

FINANCIAL POST

FP ENTREPRENEUR

# Is your business's debt friend or foe?

Brad Cherniak | May 12, 2014



*FOTOLIA New and cheaper borrowing options offer opportunity for expansion and growth, but the key question is how long will this last?*

The world is swimming in debt today. The Switzerland-based Bank for International Settlement estimates current global government debt at \$100-trillion, up more than 40% from pre-2008 crisis levels. Consumer household debt started rising many years earlier. While growth has actually peaked and decelerated since 2008 in the U.S., Canadian levels have continued to climb steadily, remaining at historic highs.

On the surface, businesses seem to be a different story. They are roundly criticized for not having enough debt, and indeed hoarding cash, acting as a drag on the economic recovery.

But this point is debatable: While total corporate cash holdings have burgeoned and remained at record levels for years, so has total corporate debt. And debt continues to be piled on as interest rates remain at historic lows. According to the Bank of America Merrill Lynch Global Broad Market Index, the average yield on all types of bonds is about 2% — less than half that before the financial crisis of 2008.

What has all this got to do with small and mid-sized businesses? They have long operated under their own set of capital market rules. Indeed, SMBs have generally been underleveraged. Not necessarily because they want to be, but because they lacked access to credit at reasonable, or any, terms from traditional lenders.

As well, they have largely not benefitted from falling interest rates due to a stubbornly large and steady risk premium applied by lenders.

The good news is this situation is slowly but steadily changing, with diverse and creative new sources of alternative credit steadily flowing into Canada. This is particularly true for profitable, mid-sized companies. PayNet's Canadian Business Lending Index, which has tracked lending to SMBs since 2005, is at its all-time high.

This has created a new dynamic that business owners need to watch closely. New and cheaper borrowing options offer opportunity for expansion and growth, but the key question is how long will this last?

Any one of a number of financial, geo-political or other factors could jolt the credit markets, or bring lending to a grinding halt. There are already mutterings about the end of “easy money” monetary policies, which could be the trigger. Or it could be overall debt levels, or falling commodity prices. Pick your poison.

That means, at the high end of the risk spectrum, the SMB credit window would likely snap shut first.

That means the business owner has a new paradigm to consider. With the cost of borrowing particularly for mid-sized businesses starting to fall fairly dramatically, some business owners are taking the opportunity to aggressively pursue new capital or infrastructure investments that offer a potential return in excess of the cost of capital.

This dovetails with the new paradigm in web-based infrastructure and technologies, which offer businesses new ways to cost-effectively target and service new markets. But the mirror effect of new technologies has been to reduce barriers to entry to most types of markets and, therefore, companies' competitive defenses.

It has always been the case that the strong survive and the weak perish, but if your competitors are utilizing cheaper capital to outspend you to get bigger, faster, they are also becoming the more likely survivors when capital becomes scarce again. Of course, there will also be some companies that will not be successful in borrowing aggressively to become stronger businesses.

The bottom line is the status quo is no longer the safe haven it has been historically. It may no longer be enough to maintain your competitive strengths in a market where your more-aggressive competitors are enhancing theirs. Their overall risk is higher than yours as a more conservative company, but the ultimate outcome of who is a winner and who is a loser ignores the risk of the outcome beforehand.

So, as a mid-sized business, you need to ask yourself what you can be doing to make your business stronger. And does the return exceed the cost? These questions have never been more topical and critical for SMBs, who may have to accept a higher overall level of business and financial risk to compete going forward.

Next month, I will explore some of the options business owners have.

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