

Business Tips

Seven Questions Asked in a Borrowing Situation

In his books *Borrowing for Your Business*, and *Borrowing to Build Your Business*, former San Antonio banker George M. Dawson discussed seven questions asked in any borrowing situation. I believe these seven questions can help any business borrower better understand how lenders evaluate their loan proposal. Below are some thoughts using the seven questions.

First, how much money do you want? This question seems straightforward but some borrowers have not determined how much they really need. Lenders want to know the borrower has taken the time to pin this down as accurately as they can. Remember to allow for contingencies, as the unexpected may happen. Another key is to borrow enough so you do not have to go back to the lender asking for more right away. Borrowing too little may just be enough to get you in trouble.

Second, what are you going to do with the money? Lenders want to know where the money is going and specifically what it will be spent on. Just saying “working capital” does not give the lender comfort. List the categories the money will be used for and how much will be needed for each category. Examples are equipment, remodeling, lease improvements, furniture, fixtures, inventory, or debt consolidation.

Third, why is this loan a good thing for your business? You will have to show why your business will benefit from the loan proceeds. Lenders like to make loans that are productive, meaning loans that result in higher sales or margins, and reduced costs. Loans to start a business are another example.

Fourth, why do you need their depositors’ money to do it? Lenders like to know why you have to borrow. In most cases it is for good reasons, like starting a business, purchasing seasonal inventory, or purchasing additional equipment. For an existing business, lenders want to see if the company is generating profits to pay for ongoing operating expenses and the loan is not going to be used for these purposes. Keep in mind especially when starting a business, lenders will require from you an investment in cash or assets that is 15% to 30% of the total deal. This is to make sure you have something at risk. They will require you sign a personal guarantee and they will also check your credit history.

The fifth and sixth questions are somewhat related. When will you pay it back? And how will you pay it back? Lenders want to see through conservative cash flow projections the business will have the capacity to pay back the loan. They want to see adequate collateral pledged. They will evaluate if you have enough experience in the business to make the right decisions. They will also evaluate the health of your industry and the extent of your competition.

Finally, the seventh question asks, what happens if your plans do not work out? Show in your proposal you have anticipated what could go wrong and your plans to work through those problems. Show you know the risks in your industry and risks of an economic downturn. Lenders will have comfort knowing you have thought through these problems and have plans to deal with them. In the case of a business startup, secondary sources of personal income are important in case cash flow from the business gets temporarily tight.

Dawson reminds us in his books that business people are mostly positive but lenders are trained to be more doubtful and cautious because their training is largely focused on these seven questions. Please look into the books for a complete discussion. Remember SBDC advisors can always provide free assistance with developing a business plan and loan proposal.

Business Tips” was written by Mr. Dave Erickson, Director and Certified Business Advisor IV, of Angelo State University’s Small Business Development Center. For more information on the topic of this article or the services of the ASU • SBDC, contact him at David.Erickson@angelo.edu.