

# Obtaining a Loan

## Applying for a Loan

When applying for a loan, you must prepare a written loan proposal. Make your best presentation in the initial loan proposal and application; you may not get a second opportunity. The basis for your loan proposal is your Business Plan.

Always begin your proposal with a cover letter or executive summary. Clearly and briefly explain who you are, your business background, the nature of your business, the amount and purpose of your loan request, your requested terms of repayment, how the funds will benefit your business, and how you will repay the loan. Keep this cover page simple and direct.

Many different loan proposal formats are possible. You may want to contact your commercial lender to determine which format is best for you. When writing your proposal, don't assume the reader is familiar with your industry or your individual business. Always include industry-specific details so your reader can understand how your particular business is run and what industry trends affect it.

### **Description of Business:**

Provide a written description of your business, including the following information:

- Type of organization
- Date of information
- Location
- Product or service
- Brief history
- Proposed Future Operation
- Competition
- Customers
- Suppliers

**Management Experience:** Resumes of each owner and key management members. Emphasize any relevant experience.

**Personal Financial Statements:** SBA requires financial statements for all principal owners (20% or more) and guarantors. Financial statements should not be older than 90 days. Make certain that you attach a copy of last year's federal income tax return to the financial statement.

**Loan Repayment:** Provide a brief written statement indicating how the loan will be repaid, including repayment sources and time requirements. Cash-flow schedules,

budgets, and other appropriate information should support this statement.

**Existing Business:** Provide financial statements for at least the last three years, plus a current dated statement (no older than 90 days) including balance sheets, profit & loss statements, and a reconciliation of net worth. Aging of accounts payable and accounts receivables should be included, as well as a schedule of term debt. Other balance sheet items of significant value contained in the most recent statement should be explained.

**Proposed Business:** Provide a pro-forma balance sheet reflecting sources and uses of both equity and borrowed funds.

**Projections:** Provide cash flow projections for each month of the first year, yearly for the first three years of operation, or until positive cash flow can be shown. Include earnings, expenses, and reasoning for these estimates. The projections should be in profit & loss format. Explain assumptions used if different from trend or industry standards and support your projected figures with clear, documentable explanations.

#### **Other Items As They Apply:**

Lease (copies of proposal)  
Franchise Agreement  
Purchase Agreement  
Articles of Incorporation  
Plans, Specifications  
Copies of Licenses  
Letters of Reference  
Letters of Intent  
Contracts  
Partnership Agreement

**Collateral:** List real property and other assets to be held as collateral. Few financial institutions will provide non-collateral based loans. All loans should have at least two identifiable sources of repayment. The first source is ordinarily cash flow generated from profitable operations of the business. The second source is usually collateral pledged to secure the loan.

#### **The 5 C's of Credit**

Your bank is in business to make money. Consequently, when a bank lends money it wants to ensure that it will be paid back. The bank must consider the 5 "C's" of Credit each time it makes a loan.

**Capacity** to repay is the most critical of the five factors. The prospective lender will want to know exactly how you intend to repay the loan. The lender will consider the cash flow from the business, the timing of the repayment, and the probability of successful repayment of the loan. Payment history on existing credit relationships - personal and commercial - is considered an indicator of future payment performance. Prospective lenders also will want to know about your contingent sources of repayment. Your

personal credit score will be considered as an indication of your propensity to repay the loan.

**Capital** is the money you personally have invested in the business and is an indication of how much you will lose should the business fail. Prospective lenders and investors will expect you to contribute your own assets and to undertake personal financial risk to establish the business before asking them to commit any funding. If you have a significant personal investment in the business you are more likely to do everything in your power to make the business successful. A lender does not want to be the only one taking a risk on your business. A bank will only lend 80 percent of the funds needed. It will require you to provide at least 20 percent from other resources.

