Mistakes Made & Lessons Learned:
What Experience Teaches About Success and Failure
By Patrick Trammell

An experienced entrepreneurial asset-based lender shares the lessons he has learned along the way to success.
Our company, Southeastern Commercial Finance, LLC, began business on March 6, 1996. Since that time, we have made a fair amount of good decisions, and plenty of mistakes. The experiences brought by the bad decisions and mistakes have made us better lenders and better business people. The writer and theologian C.S. Lewis summed up experience this way: “Experience: that most brutal of teachers. But you learn, my God, do you learn.” So it has been with us. During the past 16 years we've had recessions, financial meltdowns, real estate bubbles, and competitors too numerous to count entering and leaving the market. And that's just over the past five years.

For most entrepreneurial finance companies, it has been a roller coaster ride with a great many of the “thrills” coming in the past few years. As a company, we've been fortunate, and (this week, anyway) we're still here. Whatever the new normal is in asset-based lending, success will still be dependent on a few timeless principals, a lot of hard work and a little luck. The purpose of this article is to share a little of the most valuable lessons we've learned as a company, some with great mentorship and counsel from friendships developed through CFA and some, painfully, from experience.

That Culture Thing – It really is about the People
Asset-based lending and factoring, as a discipline, is not rocket science. Lending is said to be the world’s second oldest profession. So innovation is limited. Most of the money we lend is green. There are, then, only two long-term competitive advantages: cost of funds and culture. The Cemetery of Asset-Based Lenders with Cheap Capital is overflowing with dearly departed industry players, and many more are on life support. Legendary success stories in our industry of the past 20 to 50 years rarely have anything to do with cost of capital. When you talk with former employees and associates of these firms, they rarely talk about cost of capital. What they do talk about is what a great team they worked with, how much fun it was, and how the experience had an impact on their lives. That's cultural, and it's a hard thing to duplicate.

The company you work at has a culture. It is constantly evolving and doesn't happen overnight. For ourselves, we've wanted our culture to be relationship-based with superior industry knowledge, great operations professionals and systems, loyalty to each other and the company, and openness and honesty with everyone with whom we do business. We also intend for everyone we hire to be a lifetime associate. When you commit to some qualities, you sacrifice others, and we've certainly done that. But we believe our culture gives us the opportunity to keep and develop people, leading to constantly improving levels of experience and expertise. Other companies have other cultural priorities which work well for them, and they are outstanding competitors. Lenders running companies, divisions, units, and their own careers would do well to think of culture more as the thing you can control, and less about pricing and competition, which you generally can't.

Those Five Cs of Credit: The One about Character. It Matters…A Lot
Asset-based lenders mistakenly assume it is all about the collateral. It's not. When James Bond entered a room, he always looked for two ways out. As lenders, we need to look for at least two ways out of a credit. The best, of course, is the success of the business. The worst, of course, is liquidation. Sale of collateral is really not an acceptable way. Hundreds of years of workout experience tell us, when a lender ends up owning collateral, that collateral is worth the least it will ever be worth.

As lenders, our loans are only as good as the borrowers who have our money. People can, and do, fundamentally change. Businesses fail for a variety of reasons, sometimes more related to bad luck than mismanagement. Credit scores sometimes do not always reflect character and integrity. All of these things are true, but it is also unfortunately true...
that past performance, both profession-
ally and personally, is often a predictor of future success and behavior. There is a likelihood that your “borrower” may become your “financial partner” at some point. Make sure your financial partner is someone who you can have confidence in from an integrity and business acumen standpoint. If not, you are letting someone who you do not respect manage part of your company’s assets.

There is a quote often attributed to Vince Lombardi, but which has been around at least since the time of Caesar: “adversity does not build character, it reveals it.” Few residents of the Asset-Based Lending Cemetery are sent there by honest borrowers whose business failed. Many, however, were sent there by individuals of poor character, and because of bad records, invisible inventory, prebilled and fraudulent invoices, and the like. Additionally, there are decent, hardworking individuals who fundamentally do not have the talent to run a business. The old lender’s proverb rings true here, “Better to be in the ditch with an honest businessman than a dishonest fool.”

It Pays to be a C Student
As mentioned earlier in the article, asset-based lending and factoring isn’t rocket science. Our industry can be painfully brutal and, alternatively, highly rewarding, but it has one unique characteristic. In most industries, and in baseball, a .900 batting average will get you in the Hall of Fame. In our industry, it will get you taps played in the Asset Based Lending Cemetery. Our industry has evolved by trial and error over several centuries, and certain principles have become commonplace. Unfortunately, our industry does not typically reward innovation in advance rates, structure, lending on generally problematic and historically shunned classes of collateral, and other such advanced business thinking.

There are very good reasons that prudent, successful, generalist asset-based lenders don’t lend on construction receivables, progress billings, earned but unbilled and other exotic forms of collateral. Conservative A/R advance rates and inventory limits and hard caps are not made up out of thin air, but are proven lending disciplines. Phrases such as “it’s construction receivables, but they’re from good companies,” “the inventory system is periodic, not perpetual, but they count it every month,” and “their customers ask them to pre-bill so it’s ok” have cost many lenders, including this one, significant dollars.

