

Working with your banker

B U S I N E S S C O A C H S E R I E S

- 
- How the system works
 - What your bank expects of you
 - How to maintain a banker-friendly relationship

Getting support when you need it

The situation

You are operating a going concern, a business that is growing. However, you are also aware that even well managed companies can falter due to numerous factors: economics, politics or a cyclical slump. Financial problems that might affect a business in the future include:

- *lengthening accounts receivables*
- *bad debts from companies that previously had excellent records*
- *suppliers becoming very demanding and, in some cases, putting the business on COD (Cash on Delivery)*
- *a buildup in inventory and reduced gross margins*

Should the time ever come when strong financial support is needed for survival, will you have access to the money you need? If not, what is the alternative?

The solution

At BMO Bank of Montreal®, we are committed to helping Canadian businesses develop and succeed. The purpose of this Business Coach is to outline how the banking system works, as well as how to make the banking system work for you. We will provide the practical information you need to build a long-term relationship with your banker. If at some point your company is the victim of a financial slump, you will truly appreciate the relationship you have developed with your banker — a relationship that may mean the difference between turning your business around or closing it down.

As this Business Coach points out, the relationship is built on trust, and trust is built on the information you share with your banker as well as when and how you provide it.

Canada's banking system

To build a strong relationship with your banker and use the banking system to your advantage, you must understand the system within which bankers operate, as well as how the services they offer you work.

All banks in Canada are subject to federal legislation. Under the Bank Act there are three types of banks:

- **Schedule I** — widely held banks that include all the major banks of which BMO Bank of Montreal was the first
- **Schedule II** — banks that are closely held by foreign banks or other eligible financial institutions
- **Schedule III** — foreign banks that have received permission to establish specialized, commercially focused branches in Canada

Banks have shareholders and a responsibility to make a profit to ensure shareholders receive a return on their capital. Banks operate by borrowing money from one source and lending it to others. The profit is the difference between the cost of borrowing and the rate at which they lend (the “spread”), less their overhead.

Remember, whatever your relationship with your banker, he or she works for a company that must make a profit. So if the risk of the loan cannot be reconciled with the return, there is no deal. Therefore, it's your job to convince your banker that you're a good risk.

Schedule I banks

Canada's major banks are usually a national (or at minimum, provincial) network of branches offering what is known as full-service banking, i.e., both consumer and commercial banking services.

Schedule II banks

Schedule II banks operate differently from Schedule I banks. Most, but not all, concentrate on commercial business with loans usually in excess of \$2 million and rarely less than \$500,000. They operate from a few locations and tend to specialize in foreign-related credit and “off balance sheet” financing. With a few exceptions, their services are not directed to small business.



What banks can offer

Short-term lending

Canadian banks are generally an excellent source of short-term financing for working capital in order to meet the operating requirements of your business.

- **For Operating Lines/Lines of Credit/ Revolving Accounts**, the bank will probably require security in the form of:
 - Good quality receivables — “good” usually means under 90 days (depending on industry and conditions); for a loan or line of credit, 75% of receivables is a reasonable target.

- Inventory — less liquid than receivables and more difficult to finance, so it’s rarely worth more than 20 cents on the dollar on forced sale. Target to borrow 50% of value of up-to-date inventory excluding work in progress and packaging.
- Other current assets; other deposits.
- Guarantees from owner/owner’s spouse.
- Collateral — outside security such as land or buildings not in the business.
- Fixed or floating charge debentures — a charge against the company’s assets, after mortgages and term loans, secured by specific charges, and so on.
- Annual review — banks review all accounts at least annually, so be sure you know your review date and have your numbers ready.
- **Letters of credit.** Banks guarantee to make payment to a seller up to a certain sum at the request of the buyer. Although useful in foreign transactions, remember that a letter of credit usually reduces your operating line by the same amount.
- **Bridge loans.** Short-term loans for special purposes such as closing a purchase while permanent capital is sought or interim financing of real estate before permanent mortgages can be drawn down. Usually heavy excess coverage is required from other sources such as collateral or pledging of shares or other assets.
- **“Bulge” accounts.** Many businesses have seasonal or cyclical requirements based on pre-season high inventory, low receivables, and so on. A bulge is a very short-term (days to, say, three months) prearranged addition to a normal line of credit, often with additional security required and monitored frequently.

