

The Secrets to Establishing and Building Relationships with Creditors and Lenders

by Jerry Merola

As a former commercial banker, I spent many years of my life evaluating businesses in almost every industry imaginable. In many instances, a review was conducted to determine the viability of providing a lending accommodation to a new client, who perhaps was purchasing new equipment, expanding an existing facility, or undergoing major renovations. These were critical times for a would-be client, as his or her ability to complete any of these processes was, in most cases, contingent upon the bank's decision to provide funding. The success of the applicant was predicated on several variables, which included 1) financial stability of the company (as reported by accountant-prepared financial statements), 2) company's ability to service the proposed debt, 3) strength and value of the collateral available, 4) economic outlook of the company's immediate industry and markets, and 5) support available from the company's guarantors. These five variables, in addition to others, formed the basis for a decision, and established the criteria by which interest rates, terms, and covenant requirements were created.

To present your business in the best possible light, consider these "spruce up" techniques:

1. Accountant-Prepared Financial Statements. Spend some time with your accountant or advisor to fully understand the contents of your financial statements. In particular, study each line item of the balance sheet, income statement, statement of cash flows, and statement notes so that you are capable of explaining the course of events leading up to the actual values presented. Keep in mind that financial statements report conditions during a defined period of time (usually December 31st or June 30th), so if a large project, sale, or event didn't hit your books until a week after the closing date, be prepared to offer such additional information to your banker. In most cases, "good news" will be evaluated favorably and may serve to offset negative events, such as a decline in gross revenues, an increase in expenses, or sub-standard profitability, as reported on the financial statements presented.

Every financial statement requires an explanation, as none are ever "self-explanatory". Provide a written summary to your banker that provides an overview of the financial period under review. Were there any one-time events that occurred, such as a flood at the main operating facility, or road construction that blocked traffic to the site for two months? Each of these events would dramatically impact any business, but without a detailed explanation, your banker may have little to go on. Yes, loan decisions are based largely on "the numbers", but the numbers don't always tell the real story - that's your job!

2. Ability to Service Debt. Before setting foot in your banker's office, develop your own loan repayment plan. Don't wait for the bank to tell you that your company can't afford the requested loan facility, as your credibility will then be lost and the chances of receiving any level of funding reduced. Instead, prepare a spreadsheet of company earnings and expenses along with a proforma statement that incorporates the new loan facility into the operation. If the loan is for the purchase of equipment that will improve production capacity or allow the business to operate in new markets, include these projected additions to revenues and expenses in the proforma statement. This single step can go a long way in showing your banker that the company has carefully evaluated its ability to service new debt and may help to establish a solid case for presentation by the banker to the loan committee.

3. Collateral Value. The existence of an adequate collateral package has become essential in today's society. Without it, a banker must rely solely on a company's future performance to repay a loan facility, which typically means greater risk and higher interest rates. Some loans are self-collateralizing - that is, the funding is used to directly purchase an asset that has a defined market value. Equipment loans fall into this category. Other loans, such as leasehold improvement or renovation loans are more difficult to collateralize, particularly if the business facility is leased or rented. Don't be surprised if your banker requests a "blanket" lien on the company's business assets, particularly if the requested loan facility would represent the company's main debt instrument. Whenever possible, look to confine the collateral lien to specific assets, thereby safeguarding the unencumbered assets for use on future transactions with the same or other lenders. Be prepared to provide a collateral "package" to your banker, which may include a variety of assets sufficient in value to adequately cover the amount of the loan facility. Confirm in advance that these offerings are "free and clear" and not already pledged to any other source. Again, a proactive approach can permit your application to be viewed in the best possible light and enhance your ability to negotiate improved interest rates and terms.

4. Industry Outlook. Bankers typically rely on printed material in evaluating different industries. Due to the diversity of the industries analyzed by bankers, it's possible that a banker may not fully understand the intricacies of your industry, and misinterpret the average standards of performance. To guard against this, provide your own overview of the industry,

complete with your marketing plan and performance targets. Don't allow your company profile to be "lumped" in with an industry classification, as many such classifications are composed of groups of companies that may not even be considered a part of your industry. Identify your company's recent successes and demonstrate how and why your business excels above the competition.

5. Guarantor Support. More often than not, I receive questions from business owners inquiring about the best method by which to avoid personal guarantees. While a personal guarantee effectively punctures the corporate veil and exposes the business owner(s) to debt repayment responsibilities, it sends a clear message to the lender that the loan applicant is willing to stand behind his or her business. Refusing to offer a personal guarantee sends an alternate message - "let the lender beware." If you're seeking funding for a new project or concept but are unwilling to provide a personal guarantee, does this mean that you're not sure about the project's ability to succeed? Maybe not, but put yourself in the lender's shoes. The answer perhaps, is to provide a limited guarantee that clearly identifies the assets at risk for the guarantor (such as specific securities, real estate, etc). In this way, both parties are cognizant of their exposure and can more effectively negotiate a favorable loan agreement.

PLAN AHEAD

Invariably, many applicants wait until a real need exists to begin a lending relationship. This type of relationship, however, must begin months (if not years) earlier, so that prospective lenders can enjoy the benefit of tracking your growth and performance. The easiest method in establishing a relationship is at the local level, where both business accounts and personal accounts should be opened. Create as "big" a relationship as you can by moving your personal investments and savings accounts into the local branch, as a frequent customer is viewed as an important customer. Get to know not only the branch manager, but the commercial lender for the district. Consider applying for a small business line of credit that is fully collateralized, as this will provide a starting point in developing a larger relationship. On a regular basis, request moderate increases in the line and don't be afraid to use it to cover temporary working capital needs. Bring the balance back to zero ("clean up") at intervals throughout the year to show the bank that you're a responsible borrower. Always pay the monthly loan installments timely. If there is a problem, or you anticipate a cash flow jam during a particular month, notify your lender BEFORE it happens, and simultaneously provide a plan by which to resolve any such delinquency.

Communication is by far the most critical step in the relationship - if you fail to communicate, the bank will almost always assume the worst, and your loan facilities may be "called". Provide regular updates to your banker, including press releases of new business achievements, so that the bank can stay abreast of your progress. Encourage your accountant to establish a relationship with your banker as well, so that each party can share suggestions and solutions in designing a lending program for your business. Keep in mind that your accountant can be an excellent source of referrals for your banker, so whenever possible, your banker will look to appease your accountant with prompt, effective service. Take time to attend bank-sponsored seminars, workshops, and grand-openings, and make a point to introduce yourself to other bank officials. These same individuals may serve double-duty on the bank's loan committee, and a personal attestation of your "character" by such individuals can go a long way toward swaying a board's decision into favorable territory.

Unless you're an independently wealthy amusement operator or facility owner, the need for financing will be an ever-present part of your business. Its level of availability can mean the difference between expanding your business to capture greater market share or sitting on the sidelines while your competition runs with the ball. Protect your ability to borrow by carefully managing your current credit facilities and plan your approach alongside a qualified accountant or financial advisor.

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