

“BUSINESS TIPS” – February 4, 2008

Most small businesses will need funding at some point. Whether you seek financial assistance from a bank, an investor or friends and family they will review your credit worthiness. A complete and thoroughly documented loan proposal, including a business plan, will help the lender understand you and your business. The basic components of a credit analysis consist of the ‘Five C’s of Credit.’

Capacity to repay is the most critical of the five factors. The lender will want to know exactly how you intend to repay the loan. The lender will consider the cash flow from the business, the timing of the repayment and the probability of successful repayment of the loan. Payment history on existing credit relationships, personal or commercial, is considered an indicator of future payment performance. Prospective lenders also will want to know about your contingent sources of repayment.

Capital is the money you personally have invested in the business and is an indication of how much you have at risk should the business fail. Lenders and investors will expect you to have contributed from your own assets and to have undertaken personal financial risk to establish the business before asking them to commit any funding.

Collateral or guarantees are forms of security you can provide the lender. Giving a lender collateral means that you pledge an asset you own, such as your home, to the lender with the agreement that it will be the repayment source in case you can’t repay the loan. A guarantee is just that – someone else signs a guarantee document promising to repay the loan if you can’t. Some lenders may require such a guarantee in addition to collateral as security for a loan.

Conditions focus on the intended purpose of the loan. Will the money be used for working capital, additional equipment or inventory? The lender also will consider the local economic climate and conditions both within your industry and in other industries that could affect your business.

Character is the general impression you make on the potential lender or investor. The lender will form a subjective opinion as to whether or not you are sufficiently trustworthy to repay the loan or generate a return on funds invested in your company. Your educational background and experience in business and in your industry will be reviewed. The quality of your references and the background and experience levels of your employees also will be taken into consideration.

If you have questions concerning the loan process, the SBDC advisors have the expertise to assist you in developing a business plan that includes financial analysis. Have everything in place before you approach a lender.

“Business Tips” was written by Mr. Paul Howard, Business Development Specialist and Certified Business Advisor II 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 Paul.Howard@angelo.edu.