Getting a Business Loan

VIDEO CONTENT

1. Definition of debt financing

- **Debt financing** is basically money that you borrow from someone else to run your business.
  - **Two categories:**
    - Long term debt financing - paid back in > 1 year
    - Short term debt financing - paid back in < 1 year
  - **Long Term Debt Financing**
    - Usually applies to assets your business is purchasing, such as equipment, buildings, land, or machinery.
    - Scheduled repayment of the loan and useful life of the assets > one year.
  - **Short Term Debt Financing**
    - Usually applies to money needed for the day-to-day operations of the business, such as
      - Purchasing inventory, supplies, or paying the wages of employees.
    - Referred to as an operating loan or short term loan because scheduled repayment takes place in less than one year.
      - A line of credit is an example of short term debt financing.

2. Debt financing from both sides of the equation … borrower and lender

- **Borrower** = you and your business
  - how much needed to implement your business plan
  - what specifically will you use if for
  - how long will you need it
  - How much debt can you afford to take on
  - Can the business pay the money back

- **Lender**
  - are you and your business a good risk
  - do we have money to lend
3. **How a lender reviews you (Often called 5 C’s of credit)**

**Capacity** to repay is the most critical of the five factors, it is the primary source of repayment - cash. 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 or commercial- is considered an indicator of future payment performance. Potential lenders also will want to know about other possible sources of repayment.

**Capital or equity** is the money you personally have invested in the business and is an indication of how much you have at risk should the business fail. Interested lenders and investors will expect you to have contributed from your own assets and to have undertaken personal financial risk to establish the business before asking them to commit any funding. Your capital investment requirement will typically be from 15% to 30% or more depending on the associated risk and repayment time line.

**Collateral** are additional forms of security you will be typically required to provide the lender. Giving a lender collateral means that you pledge an asset you own, such as your home, to the lender with the agreement that it will be the repayment source in case you can't repay the loan. Some lenders may require a personal guarantee in addition to collateral as security for a loan.

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

**Character** is the general impression you make on the prospective lender or investor and your and your business’s credit score and repayment history. The lender will form a objective and subjective opinion as to 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 considered. The quality of you references and the background and experience levels of your employees will also be reviewed.

4. **Understanding and being able to explain your financials?**

One of the biggest reasons loan officers refer existing business owners to the SBDC is that the owner does not understand the financials for their own company. As the business owner the lender expects you to fully understand all the numbers and be able to explain your forecast, cash flow, balance sheet and critical ratios. In summary the three statements are:

- Income statement showing the sales forecast, cost of goods and expenses. Must be able to explain why the forecast is reasonable compared to historical numbers and current and future market dynamics.
• Balance sheet that shows strong ratios compared to the industry benchmarks – primarily the current, quick, debt to equity though there are many ratios including some that are industry specific.
• Cash flow forecast by month for the first year that shows ability meet obligations and repay the loan.

Return to the SBDC web site to get access to information on resources, great tools and most importantly, information on contacting your nearest SBDC Certified Business Advisor.

For a more in-depth review of financials view the “Understanding Your Financial Statements” video.