) is deductible for income tax purposes. However, as the amount of debt increases relative to the total amount of debt plus equity, the interest rate will increase due to the greater financial leverage. So, at least in theory, there is an optimum level of debt and your debt levels should be based on that.

Reality is a little different. Debt levels are usually based upon several pragmatic factors:

- the amount of debt financing available through banks or other lenders
- the amount of debt financing necessary after the owners have distributed earnings through bonuses or dividends
- bank covenants that dictate the amount of equity required

These factors may well result in a debt level similar to the theoretical optimum, but the focus is more on availability of funding and the lenders' requirements, rather than minimizing the total cost and optimizing the position of the owners.

A company's capital structure often just evolves over time without the owner/manager giving it a great deal of deliberate thought. However, you should approach your capital structure strategically: think about what makes sense for you and the company. You may have various constraints, such as wanting to avoid new equity issuances because you do not wish to cede any control or equity. Or, your lenders may have indicated to you that it is time to find sources of fresh equity to grow the business.

This section examines some of the issues related to capital structure.

Business Risk and Debt

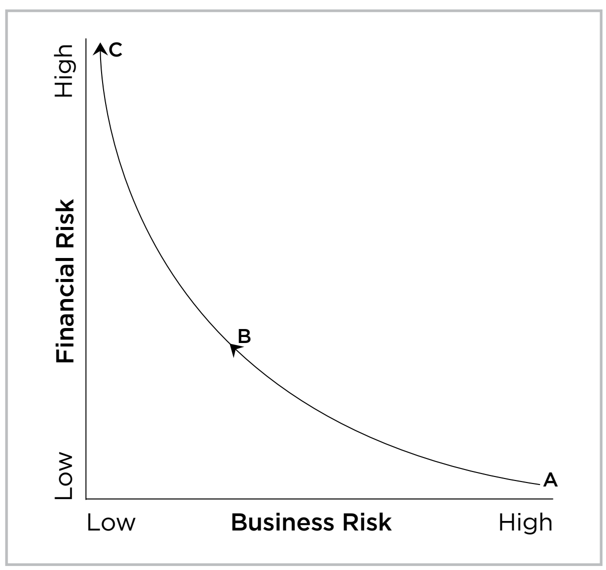
Determining the right mix of debt and equity depends upon the nature of your business, and the maturity and stability of its operations. The diagram below shows how financial risk and business risk can change over the lifespan of a business.

Financial risk is the risk of not being able to meet financial obligations such as interest and debt repayment. For a start-up, that risk is generally high as there is significant uncertainty over future cash flows. For an established company, it will depend on its annual financial obligations (i.e., interest and principal) compared with net cash inflows from operations. Financial risk can be measured by leverage (i.e., the amount of debt compared to equity in the business). (See further discussion of debt-equity ratios in **Section 4** – Equity and Investors.)

Business risk refers to the riskiness of the business itself, measured for example as the volatility of cash flows. When a business starts up, the timing of cash flows can be uncertain, and it can be hard for a business to borrow at this stage; all financing is usually done with equity. Therefore, its business risk is very high, but its financial risk is nil (point A on the diagram). As the business matures, its operations become less risky and its cash flows less volatile, so it approaches point B, which allows for borrowing.

Some unusual types of businesses such as banks have very high leverage (i.e., very high financial risk), so they are at point C. But to get there they must have very low business risk, which is why banks are risk-averse and will not lend to businesses when the businesses are most in need of funding! This is why there is the famous adage that "a banker will give you an umbrella only if it isn't raining." Banks tend to only lend where there is low risk that the borrower will not repay. Where the risk is moderate or high, credit will normally be granted by an institution other than a Schedule I bank.

Debt is generally cheaper than equity, in part because it is tax-deductible. However, as the amount of debt relative to equity increases, its cost will increase due to the higher financial risk: lenders become uncomfortable as there is less equity invested to protect their loans.



The rest of this publication explores the various sources of debt and equity available to a business. When times are uncertain, such as during and after the current pandemic, it is prudent to try to increase your resilience by borrowing less than the maximum available. In other words, maintain resilience by keeping funds in reserve or borrowing less than the maximum amount you can obtain from lenders.

Sources of Financing

When a business first starts up, all financing will be from investors putting in equity. Once operations stabilize, it is able to obtain debt financing. At very early stages, banks tend not to lend, and a business usually needs to seek other sources of debt. You need to identify and approach other sources appropriate for the specific needs of your business.

As you can see on the following chart, there are various methods and sources of business financing depending on the purpose of the financing.

TYPES AND SOURCES OF FINANCING

Financing for	Type of financing	Sources of funds
Current assets	• operating loans (for accounts receivable and inventories) • factoring and similar credit arrangements	• banks, other term lenders • credit unions (to members) • factors • customers • commercial finance companies • suppliers
Fixed assets	• term loans • leasing • mortgages • equipment loans	• banks • term lenders • BDC • leasing companies • provincial and federal government programs
Accounts payable	• trade credit	• suppliers • government programs
Equity	• owners / entrepreneurs • venture capital • private placements • public offerings • retained earnings	• venture capital companies • individuals • profits retained in the business

The Lender's Perspective

From the perspective of the lender (or investor), the greater the risk taken, the greater the reward required. In other words, riskier loans (or investments) cost more. Risk determines the type of lender / investor, the type and amount of security coverage, and the form of the debt. External conditions also influence financing. When uncertainty arises because of changes in national, provincial or municipal economic policies, financial markets, or local or world events, it affects the types, sources and terms of available financing.

Regardless of whom you approach, seeking financing is not unlike preparing your business for sale. A lender will conduct a due diligence investigation similar to one that a purchaser would undertake before investing in a business.

When you make a financing proposal, the lender will assess your operating performance, management effectiveness and style, and the funds required based on several factors:

- stage of development (i.e., whether the business requires start-up, expansion or acquisition financing)
- duration of each stage
- predictability of operating performance
- required capitalization
- management quality and effectiveness
- current financing sources

The most significant element is that the lender must have sufficient confidence in the management, product, business plans and strategies of the applicant. And, of course, this means you, as the borrower, must have utmost confidence when approaching a lender both in your product or service and in your business. If *you* are not convinced that you qualify for the financing, you will not convince the prospective lender.

