



GETTING A BUSINESS LOAN

With few exceptions, most businesses require an influx of cash now and then. Sometimes it is for maintaining growth; sometimes it is for maintaining the status quo. From where does this money come? Statistics show that for 1997, 65% of small business funding came from the owner.

But that means that 35% of the funding comes from other sources— either outside investors, or lenders. So, statistically speaking, the majority of businesses end up borrowing money some time or another. Getting a business loan, especially the first one, usually takes time and effort on the part of the borrower. This can be frustrating for a business owner who is used to "taking risks." The business owner mistakenly assumes the lender is willing to take the same kind of "risk" with his business. This is just not the case.

In fact, a lender is not in the business of "taking risks." Rather, the lender is in the business of making money on the money being loaned. So the main objective when you borrow money is to make the lender feel comfortable in loaning you money.

You do this by providing answers to all the questions in the lender's mind. What are these questions?

They fall into the following categories:

1. How much do you want to borrow? This may sound obvious, but you would be surprised at how many business borrowers don't communicate this specific request properly.
2. What do you plan to do with the money? This determines the length of the loan needed, among other things. A good business plan is important in this area.
3. How and when do you intend to pay it back? The lender's opinion as to your ability in this regard is a critical factor in the borrowing game. Thus, the cash flow analysis of the business takes center stage here.
4. If your plans fail, what alternatives do you have to pay back the loan? This is where the issue of collateral and liquidity come into play.
5. For smaller businesses, especially those with limited collateral, what happens if you, the business owner, die or become disabled? How will the loan be paid back then? The lender wants to know about your life and disability insurance situation.
6. What type of person are you? A lender is very much concerned with the character of the borrower since this impacts all phases, including your ability to manage a business effectively.
7. What is the outlook for your particular business, and the industry as a whole? If you are in a declining field, it's a negative. If your business is showing great growth, it is a positive.
8. What has been your credit history to date? This is where your "credit past" can either help you a great deal, or hurt you. If you have a weak "credit past" you'd better be able to explain in a way that is acceptable to the lender.

All of these questions must be answered satisfactorily in the lender's mind or you will not get the loan. It's that simple. So, let's go through the process in more detail. The bottom line is that, the more you understand what is expected of you as the borrower, the easier it will be to get the loan you want.



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Start With A Good Business Plan

A business plan can be one of the best ways to promote yourself and your business to a lender. It can serve as an outline for the entire process of borrowing money, and it can answer just about all of the lender's main questions.

What this plan does is to give the lender a realistic look at all phases of the business and its future possibilities. It consists of 4 basic sections:

- 1) A description of the business activity, the industry as a whole, and its potential;
- 2) The marketing plan which tells about the potential market, and how you intend to communicate(advertise) your business to this market;
- 3) Management information which serves as a biography/resume of who runs the business; and,
- 4) Financial information in which various financial statements—both current and projected—are used to identify the business value from a dollars and cents perspective.

A well written, well presented business plan can go a long way toward providing a lender with much of the information that is needed in determining how to handle your loan request.

Providing Proper Financial Data Is Mandatory

From a "numbers crunch" standpoint, this is where it all starts. The lender is looking to make a loan to a business that can pay it back; the business should have profit potential, growth potential, and solvency potential.

The lender will request a number of financial statements from you to help judge this, both from an individual perspective, and an industry comparative standpoint. The most common ones are: 1) Profit and Loss Statement; 2) Balance Sheet; 3) Cash flow analysis; and, 4) Sources of funds statement. Projections as to future performance will also be used in the decision-making process.

A brief description of these financials is as follows:

Profit And Loss Statement: This report lists your income and expenses by various categories to arrive at your profit or loss for a given period of time. It helps a lender determine various ratios to see how much of a loan you can afford.

Balance Sheet: This identifies your assets, liabilities, and capital to show what the business "net worth" is. It does several things for a lender. First, it identifies all your outstanding debt. Second, it lets the lender know your liquidity. These are two very critical pieces of information a lender needs.

