Finding The Sweet Spot With Seasonal Customers

lending business customers risk management

Summary: It is difficult for season business customers to manage through each season and it is not easy for their banker either. Fortunately, there are good approaches to minimizing risk when you lend to seasonal businesses.

Those who have been around for a while will remember an old TV advertisement that featured a smart owl that was asked how many licks it took to get to the center of a Tootsie pop. The owl licked three times before eating the rest of the candy whole. In reality, it seems people have tried this and the actual number is somewhere closer to 140 licks.

As you search the office for a Tootsie pop to test this out, you already know it can be very tough for your customers to run their small businesses. It's even tougher when the business has to fit all of its activities into the summer (outdoor water park), the run-up to Christmas (a Christmas tree farm), or winter (ski resort).

It's not easy to be a seasonal customer's banker, either. Fortunately, there are good approaches to minimizing risk when you lend to seasonal businesses. By focusing on their history, the low and high points of the borrower's assets and liabilities, the quality and availability of seasonal collateral, and the current season's circumstances and flexibility, banks can make intelligent, informed lending decisions.

Begin by asking when inventory peaks and when it reaches its low point. Most seasonal businesses have predictable inventory patterns when their sales occur as anticipated, though of course weather and other variables can create surprises. A ski retailer maximizes inventory in the fall. By January, after holiday sales, the company's inventory is likely at its annual nadir. Dynamic restocking decisions can help smooth things.

Next, find out when receivables peak. This is often, but not always, at the same time as peak sales or when they are at their low point. Extended payment and consignment terms can separate peak receivables from peak sales, as can a mix of seasonal and non-seasonal revenue. Similarly, receivables' low points should follow peak sales plus collection time.

Understanding revenue patterns helps a bank estimate the necessary seasonal lending, monitor the loan as the season goes forward, recognize when non-seasonal income temporarily obscures a seasonal failure, and examine the borrower's credit and collection policies for soundness. Look closely at the borrower's history, receivables and other factors.

For some customers, you will also want to know about peak and low trade financing as well. Trade financing often mirrors the purchase of raw materials or finished goods, though some vendors permit scheduled monthly payments or "pay as sold" arrangements. More extensive vendor financing typically involves a formal security arrangement, which the bank should also know about to stay protected.

Other cash outlays may also compete with loan repayment. These might include the immediate cost of running the business, plus term loan payments, quarterly tax payments, retirement account contributions, capital expenditures, or dividends. By better understanding the amount and timing of priority cash payments, you'll find it easier to monitor the loan and estimate the likelihood of repayment or problems.

Everyone hopes the season will go well, but you must also consider the possibility that the season will fail because of weather, changing fashion trends, or some other reason. A good starting point is to make sure the borrower has a realistic, flexible plan for dealing with a failed or lackluster season.

If you work with seasonal business customers or may think about starting, plan to stay in touch with the borrower before, after, and during the season. It is also critical to get any information you can that would give you an early warning about seasonal issues or potential distress. With all of this, you should be on your way to finding the sweet spot in managing your seasonal business customers.

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