Banks and other lenders look at specific performance ratios before making a loan:

Debt to equity:

- Banks may lend up to two or three times the amount of equity, depending upon the business.

Debt servicing:

- Many lenders require your operating income to exceed your debt servicing requirements by at least 1.5 times; in other words, operating income must be 2.5 times debt servicing requirements.

Return on investment:

- The net income divided by owners' equity (including retained earnings) is taken as a percentage.

Break-even analysis:

- The level of unit sales needed to cover overhead expenses is calculated by dividing total fixed costs by the sale price per unit minus variable costs per unit. The result is the number of units that must be sold to cover overhead expenses.

Ratio of current assets to current liabilities:

- This is a measure of your ability to pay off current liabilities. It is calculated by dividing current assets (cash, accounts receivable, inventory) by current liabilities (accounts payable, debt due within one year) to find the multiple by which current assets exceed current liabilities.

These are only a few of the many ratios used by lenders and investors to make investment and lending decisions.

Many elements above are quantitative or otherwise precise and objective. However, the final decision on whether to make a loan or investment will be based on a subjective assessment of the quality of management.

Maximizing Internal Sources of Funds

Before you begin searching for external financing, ensure that you are doing everything possible to maximize internal sources of funds. This will help you achieve the solid ratios and financial strength vital for attracting the right lenders.

Before going to the lenders or investors, look inside your own company for untapped sources of capital. Here are the key ways to generate internal sources of capital:

- Your business can generate considerable cash by changing the timing of when you collect your receivables and in the turnover of your inventory. For example, if you normally have $300,000 in accounts receivable and reduce the average collection period from 60 days to 45 days, you will free up $75,000 in cash ($300,000 less 45 days / 60 days × $300,000) – financing you will not be required to raise and pay interest on.
- Existing assets may also be used to generate funds for operations or expansion. For example, you could sell used equipment at an auction or through an online marketplace. In this way, you can minimize the amount of external funds you have to borrow and thereby avoid interest costs on an equivalent amount of debt.
- Cash can also be generated by streamlining your costs. Review your cash management policies, suppliers, shipping and other overheads. Accounting and management software can be used to analyze costs specific to particular areas of your operations and identify where savings are possible.

The savings in any one area may seem small, but when several initiatives are bundled together, they can make a significant difference.

While changes in interest rates are beyond the control of the business, other elements of cash flow can, and should, be constantly managed. Cash flow difficulties happen to businesses with good sales as well as those with declining sales. No company is immune. Indeed, during a period of rapid growth, a company could face a cash flow crunch by trying to pay its debt obligations and operating expenses while waiting to collect accounts receivable.

3. Banks and Lenders

> For a country, everything will be lost when the jobs of an economist and a banker become highly respected professions.
>
> Baron de Montesquieu (c. 1750)

Banks

Banking in Canada consists of domestic banks, and subsidiaries and branches of foreign banks. “Schedule I” banks are domestic banks, and “Schedule II” banks are subsidiaries of foreign banks. “Schedule III” banks are branches of foreign banks, which operate under various restrictions.

There are 35 Schedule I banks ranging from “the big five” (Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, Royal Bank of Canada, and the Toronto-Dominion Bank) to large second-tier banks, such as Laurentian Bank of Canada, Manulife Bank and National Bank of Canada, to a variety of lesser-known names such as VersaBank and Zag Bank. (Note that the largest banks operate their consumer operations under various brands, so for example, CIBC is the Canadian Imperial Bank of Commerce and TD Canada Trust is part of the Toronto-Dominion Bank.) There are 17 Schedule II banks from Amex Bank of Canada and Bank of China (Canada) to UBS Bank (Canada). Finally, there are 32 foreign bank branches doing business in Canada.[1]

Most businesses use one of the larger Schedule I banks as their primary banker since they offer a Canada-wide branch network and hundreds of ancillary services, but the smaller banks as well as foreign banks offer services in specialized niches and in some cases may even be your primary banker. There are other sources of banking services including co-operatives, trust companies and loan companies, although in the latter two categories many are subsidiaries of banks.

> This publication focuses on banks as a source of financing (lending). Non-borrowing banking services are discussed in a companion publication, *Cash Management – A Recovery Toolkit for Businesses*, available as a free download from **CPA Canada**.

Lending services offered by the banking industry include:

- operating lines, including demand loans and bankers’ acceptances
- non-revolving loans including term loans
- mortgages
- letters of credit
- other credit-related services

1 Office of the Superintendent of Financial Institutions. (2021). **Who we regulate**. (**www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/wwr-er.aspx?sc=1&gc=1#WWRLink11**)

Collateral Financing

Lending is always based on an assessment of the borrower, although different lenders focus on different areas. All lenders consider income and cash flow to assess ability to service the loan (i.e., make regular payments of interest or principal and interest) and to repay or refinance the amount borrowed. Lenders also consider collateral: assets pledged that can be liquidated (i.e., sold) if the borrower fails to repay the debt.

Bank lending is usually based on collateral available. This is also referred to as "asset-based financing," although banks also pay a great deal of attention to expected cash flows or earnings available to service the debt. There are exceptions, particularly with asset-light businesses such as service businesses, or customers involved in longer-term contracts (e.g., construction). In such cases, the banks focus on ability to service the loan and the track record of the business.

Operating Lines

Operating lines are short-term credit lines that in general are expected to be brought down to nil from time to time but are available to deal with working capital requirements of the normal trade cycle. The amount made available is focused on expected requirements based on cash flow forecasts as well as the security that current assets offer. The specific features are customized to the needs of the business. For example, the operating line can be a semi-permanent feature of your financial structure.

Operating lines of credit are typically available in Canadian or U.S. dollars as:

- demand facilities
- overdrafts
- bankers' acceptances (BAs) – often as part of a demand facility
- other uses of credit lines, such as foreign currency spot and forward availability
- letters of credit

Rates for operating lines of credit are based on bank prime for smaller commercial customers, or a market rate such as the Canadian dollar offered rate (CDOR) for larger corporate customers or when the borrowing includes bankers' acceptances (discussed further below).