- **Overseas credit.** Credit facilities can be arranged in other countries. Ask your banker.



Tips

Find a banker who understands your business.

Term loans

These are loans that are to be paid back over a period of generally one year to five years, and occasionally longer depending on the life of the asset. The interest rate can be fixed or floating.

These loans are for specific needs with a long-term benefit, such as a new piece of equipment, or the purchase of another company or operation. Some term loans can be non-revolving loans payable on demand.

The bank will probably require:

- **Coverage by the value of the asset(s)** with some cushion for it’s depreciation or fluctuating market value.
- **Recognizable economic benefit.** A payback of the value of the assets in less than five years.
- **Coverage of interest.** Sufficient “free” cash flow to be sure interest will be paid on time; two to two and a half times is common. Example: interest \$5,000; free cash flow \$10,000 to \$12,500.
- **Scheduled payback.** Term loans usually have monthly payment schedules. Sometimes there are alternate repayment schedules such as, quarterly, lump sum or “balloon” payment at the end; sometimes there are blended principal and interest payments, although this practice is more common with mortgages.

Mortgages

- **Conventional.** For buildings or land, interest rates are fixed for one to five years and the loan usually amortized over a long term — 10 to 15 years.
 - **Collateral.** Where land or buildings are taken as security for other loans.
 - **Chattel.** For security over moveable equipment.
- The bank will probably require:
- **Coverage by the asset(s).** Up to 70% of replacement value of land and buildings.
 - **Blended payments.** Mortgages usually have fixed schedules of monthly or quarterly payments that include interest and graduated repayment of principal.

Other loan or financing possibilities

- **Leasing.** Either arranged directly (see the companion Business Coach booklet *Finding Sources of Capital* on this topic) or through the supplier of the equipment. Particularly useful when the equipment is subject to rapid obsolescence.
- **Factoring.** A variation of accounts receivable lending, but more expensive. However, the bank provides the credit checks, collections, and so on.
- **Warehouse receipts.** A variation of lending against inventory; not common with small businesses.
- **Floor planning.** Particularly useful for financing of models, for display purposes, before the selling season. Used particularly in automotive financing situations.
- **Business improvement loans** under the federal government's Canadian Small Business Financing Act. These are term loans for new,

or additions to, fixed equipment or buildings or leasehold improvements. Since these loans are subject to a government guarantee, amounts up to a fixed limit can be obtained at competitive rates. Ask your banker.

- **Guarantees.** Many provinces, some federal government departments and the Business Development Bank of Canada (BDC) will guarantee bank loans. Check with your banker, local BDC branch, federal government offices, and provincial government offices.



Tips

Sharing your Business Plan with your banker will ensure a stronger, long-lasting relationship.

Non-loan services

- **Payroll deductions.** The bank will often handle all payroll accounts including deductions, through either originating cheques to be mailed or depositing directly to employees. Watch your account balance, since money may go out two days or more earlier than if you had managed it yourself.
- **Term Deposit Receipts/Certificates of Deposit.** If you have excess cash, the banks can use it and pay you interest. Consider Term Deposit Receipts (TDR) or Guaranteed Investment Certificates (GIC) of 30, 60, and 90 days and longer. The interest is payable to your account and the TDR/GIC is usually renewed unless specifically cancelled. Check cancellation privileges or ability to borrow against TDR/GICs if a new need for cash suddenly arises.



- **Cash management.** Most banks offer cash management services, internet or telephone banking, draw cheques, lock box, night depository etc.
- **Insurance.** Business loan insurance covering only the outstanding principal can be arranged through the bank. The coverage diminishes as the loan does.
- **Electronic funds transfers.** Useful for multi-location businesses. Deposits in other branches can be credited same day to your branch, or account.
- **Credit cards.** Can be useful for salespeople and managers, since they reduce need for advances. Individuals are responsible, but statements can be mailed to company for payment and to maintain records centrally.

