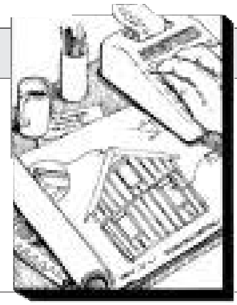

Ten Steps to a Loan

by J. Tol Broome, Jr.

I am convinced that most small business owners are scared to death of bankers. They view loan officers as stiff-lipped stuffed shirts who take pleasure in foreclosing on little old ladies on Christmas Eve. Banks are often accused of loaning money only to those who don't really need it, and even then only if the loan is backed by cash or blue chip stocks.

But banks don't make any money unless they make loans. Since only about 20% of American businesses have names like General Motors, banks are very active in financing the other 80% that are considered "small" businesses. The question is: How can you, the small business owner, tap into banking resources to help expand your business?

Here are ten ways to improve your chances of getting a loan from your local bank.

❶ ***Prepare a business plan.*** As is true when you start a new venture, the first step in preparing to expand your business is to put together a business plan. A good business plan should include information on the history of the business, a market analysis, background on management, plans for the future, and the often-dreaded numbers section (see *Business Forum*, 4/94).

It's not as bad as it sounds. The narrative section (everything except the numbers) does not have to resemble *War and Peace*. In fact, most bankers appreciate a concise narrative. You can usually cover this part in three or four pages.

The financial part of the plan should include historical information (at least three years back, if possible) as well as projections for the future. The banker will also need to know that you have thought through the effects of upcoming growth on your company's bottom line.

Keep your financial projections simple, but base them on reasonable assumptions. If you have grown 25% each of the last two years, for example, it is probably unrealistic to project a 100% sales increase for the upcoming year. Most important, the projections should demonstrate that your business will operate profitably in the future.

❷ ***Make community contacts.*** Your bookkeeper and accountant can be very helpful in the preparation of your business plan, particularly the numbers section. Many communities also offer business counseling services through organizations such as SCORE (Service Corps of Retired Executives), Small Business Technology and Development Centers, Small Business Administration, small business incubators, and local universities and community colleges. I have seen many small business owners benefit from the free advice from organizations such as these, and recommend them to any business owner undergoing significant change.

❸ ***Establish credibility.*** Many business owners are reluctant to "toot their own horn," but establishing your qualifications as a manager is important when seeking bank financing. Every loan officer learns in "basic training" that the strength or lack of management often makes or breaks a business. So lenders are interested in knowing why you are qualified to sell your product, to understand the numbers, and to manage other people.

If you are the only "manager" in your business, don't worry. This will not necessarily be counted against you, since many small businesses have only one key person. As long as you can prove to the banker that you have the qualifications to run your business profitably, you shouldn't have any problem establishing credibility.

❹ ***Build equity.*** Loan officers pay very close attention to the capital base of existing businesses seeking financing. Why? Because if your company already has a large amount of debt, the bank will be reluctant to add to it.

For corporations, most banks measure capital strength by calculating a debt/worth ratio — total liabilities divided by stockholder's equity. A red flag goes up if this ratio is higher than about 3:1.

For proprietorships, equity is harder to measure because the business and business owner are legally one and the same entity. In this case, your personal financial statement will become more important, since the bank will want to see that you are building personal equity through the profitability of your company.

❺ ***Offer sufficient collateral.*** Any discussion about borrowing money will inevitably get around to the $64,000 question: What do you have to offer for collateral? If you anticipate this question and are ready with an answer, you definitely will be ahead of the game.

Simply list everything you could offer for collateral along with a description of the asset and an estimated value. If the loan will be used to purchase specific assets, such as office equipment or new tools, be sure to include these on the list. Bankers have a habit of expecting the worst, and a good collateral list can improve the loan officer's comfort level.

❻ ***Know exactly why you need the money.*** I am often amazed at business owners who come to the bank for financing, but who really don't know how they will use the borrowed funds. Give careful thought to how much money you will need and to the reason for the loan. Prepare specific information on the purpose of the loan *before* you go to the bank.

❼ ***Have a plan for repayment.*** Every banker learns in "Lending 101" that the most important component of any loan request is the repayment source. If the bank doesn't get repaid, it doesn't make any money. Before you go to the bank, give some serious thought to how you will repay the loan. If it's an installment loan, the more you know about how large a monthly payment you can make, the better it will look from the banker's side of the table. If a lump sum payment is involved, show the loan officer how you plan to raise the money. On the other hand, if the means of repayment is in doubt, maybe the timing isn't right to borrow the funds.

❽ ***Look at the downside.*** Every business decision has some downside risk, and it is important to address the potential pitfalls in your loan request. The trick is to acknowledge the drawbacks without sounding too pessimistic. Try to show the banker that you have considered the "what-ifs" and that you have a "Plan B" if things don't go smoothly. For instance, let's say you are seeking a loan for inventory that you hope to sell quickly. Your fallback position might be to run a sale on unsold inventory to ensure that it is still sold in a timely manner. Letting the banker know this shows that you have considered a contingency plan that will result in the bank being repaid, whatever happens.

❾ ***Find the right bank.*** In some communities, there are as many different lending philosophies as there are banks. Finding the right one can be difficult.

There are several ways to "prospect" for the right bank. First, if you have a deposit account or personal loans at a particular bank, you already have some rapport there that can be used to expand the relationship to include a small business loan.

Second, consider using your contact base. Your accountant or attorney probably know many bankers and can often steer you in the right direction by making the initial contact on your behalf or by giving you a name to call.

Third, ask your customers who they bank with. They will often have longstanding relationships with certain bankers, and may be willing to help you get a foot in the door.

Make a "cold call" only as a last resort. This approach is too impersonal and has the least chance of success.

❿ ***What not to do.*** Knowing what to avoid can make the difference between a "Yes" and a "No" from the lender. There are a number of red flags that bankers look for.

- Know how much you want to borrow. Responding to the question "How much do you need?" with "As much as you will lend me" may sound like a safe answer, but it demonstrates to the banker a lack of planning, and it will almost guarantee a denial no matter how profitable your business.
- Neatness counts. You would be surprised at the number of coffee-stained business plans with missing pages bankers see. If the banker perceives that you don't care enough about your need for financing to present a neat and complete package, then why should the loan officer be expected to show any enthusiasm for your request?
- Finally, don't defer answers to financial questions to your accountant. Lenders cringe at the thought of a business owner who has not taken the time to understand the financial side of the business. And if the lender cringes, then the loan request will usually crumble. ■

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