Operating lines are generally approved for a one-year period and reviewed annually; security coverage and compliance with terms and conditions ("covenants") are usually monitored monthly or quarterly. Operating lines may be "uncommitted," i.e., the bank is free to not fund the loan, or "committed," i.e., the bank agrees to fund the operating line up to the committed amount provided the existing loan is in good standing and the business has complied with its covenants. The bank will charge an additional fee for committed lines of credit.

Operating lines are typically secured by charges over accounts receivable and inventories. The level of the outstanding loans is usually capped at specified margin levels, typically:

- accounts receivable: 65% to 85% of good receivables (i.e., under 60 or 90 days, depending on the business's trade terms)
- inventories: 40% to 50% of cost of finished goods on hand

When establishing margin ratios, banks will take many factors into account, for example:

- company's track record of profits and retained earnings
- stability of the industry
- payment terms and collection experience of the business
- credit rating of the borrower's customers
- legal jurisdiction of customers
- experience with product returns and credits offered to customers
- terms of sales contracts

Larger operating lines (i.e., over about $50 million) may be offered by a "syndicate" (or group) of banks. A lead bank will be the primary contact, but having multiple banks involved allows them to share the credit risk.

Non-Revolving Loans

The typical non-revolving loan agreement provides for repayment to be extended over a longer period, usually more than 12 months from the date the lender advances the initial disbursement of all or any portion of the loan. However, a non-revolving loan can be for less than one year, which would make it similar to bridge financing.

Although a business may use this type of loan for a number of purposes, it is usually used for fixed-asset financing with security taken over fixed assets. Loan amounts are based on the company's financial position and needs.

Advances under a non-revolving credit may be taken in a single drawdown or as a series of drawdowns, or they may fluctuate as fixed-asset purchases are required. Funding is usually available in all major currencies. Non-revolving loans are usually advanced directly but may sometimes be paid directly to a supplier.

Repayments are generally made monthly, but quarterly, semi-annual, or annual terms are also available by negotiation. Other variations include deferring first or early payments, seasonal payments, or having a balloon payment (i.e., final lump sum amount) at the end of the repayment period.

Bankers' Acceptances

A bankers' acceptance (BA) is a promise to pay (i.e., technically, a "short-term promissory note") issued by a corporation but then guaranteed by a bank. Normal terms are 30, 60 or 90 days, although longer terms are possible as well. Since it then represents an unconditional obligation of the bank, the BA trades in the market as an obligation of the bank.

As consideration for providing the guarantee, the bank charges a "stamping fee," so that the total cost to the corporation is the market BA rate plus the stamping fee. The usual market BA rate is CDOR. For example, for a 30-day BA, if CDOR is 75 basis points (0.75%) and the stamping fee is 200 points (2%), then the cost of borrowing is 2.75%.

In the context of bank loans, BAs are normally offered within the total credit line of the business. Within an operating line of credit, the business may have the option of borrowing at the bank's prime rate (which changes whenever the bank decides to change it) or as a BA (where the rate is fixed for the term of the BA). Normally, the cost of the BA including the stamping fee will be slightly less than prime, but the borrowing is locked in for the term of the BA.

Term Loans

Term loans are offered to finance the acquisition of medium- or long-term assets (i.e., specific fixed assets such as equipment, a business expansion or a business acquisition), working capital or debt consolidation.

Terms generally vary from one to five years, but amortization may be over eight to 15 years, depending on the nature and condition of the assets and their expected useful life. If the amortization period is longer than the term of the loan, then the remaining balance is due at maturity (or the loan might be refinanced). Loans may also be non-amortizing, meaning that only interest payments are made during the term of the loan. In that case, the full amount of the loan is due at maturity. Since security is usually based on the fixed assets rather than the current assets, there is no margin requirement.

Interest rates may be either floating or fixed. The option may exist to convert from a floating to a fixed rate during the term; however, a fixed rate can usually not be altered. Floating rates will be specified by an index rate (e.g., CDOR or bank prime) plus or minus a spread. So floating rates might be set as, for example, CDOR plus 175 points, or bank prime less 125 points.

Commercial Mortgages

Mortgages are loans issued with real estate as security. Terms vary from one to five years, but amortization may be from 15 to 25 years. In some cases, the mortgages may be non-amortizing, with payment of interest only, so the full amount of the loan is due at maturity.

In most instances, loans may be up to 60% of property value, although up to 75% may be considered in exceptional circumstances. As with other types of credit, banks may be quite conservative in assessing commercial real estate, so often better rates and terms may be found with non-bank lenders.

Letters of Credit

A letter of credit (LC) is used in the case of international sales where the buyer and the seller do not have an existing relationship. It obligates a bank to make a payment on behalf of a customer in connection with a specified transaction. Then, if executed, the LC entitles the bank to reimbursement from the customer. Canadian companies mostly use LCs when importing from another country. Offering an LC eliminates a supplier's concern about the importer's creditworthiness.

As soon as the applicant signs the document accepting its terms and conditions, the LC becomes a promissory note. The issuing bank reserves funds to meet claims against the LC. The bank is committed to paying the LC once it receives certain specified documents (e.g., bills of lading). The bank must honour the LC if the goods arrive in accordance with their description in the LC, even if they are defective. Therefore, if you are an importer, be sure to provide a sufficiently explicit description of the product in your application for the LC. The bank will compare this description with the description in documents it receives from the customs broker. If there is a discrepancy, the bank will not honour the LC.

Normally, the full amount of the LC will be applied against the available credit line. For example, consider a manufacturer with a $5 million line of credit that asks the bank to issue an LC for a $200,000 purchase. The bank will reduce the credit line available by the full amount of the LC, leaving an available credit line of $4.8 million.

If you are an exporter, you can request an LC to reduce the risk of the buyer not paying for the goods.

Other Credit-Related Services

Most banks offer some level of venture capital, mezzanine funding and leasing services. Banks are becoming significantly involved in fee-based services. These may involve merchant banking-like functions (e.g., mergers and acquisitions, financial consulting, bridge financing) and money market functions (e.g., bankers' acceptances, commercial paper).

