What Lenders Are Looking For in a Small Business

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The following information is an excerpt from seminar materials prepared by Bonnie Paisley and Meg Meister at a recent seminar on How to Finance the Small Business. This outline provides information about what lenders are interested in when considering lending money to a small business and includes tips on how small businesses can improve their chances in obtaining bank financing.

Understanding the Small Business Loan Process and Documentation Requirements of Commercial Bankers

1. Banks look for ideal loan applicants. Their goal is to make a loan to a person or group of people who are going to pay back the loan under the terms agreed to. In an effort to meet that goal, lenders are interested in the following issues:

a. An indication that cash flow will be sufficient to make the loan payments

b. An owner and/or management with a track record of profitably owning and operating the same sort of business

c. An owner with financial reserves and personal capital sufficient to solve the unexpected problems that affect all businesses, including an indication that the owner has invested personal equity in the business

d. The core competencies of the business, the competitors and the competitive advantages (The lender is trying to assess the competency of management)

2. Loan documentation supports the business or underwriting requirements of the bank and the legal requirements to secure the loan

a. A promissory note evidences the debt

b. A mortgage places a lien on real estate

c. A security agreement grants a lien on personal property

d. A security interest in personal property is generally perfected by filing a financing statement in the Secretary of States office or, with certain types of collateral, by taking possession of the collateral, either actually or through a control agreement with a third party.

e. A loan agreement is usually used in the context of construction loans or more complicated transaction where financial covenants are required or lending is based on a borrowing base of inventory or accounts

f. A personal guaranty of all owners will likely be required

Increasing Your Chances of Obtaining a Loan for a Small Business

1. Cultivate a relationship with a banker from early

a. Open a checking account and establish a relationship with the account officer or branch manager

b. Maintain contact

c. Request an introduction to a loan officer and consider meeting with the loan officer to explain your business even if you don't need a loan right then

d. In a few years, when you need a loan, start with this banker

2. Applying for a Loan/Line of Credit

a. Be organized: Know how much you need, why you need it, and how you're going to pay it back

b. Improve your chances of getting the loan by writing a loan proposal. It should contain:

1) General information business name, information about the principals, purpose of the loan, amount needed

2) Business description: history and nature of the business including a summary of recent changes, number of employees, current assets, ownership structure

3) Management Profile: education, experience, skills and accomplishments of each principal

4) Market Information: define company's products and markets; identify the competition and explain how the business competes and why it's different; profile the customers

5) Financial Information: financial statements – balance sheets, income statements and business tax returns for three years; personal financial statements on the principals (e.g., more than 20% owners); description of collateral; information on existing loans

6) For line of credit secured by accounts receivable and inventory (banks generally may lend up to 75-80% of current accounts receivable and up to 50% of inventory value):

accounts receivable and payable information; current inventory list; copies of significant contracts with large customers covering long-term sales agreements

7) For real estate loans: detailed description of the real property, including location, land and building size, rental information; income and expenses of the property; property tax valuation and/or recent appraisal; purchase agreement if applicable; environmental analysis; owner's title policy

8) Miscellaneous Information: articles of incorporation, bylaws, LLC operating agreement or partnership agreement; tax ID number; three months' bank statements