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How Bankers Think

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

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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 historical use of loans.

Lenders Use the Three “C’s” Rule

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

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.

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.

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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.*

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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

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: $(Inventory\ Cost \times 365) / COGS = \#\ of\ Days\ to\ Sell$

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.

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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**

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

For more information, contact:

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