Cash Flow Analysis: This report is being used more and more, even with smaller businesses. It shows what actual cash you have coming in, and going out. This gives the lender a very clear idea of whether you will be able to make the loan payments out of current revenues adjusted for expenses.

Sources Of Funds: This schedule is pertinent especially for new businesses, or new acquisitions since it basically shows where you get various funds with which to capitalize or acquire various items.



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There may be other reports requested for different types of businesses, or business characteristics, such as:

Accounts Receivable: If accounts receivable are an important factor in your business, then the lender will want an analysis of these receivables. Are any of the receivables already pledged to another creditor? What is your average turnover ratio? What is the average age of the receivables? How much does your largest single account owe you, and what percentage does this represent of the total accounts?

Inventory: If your business sells a product where inventory is maintained, the lender will want to know the salable condition of this inventory. Will it have to be marked down? Is inventory rising proportionately higher than your gross sales? What is the inventory turnover rate?

Assets: The condition of the business assets is very important to a lender since these would be used for liquidation purposes if you default on the loan. So a listing of the assets, age, and condition are usually required.

Long Term Contracts: Contracts that you already have with customers provide a stream of assured revenue, so a lender looks for this, if the contracts are favorable ones.

Types And Terms Of Loans

The purpose for which you borrow and the amount you borrow often affect the type of loan you'll get, and the term of the loan. Insofar as the term of the loan, there are basically two types of terms: short term, and long term.

The short term loans are usually reserved for specific purposes such as financing seasonal inventory, or financing accounts receivable. They are normally expected to be repaid within a year; many times within months. Short term loans are expected to be paid from the liquidation of the current assets they have financed.

Long term borrowing is for the opposite situation where the loan will be in existence for a longer period. These can be intermediate loans where the payout time is up to 5 years; and long-term where it is expected to last more than 5 years. Longer term loans are usually expected to be paid from the business earnings, or cash flow.

The type of loan is either a secured loan or an unsecured loan. The secured loan requires pledging assets as collateral. The unsecured loan relies more on your credit reputation and is usually for a short-term loan. In addition, most unsecured loans are "demand loans." That means the lender can ask for payment of the entire loan balance when they deem it appropriate.

Issues Of Collateral And Other Limitations Lenders Set

A lender is always looking to make the loan terms as risk-free as possible, so the issue of collateral usually comes up. This is a pledge of security the lender is asking from you. The kind and types of security pledges will vary with the lender, your credit worthiness, and the type of loan.



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Listed below are some of the most commonly-requested types of collateral:

Co-maker: The lender asks for someone other than just the borrower to guarantee the debt. If the borrower defaults, the lender can make the co-maker pay instead.

Chattel Mortgages: The lender places a lien on the equipment of the business; you cannot dispose of it so the bank can liquidate it if you default on the loan.

Real Estate: Property and buildings fall into this category. The lender can put a lien on the real estate to serve as collateral for the loan.

Accounts Receivable: Especially true for short-term loans, the value of the accounts receivable can be used as a form of an asset. The money from the receivables will go to the lender directly if it is a "notification plan."

Investments: Whether it be stocks, bonds, savings accounts, etc., the lender can request you pledge these assets, and put a "hold" on them while the loan is outstanding. Rarely does a lender use a 100% value for stocks or bonds as insurance against market declines.

Lease Assignments: This is used in franchise situations or closely-held business relationships. The lease or rent payments become automatically assigned to the lender in the event of default, thus the lender gets an income stream to cover the loan payments.

Warehouse or Trust Receipts: The lender takes specific business inventory items as collateral, and you agree to pay back the loan or a portion of it when these specific items are sold. This is used in businesses such as automobile dealers, boat and appliance sale businesses, and manufacturing businesses where readily marketable merchandise is produced.

Lenders frequently place limitations on the borrower, depending on the credit risk associated with the loan. Sometimes business owners react emotionally toward these limitations. They feel "tied down." Unfortunately, the lender tends to be adamant about them, and this area tends to be one of the biggest "sore spots" in borrowing.

Some of the more common limitations have already been alluded to: loan repayment terms, and use of collateral. The other two main types of limitations concern periodic reporting requirements, and restrictive covenants.