Non-Bank Lenders

The term "non-bank lender" has multiple meanings. In the consumer market, it often refers to alternative sources other than banks for mortgages. Here, however, it means any source of debt other than a bank. Technically, it means a lender that does not accept deposits and hence is not a bank. But even that definition has exceptions. For example, credit unions accept deposits and make loans but are not banks.

Lending in Canada is dominated by the Schedule I banks; so in general, the term "non-bank lenders" may refer to a source of funds other than a Schedule I bank. Many such lenders offer products similar to those of the Schedule I banks, but there is also a variety of other credit products available. These are discussed further in **Section 5** – Financing Alternatives.

4. Equity and Investors

> "The second vice is lying, the first is running in debt."
>
> Benjamin Franklin

"Residual Interest"

Equity is the residual interest of owners or shareholders: arithmetically it equals total assets minus all liabilities. It can be thought of as the foundation of business financing. As noted earlier, a start-up normally is financed only by equity since its cash flows are too uncertain to permit any debt financing. As the business grows and stabilizes and cash flows become less variable, then the business can assume debt.

Many businesses suffer from a lack of equity capital at some point during their life cycle; that is when it becomes a roadblock to both growth and progress. It can even be a threat to the company's survival. The pandemic has highlighted this as companies with available cash or borrowing capacity have been able to better weather emergencies such as having sales eliminated or significantly reduced.

Creditors who hold debt are protected by equity capital. They are paid off before equity investors if there is bankruptcy or liquidation. Thus, equity owners take the greatest risk, and correspondingly expect the greatest reward, which makes equity an expensive source of financing. That is why, once operations are stable, businesses seek to obtain debt financing: debt is cheaper than equity.

The cost of debt is measured in terms of interest payable; the cost of equity is related to the amount or share of ownership given up and dividends paid. The true cost of ownership can be not just a portion of any retained earnings but, more significantly, that of sharing increases in the value of the business with other investors.

The Debt-to-Equity Ratio

A rule of thumb in determining how much equity is sufficient is with the debt-to-equity ratio. As noted in Section 2, banks have extremely high debt-to-equity ratios; however, for most businesses typical ratios are from 1:1 to 2:1. The debt burden is also assessed against the ability to cover the cost of the debt, which is measured as "times interest earned." This is earnings before interest expense and income taxes (EBIT) divided by interest expense. Here is an example of the calculation:

	Year ended December 31, 20X1
Sales	$ 2,500,000
Cost of sales	(1,600,000)
Gross margin	900,000
Expenses	(650,000)
Interest expense	(100,000)
Income before taxes	150,000
Provision for taxes	(45,000)
Net income	$ 105,000

In this example, EBIT is income before taxes + interest expense ($150,000 + $100,000) = $250,000. So, EBIT divided by interest expense is $250,000 ÷ $100,000 = 2.5 times interest earned. That is on the low side of a healthy ratio, which is normally in the range of 2.5 to 4 for most businesses. Once the ratio goes below about 1.4, then lenders become concerned as to the business's ability to service debt in tough times. A ratio below about 1.2 means the business is close to being insolvent, that is, unable to service its debts.

Outside Investors

Adding equity investors can mean bringing in another investor or shareholder to the business. This might be friends or family, acquaintances or other informal investors, an institution or experienced venture capitalist.

Often, having outside investors can improve the quality of financial reporting and encourages a focus on internal control. Both are essential in a well-run business, but the increased formality in reporting to outside investors, perhaps with representation on the board of directors, adds an element of financial discipline and rigour, which may be favourably received by banks and other lenders. Of course, for an owner used to answering to nobody else, outside investors can be seen as a nuisance or impediment.

Having additional shareholders can have the following positive results:

- add financial and management depth:
  - increase credibility of the business to lenders and other investors
  - bring knowledge of financing and sources
  - add discipline to business planning
  - build additional negotiating strength and a source of counsel
  - bring knowledge from other businesses
  - provide contacts in the business community
- make additional funds available, if needed
- improve the debt-to-equity ratio, which is a good thing from the perspective of the lenders
- enhance objectivity, since there is an outsider looking in
- have a fully functioning board of directors, which encourages or results in:
  - periodic reviews of business plans
  - more formal accountability and written reports
  - increased focus on governance and internal control: good for the business and viewed positively by lenders and investors
  - financial or operational assistance in case the owner is no longer capable to pay, and perhaps contacts for urgent assistance
  - aid in estate planning; for example, the incumbent shareholder can liquidate some of his investment to the partner and establish a successor in the business

Having additional shareholders can have the following negative results:

- reduce the operational freedom of the owner / manager
- force the owner / manager to abide by a shareholders' agreement
- require unanimous shareholder approval for certain matters

- compel the owner / manager to report to other shareholders, even if they only hold a small position

A business requires different types of financing from different sources as it progresses through its many stages of growth. There will likewise be different sources of equity financing required at various growth stages of the business.

Following are some examples of sources of equity financing available to the entrepreneur:

- Private sources (informal investors):
  - personal funds, friends, relatives, etc.
  - angels (i.e., private investors who fund early-stage businesses)
  - clients of professional advisors ("private placements")
  - customers
  - successful entrepreneurs
- Government sources:
  - provincially sponsored business development equity corporations
  - grants or subsidies (which represent "free" equity)
  - forgivable or performance loans
- Industry sources:
  - significant competitors, suppliers or customers
  - strategic partnerships, for example a joint venture with a supplier
- Venture capital:
  - institutional pools such as pension funds, trust companies and insurance companies
  - corporate holding companies
  - private investment syndicates
- Employee share ownership plans:
  - or ESOPs, under which employees acquire ownership in their employer
- Internal sources:
  - retained earnings (i.e., by not distributing profits)

5. Financing Alternatives

> A small debt produces a debtor, a large one, an enemy.
>
> Publilius Syrus (first century BCE)

In addition to straightforward debt (term or operating) and equity, there is a variety of additional types of financing. Some alternatives have characteristics of both debt and equity (e.g., mezzanine debt), others offer different options to a business.

