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# WHAT DO LENDERS LOOK FOR WHEN YOU WANT TO BORROW MONEY?

Financing for your business is always a tricky task.

Start-Up businesses will always find it difficult to borrow money particularly if they haven't got a house that they can provide as security for any loan that is provided.

There are some banks/institutions that do provide a nominal "unsecured" personal loan (around $20,000 - $25,000) but that doesn't necessarily give the start-up business owner the level of funding they need.

Sadly, the small business owner needs to develop a track record of operational activity over time before the bank/financial institution will "lend against the business cash flow position".

Some of the things that lenders look for are: -

## 1. The Balance Sheet

A balance sheet outlines three basic components being: -**Assets**, **Liabilities** and **Net Worth** (or Equity).

### Assets

Having a lot of cash in the bank account does not necessarily infer a strong balance sheet. That is because it is very liquid and can be utilised very rapidly. It is better to build up tangible, illiquid assets that the bank can take security over for any borrowing. These include: - land and buildings and plant and equipment.

Stock (inventory) and Debtors (people who owe you money) are available assets but again the bank will look very critically at them to see what the quality may be for those assets. Effectively, the bank looks upon it as "what would be recoverable IF the business goes bust" and what could they get back. Therefore, the bank may view loans to associates or related parties in the balance sheet as virtually uncollectable. As far as debtors and stock are concerned the bank will apply a "scaling" factor to those assets and that could be quite severe. E.g. they may "extend the value" for security purposes at 25% of the total value for these aspects. That further assumes that the bank considers them "good quality" collectables.

### Liabilities

The fewer liabilities you have the more comfortable a bank will feel as they consider your application.

Debt in the balance sheet secured against specific assets normally means that there is no "security value" in the assets and the two items cancel each other out.

If you have a large amount of creditors (money you owe your suppliers) outstanding and they have been outstanding for more than a short term, the bank will view that unfavourably. Try and keep all your creditors payable within a maximum period of 30 days.

Other liabilities such as outstanding Australian Taxation Office ("ATO") debt; superannuation unpaid and payroll tax unpaid will all be scrutinised very critically.

Loans by the owners to the business are all viewed favourably as it demonstrates that the business is partially funded by the owners and that they have provided some "hurt money" into the venture.

**Equity**

The more equity that is shown in the balance sheet the better it is for the proposed financier. Good levels of equity or shareholders' funds demonstrate commitment by the shareholders/owners. If a negative equity position exists that would be of great concern to any lender.

## 2. The Profit and Loss Statement

Generally, lenders look to examine three years Profit & Loss ("P&L") statements. This is to enable them to determine what the level of sustainable net profit is evident over that period and what is probable going forward.

They will apply their own measures against industry benchmarks to see if your business expenses are in line with those benchmarks. They will generally examine all expenses very carefully.

Close examination of gross profit margin, closing stock figures, sales and turnover are all areas that the lender will scrutinise and compare to industry standards.

For an "owner/operator" type business, they will also look closely at the level of drawings or wages that are being taken from the business. It may be (e.g.) that the profit is high but the drawings are minimal or conversely that the profit is low and the drawings high. Either of these situations will generate enquiry from the lender so be prepared with a response if that applies to you.

## 3. Cash Flow Forecast

A well prepared cash flow forecast for at least two (2) years is critical when making a presentation to a lender.

As well, all the assumptions that were used in compiling that forecast need to be fully understood and readily explainable to the lender by you.

The forecast also needs to include any loan repayments from the proposed loan that you are seeking to access from the lender.

Any forecast prepared must be realistic and achievable. The lender will (generally) examine your historical outcomes (where they are available) to determine whether the forecasts meet that criteria.

Don't make the forecasts too optimistic as that could provoke a query as to "why do you need to borrow the money from us"?

A well-presented approach to your financier is essential. Be prepared. If you do not feel comfortable in approaching your banker, engage an "advocate" or "consultant" to accompany you and assist in presentation of the business case to the lender.

Times are tough and obtaining finance is not a "lay down misere" like it used be so make sure that your financial statements are in good order and that your case for assistance is very well presented.

Any advice or guidance provided here is of a general nature and is not intended to be a blueprint for every person reading this article. You should discuss your specific requirements and circumstances with your accountant or financial advisor.