ctinnovations.com

connecticut innovations
What's next starts here.

BUILD A BORROWING STRATEGY

Questions to ask yourself when you are ready to grow your business

Many companies are now finding that they have weathered the impact of the recession, and they are looking for growth opportunities. With that, they seek new sources of cash to fund their expansion. It may surprise you to learn that the banking industry is fiercely competitive right now. With a significantly greater supply of money than demand, lenders are flush with cash. Interest rates continue to be low. In addition, the fierce competition in the banking industry means that banks are increasingly motivated to offer you attractive deals.

Yet even with the uptick in attractive lending packages, companies still need to be savvy as they shop for these deals. Preparation is the key.

We have assembled a list of seven essential questions that organizations typically ask -- or should ask -- themselves before they meet with prospective lenders. The answers to these will help make future negotiations more productive:

Q: Our company does not have a track record of borrowing. How will this affect our creditworthiness?

A: In general, regardless of whether you have borrowed in the past, your company will need to demonstrate the ability to have sufficient cash flow from its operations to repay the loan. Lenders will look to do a credit assessment based on information you provide to demonstrate this, as shown in the loan application.

Q: What is the best way to demonstrate to a lender that we are now positioned to take the risks that additional debt and new assets represent?

A: Although the banking industry is looking for customers, the appetite of lenders still remains conservative when it comes to the financial performance of the borrower. This can mean that businesses with urgent financing needs may have to wait a period of time as they demonstrate a consistent pattern of positive cash flow. For this reason, it is vital to be able to show a track record of responsible financial management.

Some borrowers, even if they did not have a formal business plan initially, have taken the time to draw one up to demonstrate that they have a strategy for growth and a solid management team. This is especially recommended if your company has been historically profitable but encountered some difficulties in recent years -- as many companies did during the recession.

Write the plan so that it demonstrates how your company plans to turn the corner. Provide realistic projections and explain how your assumptions were determined. You should also include the viability of current products or any new products your organization intends to introduce as part of the turnaround plan.

Whether you make a formal business plan or not, you must document a history of meeting expenses, as well as provide financial projections extending out at least three years to show you will fulfill the obligations of the loan. For example, a borrower was looking to grow specifically in order to service a national account with a well-known customer of their product. A description of this long-term partnership was included as part of the company's successful pitch to the bank.

Any example you can provide that shows the lender you have good accounts that pay and other reliable sources of revenue -- as well as credit insurance in case customers go away or fail to pay in a timely fashion -- will help mitigate risk in the lender's eyes.

Q: Which is a better way to go: a loan or a line of credit?

A: You should have both to finance growth effectively. A line of credit is always beneficial to a borrower. In fact, a line of credit is often required by an enhancement lender in the event of unforeseen cash flow shortages encountered by the borrower. The most common type is a secured revolving line of credit, which uses the business's assets as collateral for obtaining the line. Whatever type you have, your line of credit is your tool for covering expenses prior to collecting accounts receivable. If you are a manufacturer, you need to buy raw material and pay people to make your product before you can sell to customers. If you are a distributor, you need to purchase product, stock a warehouse and process orders. If you are a service business, your financial responsibilities include making payroll and maintaining your facilities.

Whatever business you are in, when it is time to grow, you'll need to pay for the construction or purchase of assets. In addition, you may need to hire new people. Unless you are a cash business, a loan gives you the flexibility to manage your current overhead as you invest in your future.

Q: How do I get the best rate from my lender?

A: Ask for a better one. Many borrowers assume that the rate they are first quoted is the only rate available.

Now is also a good time to shop around. Many businesses that are looking to grow for the first time since the recession – or for the first time in their histories – are in a position to ask several banks for proposals. In this economic climate, banks are more than willing to bid. Even if you have a comfortable relationship with your lender, it's worth looking at other lending sources and other types of deals to get the best rate.

In addition, lenders are eyeing services such as payroll and 401K management for revenue streams to augment what they earn by making loans. If you can make a deal that includes extra services as part of a package, you can negotiate better terms on the loan.

It's also important to be sure you are talking to a lender who is familiar with your type of business. For example, the appetite for not-for-profits varies among financial institutions. These borrowers may have to approach several different institutions until they find the appropriate one for their organization.

Moreover, lenders do tend to specialize. For example, if you are a manufacturer, find a lender who knows manufacturing. If you are a distributor or a service business, go with a lender who understands those industries. This extra research is likely to result in the best possible rate.

Q: Will a government-backed loan such as those available through the Small Business Administration (SBA) or Small Business Investment Companies (SBICs) give me a better deal than a bank loan?

A: Government-backed loan sources can offer very attractive interest rates, but they do usually require more paperwork -- and often more collateral than private lenders. The processing time of these loans can also be protracted. Consider, however, a deal that puts together a private lender with an SBA or SBIC source as a second-tier lender. For example, a bank may be unable to finance an entire loan request of $5 million due to the bank's own lending limit or comfort levels, or because of a shortfall in collateral. Other types of loans may fill this gap to complete the financing structure.

Deals that mix government-backed loans and grants as second-tier financing sources are a good way to enhance your borrowing power.

Q: Would a grant be better for our purposes than a loan?

A: Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs are examples of funding sources that provide grants – not loans – in which money does not have to be paid back. While these sources are attractive, the application process can be complex. Also, grants in general are awarded for specific projects or programs. If you are looking to grow organically, you may want to consider a deal in which funds from a lender are matched at a certain percentage by grant money.

Q: What is the most important consideration when preparing to approach a lender?

A: Regardless of their individual situations, borrowers in general report that it often took longer to close on their deal than they had anticipated. They also say they wish they had had more knowledge and more time to prepare before they sat down to talk specifics with lenders. That is where seeking help from an independent trusted adviser can be an advantage. Look for an adviser who, beyond his or her own expertise, can tap a vast network across investment and business communities to work with your people. This will help ensure you have the best borrowing strategy.

Connecticut Innovations can help by introducing businesses to potential lenders and explaining the loan process more thoroughly before borrowers get started.

NOTE: Special thanks go to several individuals who were interviewed for this article and whose insights are incorporated herein. They are:

Claudia McCann, chief financial officer, Carla's Pasta
Larry Nathan, president, L.R. Nathan Associates
Jim Rutt, president, Keystone Paper & Box
Sergio Squatrito, vice president of operations, Carla's Pasta
Linda Wieleba, senior vice president and senior loan officer, Connecticut Innovations

Related article:
How to Expedite Your Loan Application