Periodic reporting: The lender requires the business to furnish various reports to monitor the progress of the business, and, therefore, its ability to handle the current and/or future loan payment. Reports such as periodic profit and loss statements, balance sheets, cash flow analysis, aged accounts receivables, and asset acquisition/disposition statements are frequently requested. This can be a burden to the business owner, especially if these reports have not been prepared on a regular basis previously. It may require more time—and money—spent in the accounting/recordkeeping areas than ever before.



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Restrictive covenants: This is one area that ruffles more business owner feathers than all the others. These covenants are lender's controls over what a business can and can't do without approval from the lender. The lender can place restrictions or have a say in various activities the business owner previously had total control in, such as: borrowing more money; increasing the owner's wages, bonuses, dividends; pledging or selling assets; giving credit to customers; buying inventory; and required insurance coverages.

Can You Negotiate Lender's Terms?

The answer to this depends on a number of issues, not the least of which are: the borrower's credit worthiness; the amount and terms of the loan; the future potential of the business; and the relative "independence" of the lender.

The more credit worthy you are, the more in demand you will be with lenders. They know this more than you, so they would be willing to negotiate some of the terms and restrictive covenants to get a good customer like you.

Many lenders will try to "scale you back" from the original amount you are requesting to borrow. Some do it because they feel you are putting too much fluff in the request. Others do it because they genuinely feel you don't qualify for the requested amount. You can negotiate with the former; not with the latter. The same applies to the length of the loan. It is in the lender's best interest to get you to pay the money back as quickly as possible. You may be trying to stretch out the terms for a smaller monthly payment. There can be room to negotiate in this regard with most lenders.

If your business is on a "fast track" to success, with great potential, the lender may be willing to negotiate more with you in hopes of getting the bigger business down the road. They know their profits will increase with you as time goes on. So if your business is showing good, controlled growth potential, you have a decent bargaining chip in your pocket. You may be able to get the interest rate knocked back; or you can try to negotiate out some of the restrictive covenants and/or reporting requirements.

The more a lender is independent, the more the terms can be modified. Independence means the lender internally finances the loans, and/or keeps the loans instead of selling them off to another company. If the lender is selling off loans, then the terms may be dictated by another source besides the lender, and the chance for bending some of the rules lessens.

Some Tips On Dealing With Loan Officers

Remember that you are dealing with someone who makes a living out of making loans. If they are experienced, then they have made a career out of sizing up the good, the bad, and the ugly. So here are some suggestions:

1. Get an introduction from someone who knows the loan officer if possible. It really is a "Who you know" world out there.
2. Be thoroughly prepared and/or briefed about the lending company before you go in. First impressions are lasting ones, especially with lenders.
3. Have a business plan when you walk in, AND have a brief summary of this plan as well. Don't expect this busy person to want to read a 50 page plan right away. Lead with a well-written 2 page summary first.



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4. Dress for success. It shouldn't matter, BUT IT DOES.
5. Your demeanor should be confident-hopeful, not conceited, nor desperate.
6. Get your business advisors involved early with the loan process, especially a large loan request. Your accountant will almost certainly be needed to assist you in preparing the required financials, and your attorney should read the loan documents for your protection.
7. Don't moan and groan every time the lender requests more information from you. If it were your money you were lending, you'd be cautious too.
8. Follow-up the meeting with the loan officer with manners. A thank-you note sent to the loan officer after the first visit for their advice and assistance is a nice touch.
9. After you get the loan, keep in touch with the loan officer. You have started a relationship that may last for the life of your business activities. The more the loan officer knows about the positive things in your business, the easier it will be in the future to borrow more money.

Conclusion

Obtaining a loan for a business is usually more complicated than one originally thinks. It is one part disclosure and one part sales. The stronger your business compares to the loan ratios, the less you need to sell yourself to the lender. The weaker your business ratios are, the more you should sell "the future potential" to the lender. This is because the lender is providing money to you for future sustainment and/or growth of the business as much as current needs.

By doing your homework ahead of time, and making a memorable presentation of yourself, the business, and its financials, the easier it will be to get a quality loan.