LisaChapman.com

How Bankers Think

Build a sound financial base to support your company for future growth

Presented by:

Lisa Chapman

Business Planning, Marketing & Business Development

www.LisaChapman.com

615-477-8412

Questions to Consider First

- How much money do I need?
- What type of loan do I need?
- How will I use the money?
- Can a Banker accommodate that?
- Do I have collateral?
- Am I willing to Guarantee it personally?
- Do I have a realistic, updated business plan, with financial projections?

NOTE:
There's a BIG difference between Venture Capital and Bankable Loans.

Venture Capital Versus Bankable Loans

- **IMPORTANT:** Banks are not investors.
- **Investors own a % of your business** – and hope to realize their investment return from the long term increased value of the business.
- **Bankers lend against the assets of the business** - for a set time period and interest rate - to be paid periodically during the term of the loan.
- **IMPORTANT:** Your business must show the capacity to "service the debt" – in other words, to make loan payments.

Are Startup Businesses Bankable?

- Most Banks finance only existing businesses with 2-3 years of operations.

- They DON'T generally finance startups (with no historical financial performance, and just projections).

- In the rare instances that they will finance a startup, they require additional collateral or a very strong guarantor that will mitigate the risk.

Sources of Capital

- If your business lacks sufficient capital, your Banker may advise you to seek additional investors.

- Sources include:
  - Venture Capitalists
  - Individual Investors, including friends and family
  - Your own cash

- "Sufficient" capital depends upon the nature, stage, and historic profitability of your business.

- When considering a loan request, Bankers refer to 'RMA' guidelines, and analyze the company's <u>historical use of loans</u>.

LisaChapman.com

Lenders Use the Three "C's" Rule

- ✓ **COLLATERAL** – Your assets that secure the loan
- ✓ **CHARACTER** – Yours!
- ✓ **CASH FLOW** – Must support debt service

LisaChapman.com

Basic Questions a Lender Will Ask

- ✓ How much do you want?
- ✓ How did you determine this amount?
- ✓ What is the Primary Source of Repayment?
- ✓ What is the Secondary Source of Repayment?
- ✓ What Collateral do you have to offer?
- ✓ How much do you have invested in the business?
- ✓ What is the historical and projected financial performance?

NOTE: ***This is just the beginning. Come prepared to answer many more questions that help your Banker understand your business & management, financial position, industry, customers, and much more. This process should lead to a strong, long term relationship, in which your Banker can help guide you to maintain a healthy financial position.***

LisaChapman.com

Complete Financial Disclosure

Historical and/or Projected Financial Information

2 years, and interim:

- **Balance Sheet**
- **Income Statements**
- **Cash Flow Statement**
- **Personal Balance Sheet**
- **Accounts Receivable Aging**
- **Accounts Payable Aging**
- **Tax Returns – Business and Personal**

NOTE: ***Your Banker will specify exactly what's needed, based on your business, loan request, and unique situation*.**

This may appear daunting, but is important for you to understand, too.

Your "Living" Business Plan

- Title Page
- Executive Summary
- Table of Contents
- Business Description
- Marketing Strategies
- Competition
- Development Plans
- Operations
- Management Plan
- Key Personnel
- Long Term Goals / Exit Strategy
- Financial Information
- Other – to help the Banker understand the business

NOTE: ***This should be a Working Guide – keep it pertinent and simple.***

Basic Things You Need to Know About Bank Lending

Capital:

Most banks require owners to have a ‘meaningful’ amount of money invested.

Guarantees:

Most banks require owners’ personal guarantees.

Collateral:

Banks almost always require COLLATERAL as a secondary source of repayment. Do not expect to borrow 100% of the value of the collateral because assets typically decline in value over time.

Avoid two common mistakes:

- Borrowing more than you need
- Mismatching repayment terms to the use of the money

LisaChapman.com

Match the Expected Asset Life to the Loan Term

Short Term (<12 months):

- Loan term is matched to the life of the asset, when 12 months or less.
- Examples: Inventory, Accounts Receivable, etc.
- Collateral is expected to turn into cash within this term.

Intermediate Term (1-3 years):

- Loan term is matched to the life of the asset, when 1-3 years.
- Examples: Business Expansion, Working Capital, Equipment Purchases, etc.
- Primary source of repayment is generally business profits during the term.

Long Term (> 3 years):

- Generally granted for major purchase assets with a long term purpose; > 3 years.
- Examples: Real Estate, Major Equipment, etc.
- Primary source of repayment is generally business profits during the term.

Loan Agreements

Loan Agreements will generally incorporate the following terms:

- ✓ Parties to contracts with their addresses
- ✓ Definitions
- ✓ Purpose of the loan
- ✓ Repayment / Payoff
- ✓ Cancellation
- ✓ Interest and interest periods
- ✓ Payments
- ✓ Representations of the Borrower
- ✓ Events of default and Remedies
- ✓ Provisions for penalties and liquidated damages
- ✓ Fees of the Lenders
- ✓ Provisions for expenses
- ✓ Securitization
- ✓ Amendments and waivers provisions
- ✓ OTHERS – both standard and situational

RATIOS Are Your Business' Scores

SELECT EXAMPLES:

Liquidity Ratio

How 'cash rich' is your company? What is your ability to turn assets into cash?

CALCULATE: ***Current Assets / Current Liabilities = Working Capital***

The higher the better.

Inventory Turnover

How many days does it take to turn (sell) your inventory?

CALCULATE: ***(Inventory Cost x 365) / COGS = # of Days to Sell***

The lower the better.

Debt to Worth

How much debt – relative to the value of the company – does the business carry?

CALCULATE: Total Liabilities / Total Capital = Leverage Ratio

The lower the better.

Profit Margin on Sales

Shows % of profit relative to revenues.

CALCULATE: Net Profit / Sales Revenues = Profit Margin

The higher the better.

Resources for Industry Ratios & Information

→**Robert Morris Association Annual Statement Studies (RMA)**
Most lenders use them

→**Almanac of Business and Industrial Financial Ratios**
Gathered from US Treasury and IRS information

→**Dun and Bradstreet**
Most lenders use them

→**Trade Associations**

→**Trade Periodicals**

→**Small Business Administration**

LisaChapman.com

Have YOU built a sound financial base to support your company for future growth?

For more information, contact:

Lisa Chapman
Business Planning, Marketing & Business Development

www.LisaChapman.com
615-477-8412