

# The New Rules for Small Business Financing

One of the most important sources of business financing is a bank and they have been providing that source to businesses for years. But as most business owners know, getting a loan is hard work. In fact, in many cases it would be easier if our banker would ask us to paint the Mona Lisa than to figure out what we needed to do to present a picture of our business in the best possible light to get the loan we wanted, at the best terms at the lowest possible rate. Instead of giving you a paper easel and paintbrush, I am going to first give you some pointers that will equip you with the necessary tools to obtaining money, fast and easy for a loan over \$100,000 and then for one under \$100,000..

We are going to look at a typical \$100,000+ loan request through the eyes of a banker. The first question the banker asked himself, is your firm credit worthy? In layman's terms, is your business capable of borrowing money and paying it in the allotted time as required? In making this "credit worthiness" determining, all bankers use the "5 C's of Credit" evaluation formula. Listed below are each of the 5 C's. Ask yourself the same questions the banker is going to be asking about you. Be prepared and know your weaknesses.

**Character:** What is the character of the management of the company? What is the businesses reputation in the community? Basically, how your business conducts itself and the credit history of the business and yourself, as the owner. Is the banker going to be excited about your business because of the leadership potential you exert? How you conduct yourself, and your credit, in both your business and personal life gives the banker a clue of how you will handle yourself in the future. In all honesty, yourself as a person and your business are the exact same painting to the lender, in many cases there is no difference – this sentence doesn't read well.

**Capacity:** What is the business and individual's ability to repay the loan. How much debt can your company handle? What does the historic cash flow trends reveal to the banker? What does the next 12 months cash flow forecast look like? This "C" is weighted very heavily in the loan evaluation process, in fact, most banks will favor a relationship of 3X your existing cash flow to bench mark total bank debt.

**Capital:** How much money have you invested in the business? When you look at your businesses balance sheet, how much equity is in the business and what is that relationship to the outstanding debts (called liabilities on the balance sheet). Bankers like to see that you have no more than \$4 dollars in liabilities for each \$1 dollar in equity. . Your company's financial statements and your personal credit history are the answers to the capital question. Even if you haven't made substantial revenue, **that revenue must convert into equity (profits).**

**Conditions:** This applies to your marketplace and business trends. You dip yourself in the paint and spread as much of yourself over the market as possible. Current economic conditions in your marketplace are substantial when a lender is critiquing your business.

**Collateral:** Usually cash flow is the primary source of repayment of a loan, but bankers also look at the bigger picture. They look at your additional assets as a source of repayment also. Collateral represents assets that the company pledges as an alternate repayment source for the loan. Most collateral is in the form of hard assets, such as real estate, accounts receivable, rolling stock and equipment. Bankers always want a secondary source of repayment, therefore the “C” for Collateral.

Each of the 5 C’s is reviewed in determining if the loan will be made. Bankers will also look at: business plans, appraisals, business owner interviews and outside experts. Lastly, make sure that you have a sound relationship with your banker. This allows for the free exchange of knowledge and the ability to meet the needs of the business.

Over the last few years, change and its companion (information technology) is alternating the face of small business financing, those loans under \$100,000. In many cases, a computerized credit-scoring program determines small business financing. Automated credit scoring reduces the subjectivity of the loan process and improves the bank’s profitability.

In light of the “new rules” governing the small business financing process for small business at many banks, the business owner can adopt by:

1. **Assess your credit needs.** If the amount needed is closer to \$100,000, apply for \$110,000 or more. Usually if the bank wants a business plan, it may not be using a credit model.
2. **Get your credit report.** Before making a loan or credit application, obtain your credit report and check for errors and omissions.
3. **Be accurate.** If you are applying for less than \$100,000 and the bank is using credit scoring automation, go over all questions for the loan or credit application. Make certain the data you provide is accurate and ask questions to understand the information in the application.
4. **Watch your code.** Make sure you provide an accurate description of your business. The bank may evaluate your company by SIC codes, an inaccurate coding can alter the outcome of the approval.
5. **Know why.** If your application is declined ask for an explanation or a "human" review.
6. **Find a bank.** Consider the type of bank you select for applying for financing. A larger bank or institution will use the automated credit scoring system more. Seek out local community banks or specialty banks for a particular industry.

The new changes to the small business financing market represent an intensifying competitive industry. Many non-bank players (eg.Intuit, State Farm, GE Capital Corp.) are forcing banks to adapt to the market or lose market share. For the small business

owner, this means a greater choice and service as all companies wake-up to the size and power of small business.

By Dan Lacy