

GETTING A BANK LOAN

DISCLAIMER

The Mission of the Business Enterprise Centre is to foster, develop and support small business by providing relevant, accurate and professional information and assistance to those intending to start a small business or those existing small businesses that need support. This information and assistance is offered free of charge on the explicit understanding that::

- ◆ The information supplied is intended to provide general guidance and direction on all aspects of small business.
- ◆ The Centre is not engaged in rendering legal, accounting, financial or other professional advice.
- ◆ The information is not intended to replace professional advice and at all times the Centre, its officers and employees recommend that if legal, accounting or other expert advice is required, clients seek professional advice before committing funds to any business venture.
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Getting a Bank Loan

Bankers want to make loans to businesses which are solvent and profitable.

They judge you, at least partly, on your foresightedness and your management.

They expect you to plan ahead and to anticipate your financial needs.

One of the worst approaches is to appear at your banker's door in a financial crisis through lack of planning. This tells the banker that you have not stayed on top of things.

Conscientious planning and management are essential if you want to use the bank's money.

BANKS AND SMALL BUSINESS LENDING

Banks often have a hard time lending to small business operators for the following reasons:

Due to lack of planning and cash management, most small businesses approach the bank when it's already too late.

The cost of processing a \$5,000 loan is about the same as processing a \$50,000 loan. There is little incentive for spending time and effort on a small application, particularly if it looks marginal from the outset.

Banks like to see accurate financial forecasts which many small business people don't prepare.

Banks have difficulty financing new businesses without solid track records. New business start ups don't have this.

Lending to one-person operations is risky. If you get sick or hurt, there won't be anyone to carry on business.

As a low return, high risk borrower, you usually need collateral to match the loan. Most small businesses don't have this.

Many small businesses are chronically under-capitalised from the beginning. If you are looking for start up capital and don't have collateral you will need to look elsewhere eg. family and friends, silent partners, private investment companies, etc.

YOUR RATING AS A BORROWER

Banks will look carefully at the six "C's" listed below when assessing a loan application:

Character: What sort of a person are you? Are you trustworthy? Competent? Reliable? What is your history and achievements to date? How committed are you to the venture?

Capacity: When and how do you plan to pay back the loan? Can the business generate enough to pay it back? Does the cash flow projection show this? For existing businesses, do past profit & loss statements and balance sheets show this?

Capital: What's the extent of your personal investment in the business? If you're not prepared to risk your money in your business, how can you expect the banker to?

Collateral: Which of your assets could be used as security against a loan? Do you own real estate, stocks or bonds, vehicles and equipment, etc?

Circumstances: What's the outlook for business in general and your business in particular? Does the loan make sense, or will it be the straw that breaks the camel's back?

Coverage: Do you have insurance against basic risks? How would the loan be repaid if there was an accident or catastrophe?

PREPARING YOURSELF TO GO TO THE BANK

Before approaching a bank for a loan, you need to determine how much money you need in total and what sources it will come from. This will let you know what size bank loan you need. For a new business you may be putting in some of your own money, getting some through equity partners and applying to a bank for the balance.

You also need to be sure that the proposal is viable. If you are unsure, it will be hard to convince the bank.

Then you'll need some hard data to back up your proposition.

A useful first step is to contact your bank and ask what information they require for a business loan and in what format. Some banks have loan application forms. Others may give you some guidance but largely leave it up to your judgement.

Regardless of the format, banks will generally want some standard information which is detailed below:

- ◆ Basic business details. These will include name, address, phone number, contact names and legal structure of business. If more than one person is involved, explain the roles and responsibilities of everyone.
- ◆ The type and size of loan required.
- ◆ What the money will be used for.
- ◆ Financial structure of the business.

This would include a cash flow projection as a minimum. In addition you may need budgets, costing

details, and for existing businesses you will need recent profit and loss and balance sheets.

Information must be provided on how and when loan will be repaid. This normally shows in the cash flow projection.

Collateral available as security to the bank. For very small loans the banks may lend unsecured if they are very comfortable with you and your business plans.

Otherwise you will have to pledge some asset or assets as security and look to relatives or friends for a guarantee.

An overall business plan. This will include:

Nature of business and its products and services. Where possible show your banker a sample of what you are producing.

Plant and equipment required and where it will come from. Comments should be made on choice of equipment, lead time from purchase to production, suppliers, etc. Include brochures if the equipment is out of the ordinary.

Premises and occupancy details. Where will your business be located and why?

Do you own the building or are you renting? What are the lease agreements? Does the building meet department of relevant regulations eg. zoning, health department, etc? Have documentary evidence if possible.

Production details: How is product to be produced and what is production capacity?

Availability of raw materials: Where will you buy from? What is lead time between order and delivery?

Market research findings: What market research have you done? How was it conducted? What was the information gathered from this exercise?

Marketing plans: What marketing mix will you use? How have you selected your product range and how will you price, promote, and distribute your product?

Quality control procedures: What standards have you adopted for your operation and how do you ensure they are met?

Management and personnel: This will include comments on skills required and available. How will any skill gaps be met?

Contingency Plans: What insurance cover is appropriate?

The bank will be most interested in the reliability of your information.

If you forecast sales of \$10 000 they will want to know how you came up with that figure. You must be able to justify assumptions. Use a simple 1 page work sheet for your assumptions.

Don't be afraid to talk to more than one bank. Find out about the range of products they offer, fees they charge and the cost of getting a loan from them. It may be useful to do this in advance of actually needing a loan.

Fees and facilities do differ. Some are more sympathetic to small business than others. Find a bank that suits your business.

TYPES OF LOANS

There are many different types of loans. It is important to choose a loan type that suits your needs. Your bank should be able to guide you in this.

This main loan types relevant to small business are detailed below:

Short Term Loans

Often handled by way of overdraft. these are usually sought for specific working capital purposes, eg. to build up stock for a seasonal increase in sales.

The term of such a loan may vary from 30 days to six months. Repayment is expected when the purposes of the loan are served.

If your credit rating is good, you may get the money on an unsecured basis. Otherwise you'll have to put up collateral.

Don't ask for a 30-day loan if you don't expect to have the funds in 30 days. A 30-day loan that requires five renewals could be your last bank loan.

A Credit Line

Typically by way of overdraft. Under this arrangement the bank agrees to make money available as required up to a maximum pre-established limit. These advances are usually for working capital and are granted almost automatically during the period of the agreement (normally one year).

Overdrafts are usually at higher interest rates than term loans, and are therefore only appropriate for short term borrowing's, or when the amount required varies.

Term Loans Or Fully Drawn Advantage (FDA)

These loans are used for other than temporary needs.

Typically, they are used to purchase fixed assets such as an existing business, plant and equipment or buildings.

The term of the loan will depend in part on the life of the assets being purchased. For example, if you are wanting a loan to buy a computer with a life expectancy of 5 years you will not get a 10 year loan. On the other hand you may get a 20 year loan for purchase of a building.

The money is normally paid back in instalments covering principal and interest.

While a term loan is in force, you may be required to furnish the bank with regular financial information. On a quarterly or even monthly basis.

NEGOTIATING WITH THE BANK

When negotiating terms of your loan including front end fees, interest, etc, a lender may be prepared to "give" a little if you negotiate.

This is one reason for knowing what you can get from the other banks. Try to get terms that you know you can live with. Once they're set, you're stuck with them!

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