**Collateral** or guarantees are additional forms of security you can provide the lender. If the business cannot repay its loan, the bank wants to know there is a second source of repayment. Assets such as equipment, buildings, accounts receivable, and in some cases, inventory, are considered possible sources of repayment if they are sold by the bank for cash. Both business and personal assets can be sources of collateral for a loan. A guarantee, on the other hand, is just that - someone else signs a guarantee document promising to repay the loan if you can't. Some lenders may require such a guarantee in addition to collateral as security for a loan.

**Conditions** focus on the intended purpose of the loan. Will the money be used for working capital, additional equipment, or inventory? The lender will also consider the local economic climate and conditions both within your industry and in other industries that could affect your business.

**Character** is the personal impression you make on the potential lender or investor. The lender decides subjectively whether or not you are sufficiently trustworthy to repay the loan or generate a return on funds invested in your company. Your educational background and experience in business and in your industry will be reviewed. The quality of your references and the background and experience of your employees will also be considered.

## **SBA Loans**

The SBA does not lend money directly to small businesses. A bank makes SBA guaranteed loans. The SBA guarantees the bank that if you default on repaying the loan, the SBA will repay up to 85 percent of the loan amount. If you do not qualify for a conventional loan from your bank, inquire about a SBA guaranteed loan.

The following is another analysis of how to apply for a business loan.

## Preparing and Presenting a Loan Proposal

Once you have a written business plan, you are now ready to approach the money markets to try to finance your business. Your business plan is the heart of your loan proposal.

### Developing your loan proposal

Your loan proposal must answer the following questions:

- Who are you?
- How much do you need?
- How are you going to pay it back?
- What happens if you can't pay it back?

### Elements of your loan proposal

Generally, the loan proposal is comprised of the following elements:

1. **Summary: Comes first; written last.**  
This should be clear, concise, accurate and inviting. You want to summarize how the proposed loan will be used, how it will be repaid and how it will benefit your business. Remember, that you are competing with many others, so you'll also want to point out some of the distinguishing features of your business.
2. **Top management profiles:**  
The key issue here is who are you? Be prepared to come under close scrutiny. You will need resumes as well as a summary of experience, qualifications and credentials for all owners and key members of your management team.
3. **Business description:**  
You don't need to repeat all of the information contained in your business plan, but you do need to present a solid description of your business. Include a brief overview of the history of your business, plus a summary of current activities. Make sure you clearly demonstrate that you understand your markets and industry (current trends and risks). Include literature showing your products or services. It is also helpful to include letters from suppliers, customers and other business references.
4. **Projections:**  
Include projected income statements and cash flow statements for two to three years. Your assumptions should be clearly stated and realistic. Generally, you don't need to show "best case" and "worst case" unless the banker asks you to do so. But do be prepared to answer questions (in quantifiable terms) about what happens if some of your assumptions don't come true. For example, if you anticipate obtaining a major new contract or customer as a result of newly expanded capacity, can you estimate the impact on your income statement if that customer decides to take her business elsewhere?
5. **Financial Statements:**  
The loan package must include both business and personal financial statements. Make sure that you fully understand the "story" that your financial statements tell.

Be assured that your banker will fully analyze your historical financial statements and calculate all the ratios. So, prepare in advance and point out any significant trends in an introductory paragraph.

6. **Purpose of the loan:**

Present a detailed statement of how you will use the loan proceeds.. Don't forget to include the proceeds of the loan in your cash flow projections (and the interest in your projected income statement).

**7. Amount:**

Remember, that you are offering the bank a deal that will make them money -- you are not asking for an "allowance". The attitude you should take is to ask, "how much money do you need, and how much will they lend?" and not, "will they lend it?"

**8. Repayment plans:**

You will have to make some assumptions about the terms of the loan in your proposal. (Obviously, this is necessary to prepare the initial financial projections.) In the first package, you will propose the terms that you want, but ultimately this will be a point that will be negotiated with the bank. The bank will consider a number of factors as they assess the overall risk of the loan and this will impact the repayment terms they are willing to give you.

**Selecting the bank**

You may already have a relationship with a bank, and this is generally the logical first choice for borrowing money. But whether this is your first loan, or you are borrowing additional money, you should consider several points before selecting the bank.

