AMERICA'S SBDC TEXAS SOUTH-WEST

SBDC Insights on Lender Business Evaluation

THE 5 C's

Capacity ① **Capital** ② **Collateral** ③ **Conditions** ④ **Character** ⑤

Professional Small Business Development Center (SBDC) Business Advisors can assist with your project to seek capital in many ways: determining the feasibility of your venture, projecting realistic cash flows, market research and analysis, development of a business plan or financial proposal, deal structuring, lender referrals, and more. Workshops can be a great way to get started or to help grow your business with additional tools. Individual advising is available at no charge, so what are you waiting for? Let's get started!

① Capacity

Does the business have sufficient cash flow to support debt and expenses? Typically, a business needs to have $1.25 of available cash generated from income to support every $1.00 of debt to be serviced each year. The extra $0.25 provides a cushion for the business to absorb unexpected expenses or a downturn in the economy.

② Capital

Capital are the assets the owner invests in the business, such as cash, land, building, equipment, etc. Most lenders require an owner investment of at least 20%-35% of the Total Project Cost. This investment shows a financial commitment from the owner and reduces the lender's risk in the event of non-payment of debt. If the borrower's own money is involved, it provides a sense of ownership and added incentive not to default on the loan.

③ Collateral

Collateral are the business and personal assets that can be pledged as security to back the loan. Real estate, equipment, inventory, and accounts receivable are all forms of collateral that lenders will use to secure loans. Lenders will take a lien on collateral to mitigate their risk. The total loan request generally cannot exceed the collateral value. This valuation is usually 80% for real estate and other types of collateral such as accounts receivable; inventory may be at an even lower rate. By law in Texas, a borrower cannot use their homestead as collateral for a business loan.

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4 Conditions

Lenders want to understand the current condition of the market, the industry in which a business operates, and how the borrower intends to use the money. Be prepared to prove that the conditions are right for this type of business based on the conditions of the local, regional, and national economy; the type of industry; and the competitiveness of the business.

5 Character

What is the borrower's experience in the industry, managing people, and managing finances for the type of business being proposed? Work experience, experience in the industry, and personal credit history are all character traits lenders will consider. Transferrable skills are good, but direct experience is preferable. Character is often determined by analyzing how a potential borrower has handled past obligations, such as their credit history. If there are any issues with past creditors, collections, bankruptcies, or other public records, the borrower should be straightforward with the lender.

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TEXAS SOUTH-WEST

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