Bank borrowing

by Dan Sautner
Padgett Business Services

■ It's very difficult to run even the most profitable business without some bank financing. Chances are that growth—especially if it comes in spurts—will out-pace the cash that your current customers are generating.

You may also run into a problem resulting from the seasonality of the green industry, with a disproportionate amount of business coming in the spring and early summer. And if you're downsizing, the changes being put in place may require time to generate the cash you need to save.

All of these are reasons to approach your banker for a loan. The following are ways to approach this lending institution, and what they will be looking for in determining your chances.

Always think ahead and plan for requesting a loan. More importantly, do this prior to a crisis situation. Bankers have a hard time understanding that you are properly managing a good company when all of a sudden you run out of cash. Your cash flow needs are predictable, and you should be seeing any shortage ahead of time.

When you need a loan, ask the banker to visit you so he or she can see your business and how you operate it. Make sure that your banker is involved in commercial lending; otherwise, you will have to do it all again.

Explain—fully—how much money you need and why. Show the banker that you really know your business and what it takes to be successful. When your meeting is over, ask the banker to write you a letter describing what you will need to supply. (The bank may already have pre-printed lists of needed information. If so, use those.)

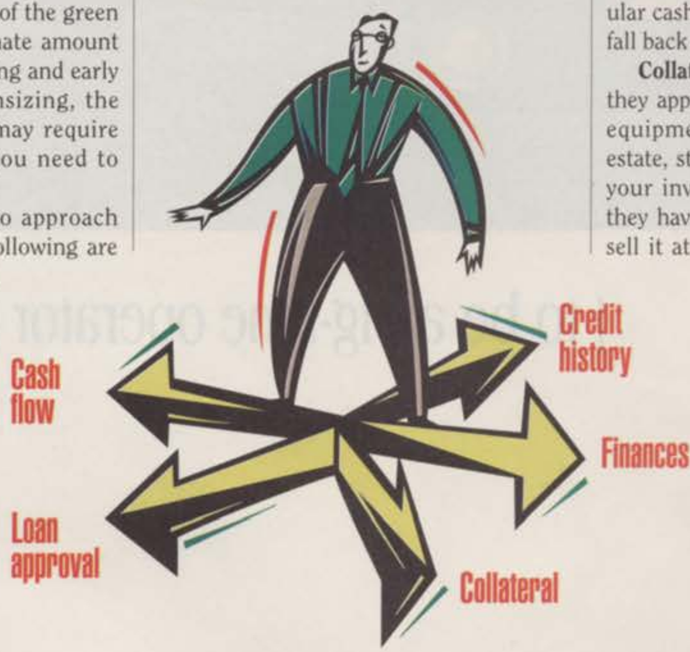
When everything is complete and packaged neatly, call the banker for an appointment. Have everything: the banker does not want to have a partial loan request cluttering his or her desk.

If you start off on the right foot, and show that you're organized, you'll have a better chance of getting your loan approved. Here are the common requirements:

1) A cover letter of request: what you are looking for, how much and why. Explain what the loan will do for your business, and how you will repay it. You may want to include a bit of your company's history: how you started, how you've done, what your services are. Be specific, and be realistic.

2) Personal financial statement.

3) The last three years' income statements for the business (or personal tax returns if you're the sole proprietor).



4) Projections (a pro-forma statement) that should explain how the loan will affect your company's cash flow over the next one to three years.

The two basic types of bank loans can be structured in a multitude of ways.

Short-term loans will tide you over until you collect a receivable or complete an anticipated large sale. These are set up as notes repayable in 30, 60 or 90 days—or they may be set up initially as a line of credit.

Unlike your personal line of credit, you will probably have to ask the banker to advance the funds as you need them with a short-term loan. As a rule, they cannot remain outstanding for more than a year. The banks usually require that they be completely paid off for at least a month each year.

Long-term loans are set for a specific amount and for a specific length of time, such as a year or two or longer, and are repayable in monthly installments. These are used for specific purposes, such as equipment purchase, remodeling, building purchase, and restructuring existing debt.

In some cases, you may be able to repay only interest, but only for a while. Discuss this with your banker.

In determining whether or not to approve loan requests, bank loan officers frequently refer to the "Three Cs" of lending: capacity, collateral and character.

Capacity is your ability to repay the loan. If this loan is approved, will you be able to repay it out of your company's regular cash flow? Do you have other assets to fall back on in an emergency?

Collateral is the security to the bank if they approve the loan. This could be your equipment, your building or other real estate, stocks, your accounts receivable, or your inventory. What will its value be if they have to foreclose on you and have to sell it at auction value to repay the loan? This figure is sure to be a lot less than you would think.

No matter what type of loan you need, expect to personally guarantee the loans, most often using your residence or other assets—such as stocks—as additional collateral. If you are reluctant to do so, the banker will think that you are not sure about your ability to repay the loan. If you're not willing to take a chance, why should the bank?

Character includes your credit history. (Even if you had a problem paying bills on time in the past, if you can explain the causes for it and if you are currently paying your bills on time, you still might get the loan.)

Character also includes your general integrity. Do you have good moral standards? Are you a positive influence in the community? This segment of the loan decision process is intangible. If your application is on the borderline between approval and rejection, your character will sway the decision in one direction or the other.

Now, you can do all of this perfectly and still be denied credit. This can simply be because your bank is tightening up on its credit across the board. It may be useful to talk to other bankers.

Sometimes you might be denied because the amount you are looking for is too small. In this situation, consider borrowing the money personally and advancing it to the company. In any case, you want to be thinking ahead of the game. Good luck.