Mezzanine Debt

Mezzanine debt is so called because it is between debt and equity (i.e., on the "mezzanine," rather than the ground level or the second floor). Normally it is a loan with a higher interest rate than conventional term financing from a bank. It may also carry an "equity kicker" whereby the lender receives options or shares in the corporation or otherwise shares in profits or cash flows. In other cases, the debt may be convertible into equity at the option of the lender. As a result, it can be quite a bit more costly than straight debt. Sources of mezzanine debt include private funds, Schedule II and Schedule III banks, venture capital arms of Schedule I banks, pension plans and individual private investors.

Mezzanine debt is subordinate to bank and other term loans and is often secured by fixed assets. Sometimes payment of interest may be deferred; interest paid is tax-deductible, unlike dividend distributions on equity. Mezzanine lenders look for situations with stable cash flows and often have a long-term time horizon. They will often expect a seat on the board of directors in addition to meeting financial covenants and terms and conditions.

Preferred or Special Shares

Conventional equity refers to common shares, which are shares that represent the residual interest in the corporation and are the last in line to receive any proceeds if the corporation is liquidated. There are also forms of equity, called "preferred shares" or "special shares," that carry special rights. They may be redeemable or retractable and so may be repaid; they may carry a stated dividend rate; and they normally receive proceeds on liquidation before common shareholders. They may be non-voting or carry a different number of votes (either more or less) compared to common shares. In fact, their special features can be quite varied. Issuing such shares permits having multiple classes of shareholders, which may be one way for an owner to bring in more equity without surrendering control of the corporation.

Government

Governments in Canada at all levels have long provided assistance to businesses in Canada ranging from grants to loans, which are sometimes forgivable. Grants may be direct (e.g., the various COVID-19 relief measures directed at businesses) or they may be indirect (e.g., scientific research and experimental development [SR&ED] tax credits) which directly reduce income taxes payable or result in a cash refund. There are also the Business Development Bank of Canada (BDC) and the Export Development Corporation (EDC), crown corporations that exist to assist businesses, created by but operating separately from the federal government.

The BDC has a mandate to support entrepreneurs in Canada. It currently has $36.5 billion in loans and guarantees to 62,000 small and medium businesses in Canada.[2] In addition to its existing programs offering financing from $100,000 to $60 million, the BDC has introduced special programs during the pandemic emergency. Its website is at bdc.ca.

2 Business Development Bank of Canada. (2020). Who we are. (bdc.ca/en/who-we-are)

The EDC has traditionally focused on helping Canadian companies compete for exports internationally by offering credit guarantees and financing. Since March 2020, its mandate has been extended by the federal government to help non-exporting Canadian companies cope with the pandemic. Its traditional product has been offering 90% credit insurance to exporters (for which it charges a fee), but now it is involved in related areas to support corporations in Canada. Its website is at edc.ca.

With the pandemic, federal, provincial and municipal governments – have introduced more programs. The programs are always changing; Section 7 – Resources to Help You Recover includes suggestions to help you explore the various possibilities.

Selling the Asset: Leasing and Factoring

A traditional way of obtaining financing has been by renting the use of an asset rather than owning it outright. For fixed (or long-lived) assets, leasing has been a popular method. The owner (lessor) is willing to lease in situations that offer a greater risk of default because if the renter (lessee) fails to honour its obligations, it is easier to repossess the asset and then sell or otherwise dispose of it. For lessees unable to access sufficient credit, a lease offers a convenient solution. At one time such leases offered a means to avoid recording the total cost of an asset and the associated loan on the balance sheet, but this has not been true for many decades. (Under International Financial Reporting Standards [IFRS®], even short-term leases must usually be shown as the full value of assets and liabilities under lease; under Accounting Standards for Private Enterprises [ASPE], this generally applies to longer-term leases. This is an approximation; the rules are complex.)

Factoring refers to selling accounts receivable to another company (called the “factor”). This differs from the normal arrangement whereby the collection of receivables may be part of the cash flows that help service an underlying loan. The risk to the lender is reduced since it owns the receivables directly. This may permit financing in cases where it is otherwise unavailable due to the financial condition of the borrower. From the perspective of the borrower, factoring should be “transparent” to the customer paying the amount owed on the receivable. If the factor is able to deal directly with the customer, that can be perceived as a very negative reflection on the company’s financial soundness. In some cases, the factor may have the option of, for example, offering a discount to the customer paying the receivable, which again will create a negative perception for the original owner of the receivable.

Leasing and factoring can provide useful options for businesses managing tight cash flows or unable to secure more conventional types of financing.

6. My Lender Is Not Happy: Dealing With a Crisis

> Neither a borrower nor a lender be,
> For loan oft loses both itself and friend
> And borrowing dulls the edge of husbandry.
>
> *Hamlet (Polonius),* William Shakespeare

My Lender Is Not Happy

The pandemic has caused successful businesses to suddenly face situations of no revenue or significantly reduced revenue, resulting in serious cash flow issues and consequent problems when dealing with lenders. For owners, financial difficulties can bring on periods of anguish, despair and unrelenting stress. If you lose your objectivity or give in to panic, these periods can be dangerous times indeed.

This is the time to deal head on with secured and unsecured lenders and other creditors. The problem might not go away, but it can be resolved. Stand back, assess the conditions, analyze the causes, develop an action plan, and carefully carry out a strategy for turning the business around.

Seek the right support. Turn to your professional advisors for guidance and assistance. As they will probably have seen your problem before in other businesses or industries, they can offer an objective viewpoint and proven strategies.

Early Warning Signs

In the months before calling a loan, lenders frequently try to shore up support of existing security by requesting the addition of new guarantors (e.g., a spouse) or the pledge of collateral mortgages on personal assets. At this point, the owners must make a difficult decision: Should they continue to allocate personal capital to the company in the belief that it can survive, or are they just throwing good money after bad?

Lenders may attempt to reduce the amount of credit available by changing margin requirements. They will closely examine the covenants of the underlying loan agreements or term sheets to determine whether the borrower has breached its contractual obligations.

