

Acquiring a Small Business Loan

Courtesy of the Iowa Small Business Resource Guide

According to a report by the National Federation of Independent Business, 85 percent of loans to small businesses are provided by banks. Knowing what these lenders are looking for will speed up the loan application process.

By presenting your case in the best possible light, you enhance your chances of getting the financing you need. Remembering this basic rule may save you time and effort when seeking bank financing for your business.

PLANNING

Before you go to the bank, ask yourself these questions:

- What must I finance to support my needs?
- What amount of financing will meet my needs?
- When and for how long will I need these funds?
- How will I generate sufficient cash flow to repay the loan?

The answers to these questions and your financial statements are central to the lender's decision.

THE REVIEW PROCESS

Every lender tries to understand the condition of the borrower's business as well as its prospects. That is why you are asked to submit several types of financial statements. This information provides the banker a chance to see how critical aspects of your business relate to one another.

Following are some of the measurements bankers use to gauge your company and its strengths.

- **Liquidity** - The amount of cash and working capital a company has is very important to bankers as an indication of how efficiently a company generates internal cash flow, which can be used to repay the loan.
- **Leverage** - The amount of debt on a company's balance sheet, when compared to the amount of equity in the business, will give the banker an idea of how leveraged (in debt) the business is.
- **Inventory** - Your banker will want an accurate account of your inventory, particularly if you run a wholesale or retail operation. An accurate inventory count will also help determine inventory turnover. Occasionally, a physical count of your inventory will be necessary.
- **Turnover** - Activity refers to the turnover of receivables, inventory and sales. By measuring these variables in relation to one another and to fixed assets, the banker gets an idea of how much activity results from the company's day-to-day operations.
- **Inventory Turnover** - Inventory ratios may have the most value in monitoring internal operations, but they provide useful background for a financing plan as well. Your inventory turnover ratio is delicate. It helps you achieve the right balance between overstocking and understocking. If you are overstocking, you pay interest on working capital as well as paying for inventory. You don't want to pay double duty. If you're understocked, you could have stockouts, which could give your business a bad image and cause a loss of sales.
- **Receivables Turnover and Average Collection Period** - Your own credits policy is one of your most important marketing decisions. If your credit policy is too tight, you lose sales. If it's too liberal, your carrying costs are higher than necessary. You must collect receivables within a reasonable time for them to remain a liquid asset. The Receivables Turnover Ratio measures the amount of accounts receivables in relation to sales.
- **Gross Profit Margin** - This ratio provides a clear indication of the ability of your business to meet direct costs and operate profitably. Gross profits are net sales (minus returned goods, discounts, price reductions, etc.) minus cost of goods sold.
- **Return on Sales** - This ratio is an overall measure of the profitability of the business. It illustrates the percentage of profits remaining after direct expenses, overhead, unusual items and taxes.

Your banker can help you calculate these ratios and others he or she may require. Ask your banker or accountant to provide you with averages for your particular industry. This can help you determine how your company stands in relation to its competition.

THE GROUNDWORK

In seeking a loan for your firm, you essentially ask the bank to become your business partner. Before entering the market for a loan, make sure you've done all necessary groundwork:

- How much do you need and for what?
- What terms do you need for your loan?
- What kind of businessperson are you?
- What shape is your business in?

Remember, loans are products that banks sell. Look for the best combination of price, quality and reputation of supplier. In the end, getting a loan depends upon your credit worthiness. Ask your banker—your partner—for assistance.