

## Monitoring Firms Offer Rx for Collateral Jitters

By JAMES C. ALLEN

Asset-based lending can be a quagmire for small business lenders.

The hassles of tracking inventory and receivables have made lines of credit tricky for lenders and expensive for borrowers. Without the services of their bank, many small businesses turn to high-cost commercial finance or factoring companies to finance their working capital.

That may be changing. A growing number of collateral control companies, like Dallas-based Diversicorp, are offering services that help lenders monitor the assets backing their loans.

"Many banks are staying out of asset-based lending because there is a very high degree of potential for fraud if they're not watching very carefully," said Jim Mayer, Diversicorp's president and chief executive.

"We're hopefully going to make it attractive for banks to outsource the administration of asset-based lending."

The problems associated with asset-based lending are especially acute in small business.

For many borrowers, what little capital they have comes from the owners' personal assets.

In the past, when companies have started to falter, their owners resorted to pledging the same business assets to separate loans.

Even without the prospect of fraud, ineptitude could be a costly problem for lenders. Many small companies are just learning how to match their inventory and receivables with the liabilities that finance them. A minor accounting error, like a misplaced decimal, may put the lender in a position of financing assets that do not exist.

"These little companies need help identifying when they are falling outside this matching process," Mr. Mayer said. "I can't tell you how many situations we have had where we caught a problem and brought it to the attention of the company before it became serious."

For a fee of between 1% and 3% of the collateral value, Diversicorp will help a lender keep an eye on its collateral in one of three ways.

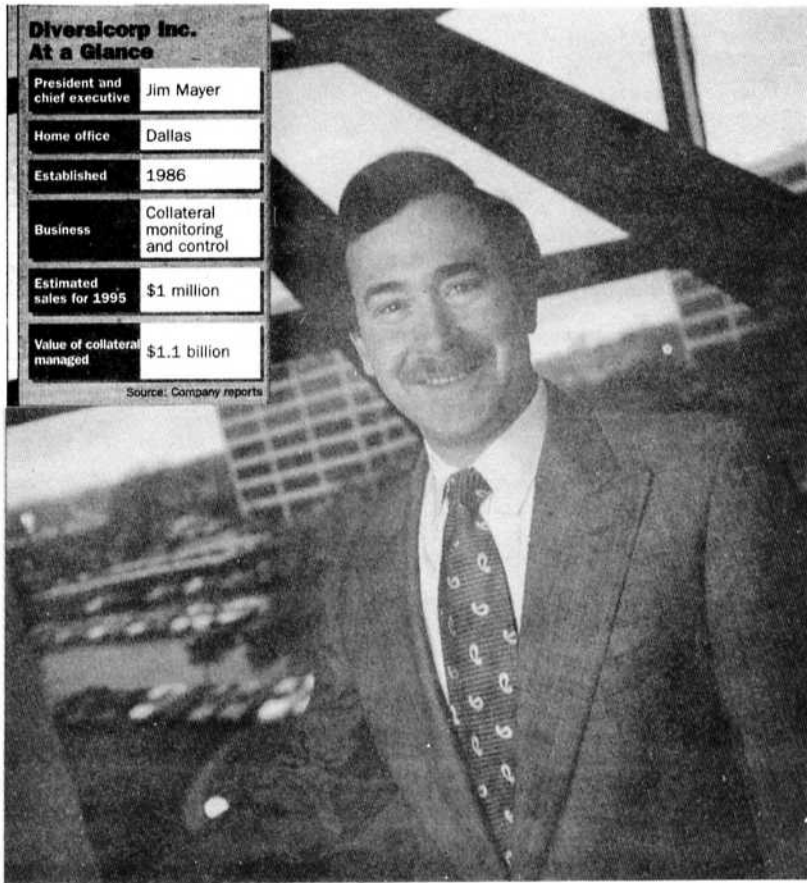
The most basic way is through one-time or periodic examinations. This helps the lender get a snapshot of the borrower's assets and liabilities at specific times.