When concern mounts, a lender will often suggest an independent consultant to give your business what is known colloquially as a “look see” or a “quick and dirty.” The consultant will review operations, assess the strengths and weaknesses, and attempt to determine the company’s viability. In many instances, a positive report can result in a renewal of support by the lender. However, the opposite may also occur; resistance or a lack of co-operation will not serve the best interests of your business.

Think Like a Lender

When you sense financial difficulty, your first step should be to identify and review the early warning signals lenders look for. Lenders know a business is in trouble when they see one or more of the following situations:

- lack of management depth (including a lack of specific skills for the particular business), or conflicts within the management team
- lack of up-to-date financial information
- operating losses or deteriorating financial ratios
- new and significant competition in the marketplace (due to product obsolescence, poor service or competitors' aggressive pricing)
- loss of a major customer or overconcentration of sales to a few customers
- continued failure to meet sales or margin objectives
- rapid expansion but slow change in personnel, systems and controls, and required financing
- exposure of the business to external conditions beyond its control (apart from pandemic-related matters), such as a construction project delayed by continuous bad weather or protracted labour strife

Generating Cash

Your first line of defence is to focus on generating liquidity. Cash gives flexibility. You need to be objective and hard-nosed when considering the various tactics set out in the rest of this section. All too often, management will rationalize why particular actions cannot be taken. Later, when the receiver takes over, the need for timely action is usually confirmed – but by then it is too late.

How can you generate cash? Following are some typical steps to consider, perhaps with the assistance of your accountant.

Generating cash by managing assets

Inventory

- Reduce and liquidate excesses.
- Speed up the production cycle.
- Establish consignment stocks from suppliers.
- Introduce "just-in-time" inventory management.
- Sub-contract production of certain components.
- Investigate ways to optimize manufacturing costs.
- Obtain deposits / prepayments from customers.

Accounts receivable

- Aggressively follow up collection of delinquent accounts.
- Offer customers a significant prompt-payment discount.
- Factor the outstanding accounts to realize a higher ratio of cash to receivables, and retire the existing operating line.

Fixed assets

- Dispose of non-performing divisions, departments, or assets.
- Sell and lease back certain assets.

Other assets

- Dispose of non-core assets or divisions.
- Sell or license any "rights" owned by the business.

Generating cash by managing liabilities

Accounts payable

- Persuade trade creditors to accept payment on extended terms. For example, extend a portion of the account to a term basis of six to 12 months with interest; offer a purchase money security interest in return for extended terms. (A purchase money security interest is a form of applicable trade creditor security under applicable provincial personal property security legislation.)
- Consider a proposal to creditors, either formal or informal, to freeze existing unsecured creditors.
- Informally extend the payment schedule.

Operating costs

- Assess all operating costs, overhead and personnel; then reduce where possible.

Other ways of generating cash

New equity capital

- Raise fresh capital from employees, suppliers, customers, venture capitalists or existing shareholders.

Hidden values in assets

- Realize hidden values in assets through sale / leaseback or a remortgage.

Restructuring

- Through arrangements with secured creditors, postpone and/or capitalize certain debt or fixed payments.

Lender Signals

The lender may send you a legal or official notice if you miss a payment or otherwise violate the terms and conditions of the loan. But there are many other signals from a lender that should prompt you to move quickly to avoid more serious consequences.

Isolated signals do not necessarily indicate problems with your lender. However, when a pattern or trend occurs, you must look at your present performance and financial condition. A summary of the various signals you may receive from your lenders is set out below. If you are able to act promptly, it might be possible to mitigate some of the effects of a deteriorating financial position.

Subtle Signals

Individual signals may not indicate a serious problem but, when combined with other factors, they may give clues to deeper issues.

More frequent contacts from the lender

When a bank sees an account deteriorating, it will start to monitor it more closely through more frequent telephone calls and visits. You might even have visitors from the bank's head office who want to see the business in operation and meet management face to face.

Change in account supervision

If your account supervision has been changed, you may now be dealing with staff, perhaps from a regional office, who are in fact specialists used to dealing with troubled accounts (these departments are often called "work out" or "special loans").

Change in pace of decision-making

You may notice that the bank is responding more quickly in making decisions about your account and credit line. Or if your bank delays responding to your requests, it may be reviewing your account and trying to reach a consensus internally as to the appropriate course of action.

Requests for more information

While assessing a credit application, a bank may ask for more information to debate the request internally. However, it could also just be seeking the information because the branch made an oversight in not initially requesting all the required information.

Reluctance to increase your line of credit

If the bank is reluctant to increase your operating line of credit, this may be a forewarning that it is concerned about your account.

Requests for asset appraisals

A request for updated asset appraisals or new appraisals on assets not now encumbered is probably a sign that the lender is re-examining its security position.

Serious Signals

The warning signs below are indications that the lender is getting more concerned. There might be time for you to analyze current circumstances and develop a new financing strategy – but you need to move quickly.

Imposition of new loan terms and covenants

Loan agreement covenants are often minimal and seldom exercised. However, if the bank strengthens and begins enforcing these covenants, this may be an indication that it is preparing documents for calling your loan.

Request for a management action plan

The appearance of certain negative trends and performance indicators may cause the bank to request an outline of how management plans to take action. The bank will then decide whether this plan is a satisfactory first step. Obviously, the bank expects you to carry out the plan as the second step.

Additional security

A request for further security is certainly an indication of a bank's concern. Previously unencumbered assets may have to be secured, or new forms of security may be imposed on the same assets. In many instances, the owner/manager will be asked to pledge personal assets "to demonstrate a commitment to the business."

More equity

A request for more equity may mean the bank wants to see you put in place a solid foundation for future expansion. On the other hand, the bank may request that the proceeds from the new equity issue be used to repay the bank's loans directly or at least improve the debt-equity ratio.

Requirement for a consultant's review

The bank may also require an independent review and assessment of your business operations and financial condition. The latter usually includes a review of the bank's security documentation, and evaluation as to how well the bank is protected. A positive assessment may even lead to increased credits. A negative assessment, however, gives the bank additional grounds for more severe action.

