# Making Your Business Attractive to Banks

It's exciting, isn't it? You've nurtured your company from its infancy to the point that you're ready to take the next step. The next step, however, requires a shot of capital. Whether a small loan to move you along, or a large financing problem to help you fund a project, here are some tips to help your company attract interest. We will not only tell you what they want to see, we will tell you how to create that picture.

There are four major factors that influence the decision of a potential lender as to whether or not to lend money to your company. Those factors are:

- Cash Flow
- Profitability/Financial Trends
- Leverage/Overall Debt
- Collateral

**Of the four**, **cash flow is the most important**. The company must demonstrate that it can service the new debt and still pay existing expenses.

In refinancing existing debt, reliable payment history can help demonstrate your ability to pay larger payments created by the new loan. In some cases, your company may need to make some changes to create the additional cash flow needed to service added debt. According to Christine Christian CEO of Dun & Bradstreet, 80% of all businesses fail due to poor cash management. Banks realize this and it is therefore easy to understand why they will look for good cash management as a necessary strength from you for your business. Strong cash management can also play a role in getting more favorable terms for the new debt.

**We discuss ways to do this in our white paper, "9 Ways to Increase Your Company's Cash Flow."**

**In some cases, the need for financing is for immediate expansion**. For example, the company may need new equipment in order to accommodate additional customers. The company may not have sufficient cash flow today to service the additional debt, but if it can demonstrate how the new business will provide the additional cash flow needed, it can go a long way towards convincing a lender that the loan is worth the risk. Ultimately, any lender wants to assess the likelihood they will be repaid, and whether the repayment would happen on schedule. All too often, entrepreneurs attempt to do this by talking to the banker and attempting to "make" them understand. In fact, this needs to be done with numbers that can be substantiated taking everything into account, including the increase in taxes created by the new business. If we just lost you and this seems impractical for your business, don't despair. There are plenty of creative ways to fund the existence and growth of your business. Keep reading. Also see our White Paper on "Creative Financing for Your Business".

**In assessing the risk of repayment, a potential lender is going to want to know that the company has staying power.** That is, will the company be around in the future? A key indicator of this is profitability, both current and historical. A company that has a history of losses and negative equity on its balance sheet will probably not be perceived favorably. A lender may feel that they would be throwing good money after bad. This can be the case even if the company is having a great year and is finally profitable. A lender needs to have a comfort level that the good year is not just a fluke, but is a standard for the future.

**One measure of profitability that lenders also look at as an indicator of cash flow is EBITDA,** which stands for Earnings Before Interest, Taxes, Depreciation and Amortization. It is calculated by taking the company's net income and adding back the named items which are not considered to necessarily affect cash flow. EBITDA is by no means a perfect measure of cash flow, but it is a common shortcut used by many lenders. A company should therefore evaluate its EBITDA when trying to obtain financing.

Most small businesses make the mistake of employing accounting practices that are geared solely toward tax compliance, and they don't wind up presenting the company's finances in the best light. (See our White Paper "What Constitutes a Complete Financial System?") A company that is suffering from negative equity should review its historical accounting to see if there are opportunities to recast the financial statements in a more realistic light, which could also improve its equity position. In some cases, adjustments can be made to bring the financial statements into line with proper accounting practices, and these adjustments can actually affect the equity enough to turn it from a negative to a positive. Such a recasting can have a huge impact on the company's ability to attract financing.

**The company's overall debt has an impact on a lender's decision as well.** The lender will evaluate how putting new debt on top of existing debt will affect the company. They will compare the debt structure to the equity of the company to make sure it is not out of line. They also like to see that the owners have some "skin in the game". This doesn't need to be cash you put into the business, it can also be profit you left in the business which is why a business should have a savings account of some sort.  A company with significant debt and little to no equity may not be viewed as having much staying power.

**Collateral is another factor that lenders look to**. The company should have sufficient collateral to justify the loan, but collateral alone is not enough. The company must keep in mind that the lender looks at collateral as their insurance policy, not their primary means of repayment. Without the other two factors of cash flow and profitability, all of the collateral in the world will not convince a lender to lend money. They don't want the hassle and expense of foreclosing and trying to liquidate the collateral. They want to know that they will be repaid. The collateral is merely a way for them to mitigate their risk in the case things go bad.

All that being said, having collateral to offer a lender is important. But the company does not necessarily have to tie up all its assets to obtain the financing. Different types of assets can even be used to obtain different kinds of financing. For example, collateral needed for an SBA loan may be very different than the collateral needed for a working capital line of credit.

One well-respected banking official explained it this way:

> "***We really want to understand the sustainability of a company…, which ties into the trends of financials and balance sheet strength (both business and/or personal) so that we have positioned the client and the bank the best not to have to go after collateral or personal guarantees should there be bump in the road."***

Demonstrating the cash flow necessary for financing and presenting the track record of profitability takes detailed financial analysis and the ability to communicate these factors to a lender on the lender's terms. The company seeking financing should be sure to enlist the assistance of individuals who know how to perform these functions. Doing so can ensure the success of obtaining the critical financing the company needs; presenting the information improperly only burns bridges. You would have to wait quite a while to re-approach a bank that has already turned you down. Make sure your company is well positioned before starting the search for financing.