Beyond this, Mr. Mayer said, his company will design and develop a system to monitor the assets pledged.

This, combined with occa-

Diversicorp Inc. At a Glance	
President and chief executive	Jim Mayer
Home office	Dallas
Established	1986
Business	Collateral monitoring and control
Estimated sales for 1995	\$1 million
Value of collateral managed	\$1.1 billion

Source: Company reports



Steve McAllister

**JIM MAYER**, president and chief executive of Diversicorp, sees a window of opportunity in lenders' lack of collateral-tracking capability.

sional on-site visits to the borrower's business designed to ensure the accuracy of the information the bank is receiving, help the lender prevent problems from intensifying, or fraud from occurring.

Finally, the company will certify how much inventory is on hand and that goods were shipped in an on-going manner. By certifying these movements of working capital, Diversicorp is accepting responsibility for administering the collateral.

While this is going on, Mr. Mayer said, the process is teaching business owners how to manage their inventory and receivables.

Borrowers don't always see the value of the service.

"It's hard to explain to the business owner that we are really good guys and not these goose-stepping auditors walking around," he said. "We actually provide a service that helps them."

This idea of helping small

business also led the company to get involved in the development of the U.S. Small Business Administration's GreenLine revolving line of credit program. Working with other service providers and asset-based lenders and traditional SBA term lenders, Diversicorp helped structure the

program.

"We needed to learn about asset-based lending because the agency hadn't done this type of lending before," said John Cox, deputy administrator of the SBA. "When we structure a program, we not only have to protect the interests of the taxpayer, but we

also have to design a program that can be accepted and implemented by lenders and small businesses."

The result was a program that Mr. Cox saw as filling a niche need.

So far, however, the program has caused more grumbling than praise from traditional 7(a) program lenders accustomed to making term loans.

Consider the case of Questar Bank in Houston.

The bank has loaned more than \$58 million through the 7(a) program over the past two years, but it has never made a GreenLine loan.

"It's a failure," complains Don Wigly, Questar's chairman.

Diversicorp's Mr. Mayer is not surprised by that attitude. Most SBA lenders generate term loans that are quickly sold into the secondary market.

The GreenLine program cannot be pooled for sale, meaning they must be carried to maturity.

More importantly, the new program appeals to the smallest, least sophisticated borrowers. Even without fraud as an intent, these companies need strong internal controls.

"The pressure from a lot of lenders is that the SBA should just be providing the guarantee and eliminating all these obnoxious controls," said Mr. Mayer.

Even though the growth of GreenLine has inhibited that of asset-based lending by banks, Mr. Mayer is not deterred. He sees growing need for the monitoring services offered by Diversicorp.

With banks looking to lower costs, many banks may find it too expensive to maintain audit staffs and other employees needed to handle every aspect of asset-based lending.

"Banks will not be able to keep auditors and do the kind of high-intensity kind of work it takes to support that kind of financing," he said. □

### Next Challenge: Lending on Foreign Receivables

Although Jim Mayer spent much of 1994 trying to build greater acceptance of asset-based lending in the United States, the future of his company may lie abroad.

The president and CEO of Diversicorp is now promoting asset-based lending supported by foreign receivables.

"The idea of commercial finance with developed nations has been one that's been on my mind and needed by these businesses but one that banks and finance companies have not been able to provide," he said.

Though both parties may be considered strong domestic credits, distance and culture can create problems for companies seeking to secure this

type of financing. Because the companies are trading overseas, bankers and regulators require credit enhancements from such agencies as the Export-Import Bank.

Mr. Mayer wants to guide companies and their lenders in underwriting the pledge to build collateral control that matches the risk. In doing that, and supporting it with professional liability coverage, he said, the company is beginning to get lenders to look at financing assets without the credit enhancement.

But given the slow response of small-business lenders to plain-vanilla arrangements domestically, Diversicorp's foreign venture may be decidedly long-term.

— James C. Allen