Although you may need money, you should be in the driver's seat when it comes to choosing the bankers or partners you want to deal with. Make sure the bank is sincerely interested in your business and will provide you with the services you need. You should also look for a banker with whom you feel you can develop a good ongoing relationship and that has experience with similar businesses. Keep in mind the value of your business to the community and what its future deposits could mean for the bank.

Key questions to ask bankers include the following:

- Do they have an industry specialty related to yours?
- What is the average size of their borrowers?
- What are their professional backgrounds, especially in terms of whether they are commercial or consumer lenders?
- How long have they been in these positions?
- Do they have the level of lending authority you need?

Whether you patronize a large commercial bank or a small community bank will depend on your needs. Major banks tend to offer a wider range of services and locations, which may be important if you have the need for a variety of financial products and services. Community banks, on the other hand, are smaller, meaning that the banker you deal with daily might be able to make your financing decision personally or get it through the bank hierarchy quicker.

**Presenting your loan proposal**

Okay, now your loan package is prepared and it's time to get ready to present your proposal. Before you go to the bank it is a good idea to role play with someone you trust. This is not the sort of presentation that you make every day, and this can help ensure that you are comfortable discussing all the material in your loan package, and

have considered all the questions your banker might ask in the initial interview. If you have a question about how to present your loan, now might be a good time to visit the Info Exchange - discussion forum on lending and seek the advice of an expert or another business owner that has been through this before.

Before you approach a bank you should:

1. Have comprehensive written documentation ready.
2. Know your numbers inside and out.
3. Know what collateral you can offer.
4. Be prepared to sell yourself.

Handle the meeting professionally -- make an appointment, show up on time and have a business demeanor throughout the meeting. You should tell a prospective banker what benefit your business brings to the bank in terms of average balances in checking accounts, savings accounts, and present and future financial needs. You should also ask them questions to see if you think they are the right people to handle your account.

After you present your loan proposal, ask the banker what can be expected in terms of a response time, or when they will request additional information. Obviously, the request won't be approved in the initial meeting. But if you've done your homework, you will already have a good idea of whether or not your loan is likely to be approved.

**If your loan is approved:**

(besides celebrate) make sure that you:

- Thoroughly review all loan documents and understand before signing. Consult with your lawyer or accountant if you have any questions.
- Get documents in on time -- frequently there are a number of documents that cannot be finalized until after the loan is approved and closed. Keep up that good impression the bank has of you by promptly responding to requests for additional information, documents, signatures, etc.
- Maintain close contact with your loan officer. It is a good idea to give her progress reports -- the bank now has a vested interest in your success and will want to be kept current.
- Communicate problems. Bankers, don't like surprises, particularly if the news is bad. So, make sure they are one of the first contacted if you encounter any problems.

Once your banker makes a loan to you, he or she has a vested interest in your business success. If you prosper, the bank prospers. If you fail, the loan they approved is not going to be paid.

**If your loan is not approved:**

- Don't despair.
- A "no" today doesn't necessarily mean no forever.
- Don't take it personally.
- Be gracious.
- Ask the banker to explain "why" your loan was not approved.
- Don't get defensive, seek information so that your next proposal addresses and corrects any deficiencies in the current application.

**Where to turn for help:**

There are a number of resources available to help you prepare your loan proposal, including Westmoreland SCORE.

**What to do when no one will lend you money:**

There may be times when knowing the money markets, as well as preparation, presentation, pluck and persistence just don't seem to work. The key to overcoming this financial obstacle is not to get bitter: get resourceful. Remember there is more than one way to skin a cat.

If you have a viable business idea you should be able to find funding... as long as you have done your homework and developed a written business plan.

Other owners have raised money from friends by making attractive interest rate offers to friends and acquaintances for loans, or offering an equity interest in the business to an investor.

The secret is to prepare yourself -- before you implement that growth strategy. Your business plan will provide you with a way to look, before you leap.