New support professionals

If unfamiliar lawyers, accountants or insolvency specialists call or visit your business, your lender is probably looking for additional technical support to deal with a troublesome situation. It may take some very direct questioning on your part to find out exactly what these individuals are seeking.

Meetings "downtown"

A request that you meet senior or specialized personnel at a regional office may indicate your bank has called in more senior or specialized individuals to intervene because of concerns. They have clearly escalated your loan into the high-risk category.

A "No" answer

Banks are in the business of lending money and supporting "good" customers. Accordingly, when a bank says "no," it is a statement that they are unhappy with the request or the business.

Reductions in authorized lines of credit

A bank limits an authorized line of credit in order to limit its own exposure. It acts according to its current assessment of the industry, the particular business's performance, or the value of the security pledged by the business.

Reduction of margins / security coverage

If the bank reduces margins or security coverage, it may be attempting to bring the borrowings more in line with the value of the security in order to minimize its exposure.

Requests for higher rates or administration fees

The bank may raise rates or administration fees to offset a perceived increase in the risk of your account. In particular, it may levy the higher fees to pay for additional monitoring and head-office internal reporting. Some banks have been known to increase fees to such an extent that the customer will indirectly get the message to take their business elsewhere.

Suggestions to refinance at another bank

If the bank suggests that you should refinance elsewhere, that provides a clear indication that they do not consider your account to be of adequate quality.

Inability to refinance at another bank

If you are unable to refinance at another bank, you should conclude you are getting the hard-knock, "second" opinion that your account is not considered attractive.

Open descriptive statements

"Non-performing," "non-revolving," "under-margined" or "over-trading" may be terms you start to see your bank using to explain a change in your relationship. These euphemisms need to be clarified. Ask the bank directly for its current assessment of your account.

Cheques returned "NSF"

Since an NSF cheque might start a chain reaction with your suppliers, banks will not send back cheques on a commercial account without a good reason. NSF cheques indicate a very serious situation.

Crisis Time – Operational Actions

Once you realize your lender or bank is uneasy but (hopefully) not panicking, you must next understand its approach so you can develop a strategy for improving its confidence in you while you reduce the likelihood it will take severe action. Banks and lenders know that taking aggressive action takes a lot of time and energy and usually produces less-than-satisfactory results. Formal proceedings often bring skeletons out of the closet – the bank may find defects in their documentation or shortfalls in their monitoring process in the past.

When banks establish that business conditions or security coverage are not deteriorating, they will usually postpone taking severe action. The bank will, in fact, likely be looking for a reason to do nothing! For you to reinforce this attitude, make sure the lines of communication do not break down and that the bank finds no reason to lose confidence in the integrity of management.

Talk to all key suppliers

Since you are already talking to your lender or bank, also talk to your landlord and other key suppliers. Keep them informed. If they understand that you are trying to deal with the crisis logically and systematically, perhaps they will "cut you some slack." Perhaps they will consider a discount or accept a promise to pay much later, rather than writing off the debt. At least, if they are co-operative, you can have a productive discussion and possibly agree on a solution.

Cut expenses

You have likely done this already, but take another look. What can you still cut out? Look at everything going through your bank account. Eliminate everything that is not necessary. For example, during the pandemic, retail stores have carefully reviewed staffing to ensure that every hour of employee time is essential to the business. Customer service may not be at optimum levels, but customers understand that we are going through crisis times. Another example is automatic monthly payments that should be reviewed. A small grocery store found that it was paying every month for access to a human resource information system that was not necessary and could be replaced by manual recordkeeping.

Focus on profit margins

Review the information you get from your accounting systems: Where can you make operations more efficient? For example, during the pandemic, restaurants have focused on menus without premium ingredients to reduce waste if sales suddenly do not materialize due to a sudden change in permitted operations (e.g., a new lockdown). Others have quickly altered their strategies by reconfiguring their space to offer retail supplies and take-home pre-cooked meals.

Accelerate receivable collections

There are multiple techniques for speeding up the collection of receivables. Not all of these apply to every business, but here are some ideas:

- Make it easy for customers to pay (e.g., by electronic payments through your bank or by accepting credit cards).
- Ask for deposits or prepayments.
- Send out invoices promptly and frequently – do not wait for the month-end.
- Follow up slow-paying accounts.

Alter payment schedule

The flip side of accelerating collections is slowing down payments. Here are some ideas; again, not every one will apply to every business:

- Did you build up credibility by paying quickly in the past? If so, take advantage of that and engage your suppliers in a discussion.
- Stretch out your payments as much as possible.
- Many businesses are now having severe cash crunches. Talking to suppliers might identify solutions that give a win-win: discount for payment, agreeing to extended terms, and so on.

Creative sources of cash

Throughout this *Toolkit* there are suggestions for creative sources of financing: governments (all three levels) for loans and grants, factoring, new sources of equity, and so on. Review these ideas one more time, perhaps with an expert.

Talk to an expert

Your CPA or lawyer might be able to give you a fresh perspective. Insolvency specialists (many of whom are CPAs) also handle restructurings and may have novel ideas as to how you can salvage things.

Steps for Dealing With a Concerned Lender

Once your lender is concerned about its debt, you can try to minimize the potential damage by following a sequence of 10 steps, set out below. At all times, you must endeavour to keep ahead of problems and demonstrate to the lender that you have the situation under control. Absent that, the lender may wrest control away from you.

1. **Ensure open lines of communication with the lender**
   Be open and forthright – avoid surprises. Surprises can cause a lender to panic! Be co-operative. Solicit joint solutions.

2. **Maintain credibility**
   A principle of finance is that credibility generates confidence. Confidence is the cornerstone of any successful borrowing relationship. Similar to the step above, good communication helps establish and maintain credibility as long as it is not fractured by deceit, dishonesty or deception. Always tell your lender both the good news and the bad news – and certainly always the truth.

3. **Act quickly and decisively**
   As the owner/manager, you must communicate to the lender a clear understanding of the problems and a commitment to do something about them. Inaction by the management often leads to action by the lender. Assess the problems and present a credible action plan. Consider consulting an experienced person if you or your organization are weak in one or more functional areas (e.g., a marketing professional or a financial consultant).

