

EXPERTS' FORUM | Bank/Financial

Cracking the Credit Code: Credibility, Character, Capacity, Capital, Collateral & Conditions

You've heard the stories and read the articles that credit is tight at some of the larger banks. Many community banks still maintain a healthy credit relationship for customers and prospects. Now's the time to learn to crack that credit code – the 6 Cs that lenders consider on every loan application. You'll then be able to present your case with confidence to any community banker. What are these 6 Cs?

Build Credibility with a persuasive business plan.

Bankers want to see a solid, credible business. So you'll need to become an expert salesperson for your project or loan application. Plan on spending some time preparing a professional-appearing business plan to build your credibility. Be sure you know and can defend your numbers, understand and speak confidently about your market and recognize your competition. A thorough business plan will automatically address the 6 Cs of credit.

Put a critical eye on your Character or Credit History.

Character is a little misleading. It actually involves reviewing your credit history and credit rating to determine your willingness to handle financial obligations. In other words, your financial character. Get a copy of your credit report before your lender does. You can be proactive with any item which could appear as a negative and enhance any positives. It's not necessarily an issue if your firm has gone through troubled times, but how you dealt with it. Plus, were you proactive and honest in communicating with your banker?

Check that your monetary Capacity or Cash Flow can cover the payments.

While character examines the desire to repay financial obligations on time, capacity measures your ability to make the payments. Cash only can repay that loan. Simply, can you afford the loan? Lenders don't know what the next year will bring. Who could have factored in 9-11 or the current recession . . . or a devastating storm, the death of a key member? That's why it's crucial to formulate a repayment contingency plan in your business plan for an unforeseen event. Generally, a company is expected to generate at least \$1.20 of cash flow for each dollar of debt.

Some industries can take a higher debt load, while others may operate with less liquidity.

Invest enough Capital in your company.

A lender wants to be reassured that you have sufficient capital or equity in the company. First, working capital can cushion any disruption in your firm's ability to generate cash and meet debt obligations. Second, an owner's equity can reaffirm that you have a commitment to the firm should something go awry. Both your company's financial statements and your personal credit can be key.

Stabilize your loan request with Collateral.

While cash flow will be the primary source of repayment, lenders look for a secondary source of repayment, namely collateral. Most collateral is in the form of hard assets – real estate or equipment, but accounts receivable and inventory can be pledged, too. If collateral doesn't come from your business, your personal assets may be substituted. Borrowers tend to believe that a bank will lend dollar for dollar for every asset. This is not the case. Banks discount or "margin" the value of collateral based on historical liquidation values. For example, accounts receivable or equipment may be valued at 80%, inventory 50%, and real estate 75%. In other words, banks are considering the cost of liquidating any assets.

Without the proper collateral, a co-signer could be required. Or, an SBA-backed loan where the Small Business Administration helps guarantee the loan could help satisfy the collateral requirement.

Make sure the Conditions are right.

There are several "conditions". The local economic climate overall and the conditions in your industry. The conditions under which you will be using the funds. . . for working capital, equipment, inventory. And, the conditions of the loan. . . loan amount and interest rate.

The final C of Credit –your Community Bank.

While credit may be tight at large financial institutions, many community banks are still interested in building small business relationships. You may wish to start your credit search at an established community bank.



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