How to Get a Business Loan

A Guide to Preparing a Winning Loan Request

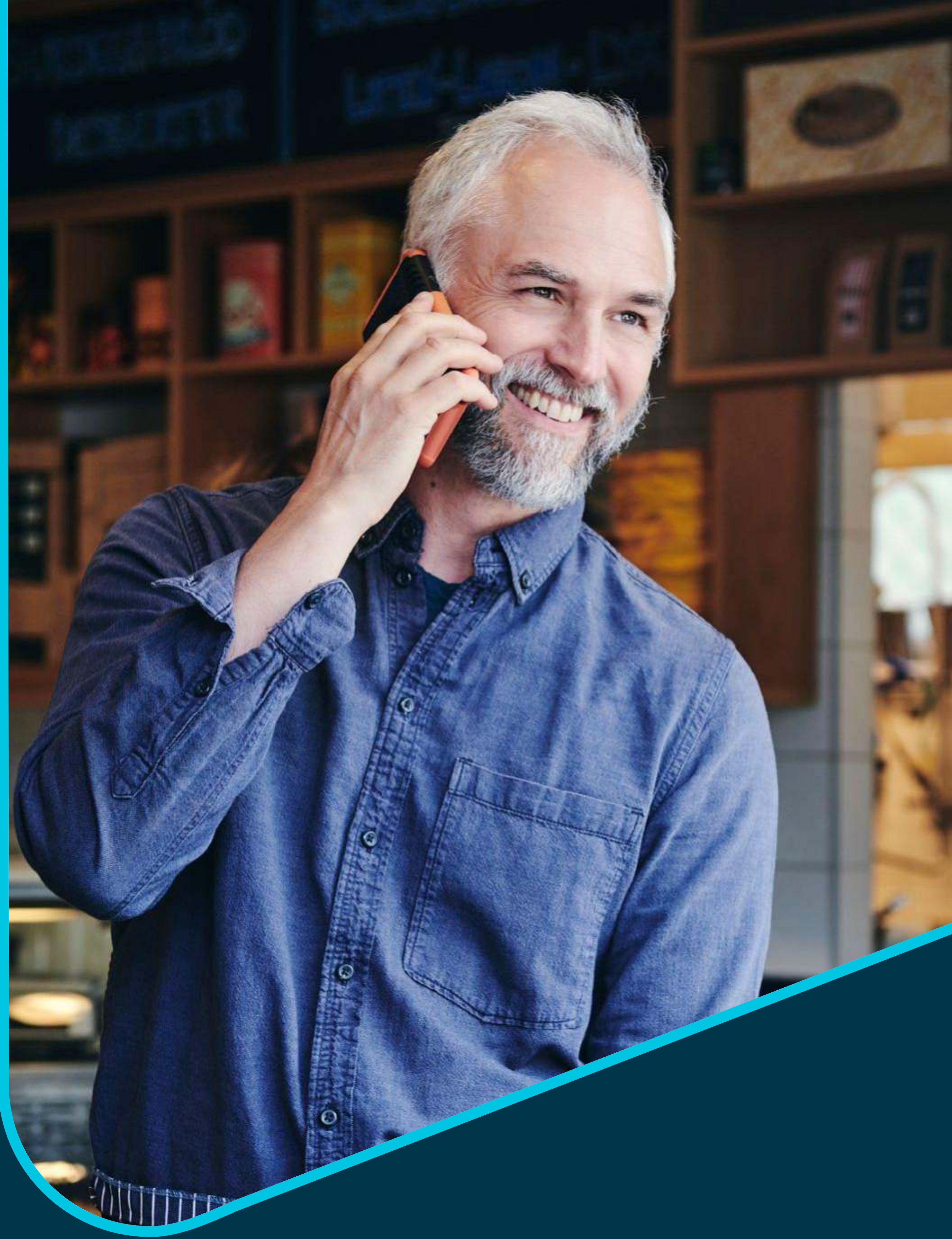

Table of contents

Introduction

Your step-by-step guide to a winning loan request

1 What are bankers looking for?

2 Choosing a bank and negotiating your loan

3 Advice for start-ups

4 Once you have your loan

Conclusion

The fuel your company needs to grow

Your step-by-step guide to a winning loan request

Bankers are just like other businesspeople. They're always on the lookout for new clients and can't remain in business if they don't sell their product. For a bank, that product is money.

However, bankers also have valid concerns about whom they lend money to. As an entrepreneur, you have to understand and respond to those concerns to present a solid and persuasive loan request.

It's in your interest to make it easy for a banker to lend you money.

