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When Applying For a Loan **Why Not Succeed**

When applying for a loan, give yourself the best chance of success. Being denied can be a painful and disheartening experience. It's not easy for a successful business person to hear in so many words that their knowledge of their own business is not satisfactory to the lender.

The resentment or even bitterness one may feel toward the lender is certainly difficult to overcome but more importantly it's a waste of our precious time and money. Avoid that by giving the lender what he needs and give yourself the best chance to get the loan approved. A good place to start would be to identify the traits of an ideal loan applicant:

- Has a good grasp on actual needs;
- Has a better understanding than anyone of his capacity to repay a loan request;
- Has a high level of preparedness in providing what the lender is likely to request; and,
- Has knowledge of the limitations of a senior lender financial role.

All these traits go hand in hand but especially the first and last one. The traditional lender role in a business transaction is one based on the historical business performance of the applicant. The senior lender is also the last one in (equity is expected to fund first) and the first one to get paid back (not the equity). If your loan needs involve a lender in a financial position that differs from that then perhaps you're in need of another financing vehicle because it's not likely senior debt.

If the lender's decision is going to be based on historical performance, the first thing the applicant must have is the information to prove it. That historical performance information must not only clearly support the loan being requested in the current period but looking back at least two more years, the financial performance history of the applicant must show that the loan can be paid. Stated another way, the applicant's financial history must reflect that if the loan had been requested three years earlier, the historical cash flow could have repaid the debt. If the applicant can present that scenario, there is a better chance of getting the loan approved.

More specifically, the more you require the lender to drive the deal by looking out the front windshield to see the future,

the more difficulty you'll have at getting approval. Conservative senior lenders are more rear-window viewers when driving a deal and looking for proof that you can pay. That's the safest route for a lender and the more that you require the lender to fully appreciate "your vision and the promise for your business in the future" the more risk you undertake that your loan request may be declined. That doesn't mean your loan will certainly be declined, but there's simply more risk.

The Three Cs of Credit

With most senior debt lenders, applicants will be required to pass at least three of the Cs of credit: character, capacity to repay (based on historical) and collateral (equity goes in first and the lender last). Some lenders may even have as many as five or more Cs of credit but the first three are the most important.

An important thing to remember is the Cs are evaluated in that specific order and the order is never compromised by good lenders. In other words, if you can't get past the first or

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second one, you'll never get to the third. Another thing to always remember is to never make the mistake of assuming that an endorser, co-maker or strong guarantor is a likely substitute for any of the three Cs of credit. You're likely to end up resenting the lender because he may turn you down if he's a legitimate senior lender. In a smaller community that can be tough in a number of ways. Applicants must "pass" on the test of the three Cs of credit or the lender will pass on the applicant.

Short term, long term or maybe not even a loan at all

Before approaching a lender, know what type of loan you need. To oversimplify, you wouldn't request a 10-year loan secured by a receivable to be collected in 60 days. Determining this lending principle in advance is that simple.

The loan you request must always match up with the economic life of the collateral because that is likely as long a term as the lender will give you. For example, the maximum term most senior lenders will grant on auto loans is five years. If a lender offers you a 15-year term on an auto loan, then the interest rate is likely to be 25 per cent. It's the only way that lender can recover his investment within the economic life of the asset and in the same time period as if he had offered you five years to begin with.

Be informed in advance concerning the economic life and value of your collateral or you are at a high risk of getting your loan request turned down. Let's recap what every applicant should already know when they walk in the lender's door:

- You've determined it's senior debt you really need, not more equity or something other than senior debt, because it fits the senior loan profile of first in and first out;
- You know the terms likely to be granted based on the economic life of the collateral you are offering and whether it's long-term or short-term financing you need;
- You've determined in advance that you can pass the three Cs in the order provided: character, capacity to repay and lender-satisfactory collateral;
- You'll figure into the equation that the more you need unproven future performance the more risk you assume of being declined;
- You are prepared to explain to the lender how long it will take for the lender to get repaid (first out); or,
- You will have a written business plan to present to the lender.

An applicant must see a written business plan as an opportunity and not a burden. After all, a good business plan allows the applicant to anticipate the questions and put all the right answers into one written document that gives the applicant the best chance to succeed at getting his loan request approved. Let's cover the main sections of that business plan document briefly:

Statement of Purpose: In this section the loan request and purpose of the request are clearly identified. The amount of equity is spelled out and the complement of borrowed funds explained. The lender's last-in and first-out role in the transaction is clearly described and the timetable for repayment is explained within the economic life of the collateral.

Business Description: The subsections in this part of the document would include a clear business description, marketing plan and other market opportunities, a description of and comparison to competitors offering the same product, plus a clear explanation of operating procedures that assure product quality and collections on sales. A list or schedule of personnel with titles presenting the strengths of your crew or staff, salary benefits and tenure would also be included.

Financial Data: Mirroring the lender's application information requirements in a lender's loan application is always a good way to begin in this section. Most lender applications ask for among other things: the entity type, ownership breakdown, outside directors if any, a schedule of all existing debt and other obligations with terms of repayment, a listing of



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all assets, assets value or replacement value estimates and the currently anticipated replacement date. Insurance coverage and later proof of that coverage is usually required.

A listing of credit and personal references is the key to passing the first of the Cs of credit. These references must be willing to vouch on your history of meeting all obligations, written or not, and complying with all applicable regulation.

A clear financial summary is also required that clearly demonstrates for the lender that your historical cash flow will adequately cover the required loan pay-

ments. Look at your income statement and balance sheet with a critical eye just like you anticipate the lender will. Note the strengths of your business and your balance sheet first but failing to note any weaknesses along with risk-mitigating factors (why the lender need not be concerned) is usually a mistake. The business plan provides the opportunity to put any outsider's concerns about your business to rest.

A subsection with a financial summary for a minimum of three past years and three years looking into the future showing that you can repay the loan based on historical and that your company's ability to repay will be enhanced as a result of getting the loan. Depending on the circumstance, you may want to divide the financial summary into two parts.

For best results looking forward, the first year's presentation should be shown month-to-month and the future years that follow in either a quarterly or annual result summary. These financial summaries are your opportunity to respond to the second C of credit which is the capacity to repay. You will also want to present a debt service coverage ratio which is your company's cash flow divided by your total obligations. The higher the result, the better your chances of getting lender approval.

A break-even sales analysis reflects the minimum sales that you must reach in order to meet all fixed expenses (after a per unit deduction of variable expenses) and other obligations including loan payments is a must. If you don't know your break-even sales, the lender may come to the conclusion that in fact you may not know enough about your business. Learn how to calculate it or bring in a professional consultant. A clear explanation of owner discretionary expenses could be the difference in approval or denial.

Figuring out whether a loan request is likely to receive approval is not difficult. First the applicant must understand the limitations of the role that the senior lenders typically play in a financial transaction that has resulted in our financial needs. Before even considering the loan, the lender will want evidence that the applicant is a law-abiding citizen with a history of meeting obligations, written or not. The lender will want to see sufficient equity go in first and financial information that clearly demonstrates the lender's repayment first and within the economic life of the collateral. In other words, the lender will expect the applicant to pass the three Cs of credit.