The legendary investor, Warren Buffett, has made a great deal of money by not investing in industries he can’t understand. Our industry would do well to consider this when making lending decisions. It is no sin to be a C student. As a lender, it is best to own up to and embrace it. When we’ve thought we’ve been smarter than that, we have paid a price.

Competition is Overrated -- Way Overrated
Before the start of the Wilderness Campaign that ultimately ended the War Between the States, General U.S. Grant commented to several of his veteran commanders, “I am sick of hearing of what General Lee will do to us! You people think he will turn two somersaults and land in our rear. We should look to what we’re doing, and let General Lee worry about his own army.” Many lenders are guilty of worrying more about competitors than themselves. Talk of what others are doing drives many lenders to stretch on credit, structure and pricing. Long term, this creates problems which no amount of new business can fix.

The conversation in our industry, as in many others, is driven by business development professionals, some of whom are superb, some of whom are not. Generally, the conversation is dominated by the activities of the most aggressive competitor, or the “next big thing.” GE Capital has been in and out of our own lower middle-market ABL segment multiple times. Few industry competitors have more resources or a more advantageous cost of funding than GE. They have on each occasion been unable to create an acceptable business model, and, after much commotion, left the market.

In every lending environment there will be industry competitors “buying business.” This has always been a reality in our industry. In the short term, this can create havoc in a market. In the longer term, these competitors take care of themselves. We learned the hard way that we were much better off telling our own story, developing our own relationships and capabilities, and running our own business. It is difficult to sustain and build a business based on what the most aggressive competitor is always doing. Be who and what you are as a company.

If Your Customer Can’t Account for the Collateral, How Can You?
No bad lending decision was ever made with good financial information. As collateral lenders, in order to make good financial decisions, we must rely heavily and frequently on financial information that is presented by our borrowers. This information must be real time and reliable. This is never more important than in a problem loan situation. Unfortunately, many of the borrowers who get in financial trouble do so because they do not have adequate financial systems, personnel and controls to make accurate business decisions.

Diligence in underwriting should include a stringent evaluation of the accounting personnel, systems and capabilities as part of the audit process. Several times, we have closed loans based on the notion that, “they’re upgrading their accounting function,” only to regret it later. The founder of NFL films, Ed Sabol, encouraged his son Steve to, “treat everyone right. Not because they are a gentleman, but because you are.” So it should be with our customers and prospects. Look for borrowers who have adequate accounting and controllership capabilities, not because the lender requires it, but because prudent business practices do.
A Loan You Never Make Can Never Hurt You
Most lenders are entrepreneurial at heart, which is part of what makes our industry exciting and vibrant. A recently retired credit officer tells the following story of his first credit training class in the 1960s, and his manager's first admonition to the trainees: “Gentlemen, as you begin your lending careers, you will be asked by many potential borrowers to loan them the Bank's money. This is not your money, it is the Bank's money. In certain instances, your good sense and analytical skills may tell you that the risk of loaning the Bank's money is too great for the reward. Your heart may tell you that the potential borrower has a great opportunity, which could be highly profitable if he should receive the needed loan. At that instant, reach into your back pocket, remove your wallet, and loan him your money. But do not loan him the Bank's money.”

The purpose of this story is clear and something we must always strive to remember. Because a transaction makes sense, and has a fantastic business plan does not necessarily make it a candidate for an asset-based loan or factoring facility. Too often, because of other positive attributes, we have tried to fit a square peg into a round hole with respect to a loan transaction. As asset-based lenders, we must always rely first on conversion of working capital collateral. Our charge is not simply to get paid back; our charge is to apply basic principles, disciplines, and procedures to make and monitor loans based on working capital assets. Simply because the plan makes sense, it does not make it prudent to deviate from these principles, even with substitute collateral. William Jefferson Clinton became the 42nd President of the United States with a message that said, simply, "It's the economy, stupid." As lenders, we must always remember, “It's the collateral. It's the collateral. It's the collateral.” When we don't do this, we cease to be true to our mission. When we don't heed this, and the business does not perform as planned, we end up with a structure and situation which is outside the realm of our expertise and training, which enhances the probability for loss.

The success of any organization that survives and prospers over the long term is based on this simple adage: “Don't make the same mistake twice.” In the asset-based and factoring arena, multiple opportunities exist for making the mistake once. Hopefully, with careful evaluation and appropriate reaction, past mistakes can become the basis for long-term success and significance. In the early 1900s an Alabama banker said, “Eternal vigilance is the price we pay for our own protection.” For those who are “eternally vigilant,” the asset-based and factoring industry can be rewarding, indeed. Hopefully, the readers of this article can benefit from our past mistakes, and we ourselves can use our own setbacks as a reminder to remain “eternally vigilant” as well. I wish you all much success on your journey. TSL

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