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6 Things to Consider When Getting a Business Loan

There are a number of reasons why your business may need a small business loan. Maybe you are growing rapidly, and there is a need for capital to purchase more equipment, more inventory, or to hire more people. Or it might be that you want to buy a competitor, or buyout other owners of your business.

Regardless of the need for funding, there are some important considerations that you should keep in mind as you prepare to request financing. Here are 6 things to determine and document before you start the process.

1. What is the specific purpose of the financing you seek? The answer to that question can go a long way towards determining which banks to approach for your need. Some lenders prefer real estate collateral above all else, while others feel more comfortable with accounts receivable and inventory as their primary collateral. Most lenders want to see evidence on how the new financing improves the financial strength of the borrower and its prospects going forward.

2. Determine what collateral you have to offer for the financing request. It is very difficult for small businesses to secure unsecured loans or under collateralized loans. Not to say that it can't happen, but there will need to be several strong mitigants in place if your loan request does not come with sufficient collateral to support it.

   Some of the key mitigants needed when collateral is short are consistently strong earnings and cash flow, a lengthy and successful company history, excellent credit scores, and the expectation of strong earnings going forward.

   How much collateral will you need? It will need to carry a market value in excess of the loan amount, and how much more than the loan request will depend on the nature of the collateral. The more liquid the collateral, the less of it you will need to provide in excess of your loan request.

3. What will the annual cash requirements be to repay the proposed loan, and how much of a strain will that put on the company's cash flow to meet its

other obligations? Look at your company's annual cash flow over the past few years and determine if it was sufficient enough to repay the proposed debt. Your cash flow should be sufficient to cover all company expenses and obligations plus annual debt payments by 120% or more.

4. Should you work with the Small Business Administration on your financing need? The SBA is an example of something the federal government does that actually works. We have witnessed the SBA help companies get financing when they otherwise would not have been able to secure the loan. The SBA can help those companies that have the cash flow to service the debt request, but may be short on collateral for the loan request.

   The SBA through its loan guarantee program can also help businesses secure a higher amount of financing than they could if they did not have the SBA's backing. The downside is that the loan approval process using the SBA is lengthier and more expensive.

5. Do you prefer the technology and possibly lower rates you can get from a large bank, or do you prefer the relationship aspects of a community banker, who gets to know your business intimately? Large banks with their pricing power can sometimes provide loan interest rates significantly lower than can a community bank, while a community bank is often better at responding to its customer's changing needs, and getting loans and other services delivered to client's more simply and quickly that does a large bank.

6. Find out what your personal credit score is, as well as your business credit score. Low scores will dramatically limit which lenders you can approach for your credit needs.

   If there are outstanding issues such as past due bills depressing either your business credit score or personal credit score, see if you can get those addressed before approaching a lender. Showing strong personal and business credit scores will make the process a lot more seamless with most lenders.