

Will You Qualify for a Bank Loan?

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The following is a true story about two companies and their attempts to get traditional debt financing from a commercial bank. The names have been changed to protect the innocent. ABC Widget Company was a 2-year-old growing manufacturing company that needed a loan to fund working capital for inventory and taxes. They developed a good business plan and took 4 weeks to put their loan package together. They went to the bank and were approved for a \$75,000 loan.

XYZ Widget Company was also a 2-year-old manufacturer that needed a loan to consolidate past debts and hire another employee. They developed a business plan showing the use of funds, projected revenue and expenses they would incur. They took it to 4 different banks and were turned down by all of them. The owner felt like banks only lend money to people that don't need it. Why did ABC get a loan while XYZ didn't?

Contrary to many people's opinion, banks want to lend money. It is the main product that they have to sell. However, most small businesses don't understand the bank's requirements and restrictions. Understanding these requirements will increase your likelihood of getting the financing you need. These are the key points and the documentation that a bank will review in considering your loan; I call them the "6 C's":

Capability: Do you bring proven expertise in this industry to your company? Does your experience show that you understand the challenges of your industry and marketplace? The bank is not an expert on your industry; they expect you to be the expert and have the necessary experience. Documentation needed: a resume, references, and a well thought out business plan.

Capacity to repay the loan: What is the amount of funds needed? What is the loan going to be used for? How will the company repay the loan? Will future cash flows be adequate to repay the loan? Documentation needed: cash flow statement, use of funds statement, and business plan.

Collateral: If this project is not successful, will there be adequate liquidation value of the assets to recover the loan amount? What assets will be used as collateral for the loan? What is the value of these assets? The bank will look at the worst case scenario and expect collateral to offset their risk. This means that the bank will discount assets to their liquidation value, which often times is substantial (to \$0.25 on the \$1.00). Documentation needed: proforma balance sheet, profit and loss statement, and a personal net worth statement. Expect to pledge your personal assets (i.e. your house or property) as a guarantee of the business loan.

Character / Credit: Have you and the company shown good money management skills? What is your credit history? If you have bad personal credit history, the bank will think twice about considering you for a loan. If you can't manage your own money, why should the bank give you theirs? Documentation needed: credit report. I recommend that you review your credit report before meeting with the bank to address any issues in your credit history that might be unfavorable to the banker.

Commitment: Have you shown that you believe in the project and are committed by investing substantially in the project? Banks will not normally loan 100% of a project, especially with start-up companies. They are not interested in becoming an owner or shareholder of your business. Banks are a lender to your business and their main objective is to invest their depositor's funds while minimizing their risk. Documentation needed: The owner should show an equity (cash, contributed equipment and tools) contribution of at least 20-50% of the total project cost. This percent varies from bank to bank based on overall risk factor of the project and company.

Circumstances: How diversified is the customer base? Is the company dependent on one or two customers? How does the company compare to other companies in their industry? How is the company positioned to handle a down turn in the economy? Is the management team in place to actualize the project's potential? This is the gray area of evaluating your loan request. Internal bank requirements are also a consideration. For example, Company ABC didn't meet the bank's requirements without getting the Small Business Administration to guarantee the loan. With the SBA's backing, they were able to approve the loan.

Company ABC was successful in getting their loan because they knew what the bank's requirements were long before they needed a loan. They had spent the first two years developing a sound business, good credit history and a thorough knowledge of the market. Company XYZ didn't think about establishing a banking relationship until they desperately needed a banking relationship. Moral: Even if you don't need a loan or don't qualify for a loan today, it is good to understand how a bank evaluates your loan package. Knowing the "six C's" will increase your chances of getting a loan and it can mean the difference between getting approved or turned down for a loan.

The Center for Economic Vitality (CEV) at Western Washington University is available with free confidential consulting for small business owners in Whatcom County. They help businesses with putting loan packages together to present to the bank. They help local companies get access to capital and SBA loans. If you don't qualify for traditional bank loans, the CEV can help you developing a plan to overcome your challenges.