Qualifying for a Business Loan Special Report

Although you may already own a business or be purchasing a business with a solid financial history, qualifying for a loan is not always easy. There are five common credit factors that will be considered by your lender before making a decision to approve your loan.

1. Ability to Repay – lenders will look at the discretionary earnings from the business and a secondary source, typically collateral, as a guarantee for repayment.

   Lenders will want to review the business's balance sheets and profit & loss statements from the last three years. If a business has consistently performed profitably and can cover the payment of additional debt, then it is likely the loan will be approved. If, however, the business has not performed as well or is a start-up but, has an opportunity to grow, the lender will want a detailed business plan showing earnings projections for at least three years. Lenders will also want to review personal tax returns for the past three years.

   Collateral is often required as a secondary source of repayment and is defined as personal and business assets that can be sold to pay back the loan. The value of collateral is discounted to take into account the value that would be lost if the assets had to be liquidated. For all Small Business Administration (SBA) loans, personal guarantees are required from every owner in the business, plus others who hold key management positions.

   The guarantee may be required to be secured by personal assets if the amount being borrowed is greater than the value of the business assets. The Small Business Administration (SBA) requires certified business valuations for loans of $100,000 or more. They may also require additional appraisals and feasibility studies, depending on the assets being used as collateral.

2. Credit History – good personal credit history is a key indicator to lenders in identifying borrowers most likely to repay commercial loans.

   You can request a copy of your personal credit report from one of three major reporting agencies: Equifax, Experian and TransUnion. Before you start the loan application process, carefully review our credit report and resolve any discrepancies.

   Lenders will consider your personal spending habits, including your credit card history and how you handle debt. In addition, they may review your real estate holdings, your personal loans and ensure that you have filed and paid your personal income taxes.

   Lenders will also carefully review the credit history of the business. They will be looking for a consistent track record of paying bills on time, your ability to collect on accounts receivables and any past credit issues.

They will want to know how the borrowed funds will be used in your business and how you plan to repay the loan.

3. Equity Investment – most lenders will require an owner to invest 25% - 40% of their own money in a business before approving a loan. This investment must be in the form of very liquid assets such as securities, IRA's or 401K's.

   Strong equity demonstrates that an owner is committed to the business. Lenders will carefully analyze the debt-to-worth ratio of the loan applicant to compare how much is being borrowed (debt) in relation to how much the owner has invested (worth). Owner equity includes cash they have invested in the business as well as retained earnings built up in the business.

4. Working capital – a lack of sufficient working capital increases the risk that your business will fail and will decrease your ability to get a loan.

   Working capital is produced when your current assets are greater than your current liabilities. Current assets are more easily converted to cash and provide a margin of protection to pay financial obligations due within one year. Working capital is used to measure the financial viability of the business.

5. Character – lenders will also consider non-financial factors, such as managerial capacity and appropriate business experience, when approving a business loan.

   Managerial capacity includes the ability of an individual to manage the resources of the business and includes their education, experience and motivation. The lender will ask if sales are growing, what the strength of your competition is, how does the business control its inventory, what do you do to control business expenses, and other questions pertinent to the operation of the business.

   If the owner applying for the loan does not have the appropriate business or technical experience, the lender will expect the owner to demonstrate that they have a partner or employees with the experience necessary to succeed in the industry. Be prepared to submit resumes for management and key employees.

Before you approach a lender for a loan, it is a good idea to conduct a self assessment in the five areas shown above and make any adjustments necessary. Obtain a credit report and collect loan documentation required such as your business plan, resumes, balance sheets and other financial documents that substantiate your business's viability. Being well prepared and organized will help expedite the loan process and act in your best interest with the lender.