4. **Engage experienced professional advisors**
   You may need to consult experienced financial specialists to help develop an objective and realistic assessment and action plan. To understand your legal options, this may be the time to talk to experienced legal counsel, but the emphasis should be on operational and business, not legal, solutions.

5. **Conserve cash**
   Your flexibility is enhanced through a reservoir of cash. Consider the remedial actions suggested throughout this *Toolkit*.

6. **Back up your action plan**
   If you have been drawing a generous salary, bonuses or dividends from the business, now is the time to tighten your belt and reduce your take. You may have to sell or mortgage personal assets to cover living expenses. If you have other sources of funds, invest in the business and demonstrate your commitment. A new infusion of capital from the owner /

manager will go a long way toward building the confidence creditors need before they can accept a proposed action plan.

7. **Co-operate with all lenders in developing your action plan**
   If all lenders play a role in developing the action plan, they will be more likely to support it. They may also suggest new ideas and alternatives. Developing the action plan in isolation may waste valuable time and lead you down a path to nowhere.

8. **Respect the priority position of creditors**
   Your credibility may be destroyed if the action plan appears to favour certain creditors at the expense of others. Develop a plan that is fair and equitable to all, taking into account their legal status.

9. **Contemplate the inconceivable**
   On the brink of insolvency proceedings, management and shareholders must be prepared to do the inconceivable. If the "crown jewels" must be sold to generate cash to salvage the remainder of the business, sell them. Nothing is sacred at such times. Ruin can be the price of pride.

10. **When all else fails . . .**
    If, in the final analysis, none of the foregoing is feasible, the most prudent next step is to develop your own liquidation strategy and present it to the lender as a more cost-effective solution. If necessary, this strategy may require you to work closely with those the lender designates in a monitoring role, rather than in a receiver's role. Ideally, you will have a role in selecting a receiver, rather than passively letting things happen.

Usually, an owner/manager is much more effective in liquidating business assets than a receiver. The proceeds from the sale of assets may be used to reduce your personal exposure on any guarantees.

If the lender demands payment, case law has established that it needs to provide reasonable notice and time to pay. If a secured lender liquidates assets through a receiver, you should review the legal aspects of the action but, in most instances, be prepared to co-operate. Your lawyer will consider legal precedents related to improvident realization, breach of undertaking, or lack of seasoning of security.

7. Resources to Help You Recover

The Plan

This *Toolkit* has provided a variety of techniques and suggestions for obtaining financing in general and dealing with the crisis that many businesses are going through right now. The paths each business needs to take to recover from the pandemic and prosper going forward will vary.

If there is a crisis right now with your lender or banker, please review carefully the preceding Section 6 – My Lender is Not Happy: Dealing With a Crisis. If you are proactively trying to prevent a crisis down the road, see the earlier sections.

To survive and prosper, regardless of where you are now, you need to have a written plan as well as a budget and rolling forecast. Other *Toolkits* in this series will help you; please refer to **www.cpacanada.ca/ontariosmallbusiness**.

Government Resources

The rules are constantly changing, and you need to be up to date. Consult current links on the Internet to be sure you are current on both government requirements and programs that assist businesses.

The links below are a starting point. They will direct you to specific resources for businesses, but those specific links frequently change. The starting point should always be those for Canada and the province (or provinces) where your business operates.

- Government of Ontario: COVID-19 pandemic information and links to specific information (**covid-19.ontario.ca**)
- Government of Canada: COVID-19 pandemic information and links to specific information (**www.canada.ca/en/public-health/services/diseases/coronavirus-disease-covid-19.html**)

CPA Canada is monitoring the COVID-19 pandemic for any new developments related to its economic impact:

- CPA Canada COVID-19 information resources (**www.cpacanada.ca/en/members-area/covid-19-resources**)
- CPA Canada COVID-19 financial literacy resources (**www.cpacanada.ca/en/the-cpa-profession/financial-literacy/financial-literacy-resources/covid-19-financial-literacy-resources**)
- CPA Canada Ontario small business financial literacy resources (**www.cpacanada.ca/ontariosmallbusiness**)

Other Resources

Excellent and up-to-date information is available from the websites of CPA firms, law firms, and others. Following are a few examples (all are Canadian sites or reference Canadian information). Of course, you should ensure that the information is current and should cross-check it with other advice before relying on it.

Business Development Bank of Canada

- Business plan template (**www.bdc.ca/en/articles-tools/entrepreneur-toolkit/templates-business-guides/business-plan-template**)
- Information to help your business take action during the COVID-19 crisis (**www.bdc.ca/en/special-support**)

CPA firms

- Bakertilly (www.bakertilly.ca/en/btc/covid-19-business-guidance)
- BDO (www.bdo.ca/en-ca/covid-19/home)
- Deloitte: and enter "Covid 19" in the search window (www2.deloitte.com/global/en/pages/about-deloitte/topics/combating-covid-19-with-resilience.html)
- Ernst & Young (www.ey.com/en_ca/covid-19)
- Grant Thornton (www.grantthornton.ca/insights)
- KPMG (home.kpmg/ca/en/home/insights/2020/03/the-business-implications-of-coronavirus.html)
- MNP: (www.mnp.ca/en/covid-19)
- PwC: (www.pwc.com/ca/en/covid-19.html)

Many other CPA firms have guidance as well; those above are the largest firms in Canada.

Law firms

- Blakes: (www.blakes.com/covid-19/articles)
- BLG: (www.blg.com/en/insights/2020/03/covid-19-breaking-developments-and-essential-resources)
- Gowling WLG: (gowlingwlg.com/en/topics/covid-19-how-will-coronavirus-impact-your-busines/)
- Miller Thomson: (www.millerthomson.com/en/covid-19-resources)
- Stikeman Elliott: (www.stikeman.com/en-ca/kh/guides/COVID-19-Canadian-Legal-Resources)
- Torys: (www.torys.com/covid19)

The law firms listed above have landing pages that take you to pandemic guidance. Many other Canadian firms have extensive information: on their home page, search for "Covid" or "pandemic resources."

For more information visit:
www.cpacanada.ca/ontariosmallbusiness

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