General services

Your banker can be an important source for:

- introductions — to potential customers/suppliers; other sources of capital
- economic trends and forecasts
- specific information on special industries
- information on companies for sale or looking for acquisitions
- export opportunities
- informative booklets such as the Business Coach Series

Tips



Take advantage of your banker's contacts for introductions to important business sources.

Lending requirements

The banker's first duty is to protect the depositors' savings and the shareholders' investments by making only good loans. It's in your best interest to convince the banker that you (and your business) are a good risk.

This is what your banker will likely consider when viewing your company:

• Security:

- current assets for the short term
- fixed assets for the long term
- collateral
- guarantees

• Liquidity:

Your ability to pay interest and pay down the principal on time or, if necessary, dispose of an asset to do so.

• Past performance:

- profits
- keeping your promise
- being on time with payments/information
- reliability

- **The company and its stability:**

- retained earnings and book value (see the companion Business Coach booklet *Making Sense of Financial Terms and Jargon* on this topic)

- paid-in capital

- dividends

- **Your own reputation and ability:**

- integrity

- experience

- commitment

- delegation and control

- **The opportunity for growth:**

- your industry: past performance, future potential

- your company: growth potential, and management’s capacity to handle it

When your business goes through challenging times

Your bank may:

- require you to reduce your loan
- ask for guarantees or additional security
- ask for more details on accounts receivable
- engage an accounting firm for a “look-see” study
- call the loan(s)
- place “third party” claims against all your receivables, i.e., notify your customers to pay the bank directly
- engage a receiver
- if necessary, collect against collateral security and guarantees



Tips

Bankers can best help you if they know your situation in time. A surprise is the sign that you aren’t running your business well.

How to keep your banker happy

If you want to maintain a good banking relationship, you should do most of the following; in fact, the first three recommendations are essential.

- **Have a business plan** and discuss it with your banker regularly (see the companion Business Coach booklet *Developing Your Business Plan* on this topic)
- **Prepare a cash flow budget** and update it monthly (see the companion Business Coach booklet *Planning Your Cash Flow* on this topic)
- **Prepare a list of aged receivables** and payables monthly, weekly or daily if in trouble.
- **Give your banker regular financial reports** before significant changes occur:
 - new large orders anticipated
 - plans for expansion
 - additions to premises
- **Report the bad news** before your banker hears from others:
 - receivables lengthening
 - inventory turns slowing down
 - suppliers becoming more demanding
 - increases in rent
 - loss of contracts or orders

Bankers can best help you if they know your situation in time. A surprise is the sign that you aren't running your business well.

- Have regular meetings with your banker whether you are currently borrowing or not.
- Establish a line of credit in anticipation of need determined from your cash flow. Maintain your credibility and ensure your banker does not forget you.



Tips

It's always smart to have your business plan and cash flow plan up to date.

- Have your banker out to your premises.
- Always pay down “bulges”, term loans and special loans on time.
- If you are going to be late with a loan payment, discuss the problem in advance and suggest a solution.
- Use your banker as an introduction to other sources of support and capital.
- Use some of the bank's other non-banking services if they meet your requirements.
- Keep your own personal finances in order. You don't have to use the same bank, but it helps sometimes.

Remember, bankers are wary of what they don't know. Keeping them in the picture is the best way to maintain their support.

Approaching a new bank

Since finding the right bank can be critical to your business, it's important to select yours with care.

- Find out which bank(s) has experience with your industry.
- Read appropriate literature from the bank.
- Get an introduction and arrange an appointment.
 - You may wish to send your business plan in advance with a one-page cover summary.
 - Make a presentation based on your one-page summary of the business plan.
 - Emphasize financing; coverage available (security and cash flow for repayment and interest); repayment schedule.
 - Offer good local references.
 - Keep your meeting to one hour or less.
- Follow up in ten days to two weeks.





At BMO Bank of Montreal, we are committed to helping Canadian businesses develop and succeed. To this end, we've created a Business Coach Series that provides information and knowledge that can optimize the value of your company's financial resources. The booklets that make up the Series focus on essential areas of financial management allowing you to focus on operating your business more effectively.

For more information on how BMO Bank of Montreal can help your business:

- talk to your Commercial Account Manager
- call us directly at **1-877-262-5907** or
- log on to **bmo.com/business-resources**

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