This guide gives you step-by-step advice on how to do that and, hopefully, get the business loan you need to finance your company's profitable growth and success.

Your checklist for a winning loan request

Prepare a business plan
You want to show that your project is well researched and low risk, using statistics and data from multiple sources to back up your ideas.

Prepare financial projections
Your business plan should include financial projections for the next two years. These projections are forecasts of your cash inflows and outlays, total income, and balance sheet.

Identify your investment and collateral
Bankers want to see you're making a financial contribution, as that shows your commitment and reduces the bank's risk. It's also important to show that you have the capacity to reinvest in the future, if necessary.

Check your credit history
Bankers believe how you've handled your debt in the past indicates how you'll handle it in the future. You'll look a lot more credible if your discussions with bankers reflect your credit history.

Shop around
Various banks offer different loan products. Key differences are often buried in the fine print, so it's worth looking at all your options before deciding.

1

What are bankers looking for?

- Top 6 questions your banker will ask
- Check your credit scores
- 7 tips to improve your credit score
- Do you know your financial ratios?
- Think about your collateral

When asking for a loan, you need to demonstrate that your project will contribute to the profitable growth of your company and that you will be able to pay back your loan.

By presenting yourself professionally, with a solid business plan and realistic financial forecasts, you'll improve your chances of getting a loan.

Gain your banker's trust by being transparent about your goals, the pitfalls you've identified and possible solutions to these challenges.

Top 6 questions your banker will ask

You must demonstrate you have the experience, skills, determination and self-confidence to successfully carry out the project for which you're borrowing money.

1

What is your financial strength?

Bankers will want to see financial statements, assess your net worth and look at your credit history.

2

What will your project's financial impact be?

How will this project contribute to your firm's profitable growth? Analyze your market opportunities and financial projections.

3

What is your investment and collateral?

Bankers want to see evidence of your financial commitment, in the form of money you're investing or an asset you are offering as collateral.

4

What's your overall business plan?

Does the loan fit into your company's strategic plan? Will you undertake any growth initiative in a coordinated, informed way that improves the odds of success?

5

What's your personal financial situation?

Can you meet your personal obligations without drawing on the firm's earnings?

6

Have you done your due diligence?

How thoroughly have you researched your project? For example, have you looked at all your options for a planned equipment purchase?

Check your credit scores

The bank will look at your personal credit score and the credit bureau report on your company.

Make sure you've obtained and reviewed this information before meeting your banker so you can be ready for any questions.

You can obtain your personal score from Equifax Canada or TransUnion (see their websites to learn how) and your business's credit bureau report from either one, or from Dun & Bradstreet. Because agencies don't share information, it's a good idea to review your credit history from all the credit agencies.

7 tips to improve your credit score

1. **Pay your bills on time**
   It's not only a good way to avoid interest and penalties, but it's also the best way to improve your credit score and show your banker you are a reliable business partner.

2. **Have the right credit mix**
   The credit rating bureaus look at the types of debt you have when determining your credit score. Avoid having too many credit cards and make sure you only apply for the credit you need.

3. **Keep your credit utilization rate low**
   The amount of credit you use is considered a predictor of default risk and will have a direct impact on your credit score. In general, bankers prefer to see less than 10% utilization.

4. **Separate your business credit from your personal credit**
   Use business loans, your business line of credit and business credit cards to finance investments, purchase supplies, and top up working capital.

5. **Check your credit report regularly**
   This will ensure that the report is up to date, that all the information is correct and that you have not been the victim of fraud.

6. **Avoid debt collection and bankruptcy**
   Avoid getting into a situation where a creditor will go after your assets publicly, as this will obviously be very negative for your credit score.

7. **Be patient**
   Improving your credit history can take time. Keeping the utilization low on your personal and business credit cards will help you build a good credit history.

Do you know your financial ratios?

Ratios are used to compare different aspects of a company's performance and to show how the company stacks up against a particular industry or region. They reveal basic information, such as whether you have accumulated too much debt, have stockpiled too much inventory or are not collecting receivables quickly enough.

The bank will review your ratios to spot any negative trends or underperformance versus industry averages. Ratios related to your balance sheet, which shows your firm's assets against its liabilities, are of particular interest.

Bankers will often make financial ratios part of your loan agreement. For instance, you may have to keep your equity above a certain percentage of your debt or your current assets above a certain percentage of your current liabilities.

Calculate your financial ratios

3 main types of financial ratios

1 Leverage ratios

Leverage ratios provide an indication of your company's long-term solvency and the extent to which you are using long-term debt to support your business.

2 Liquidity ratios

Liquidity ratios measure the amount of liquidity (cash and easily converted assets) that you have to cover your debts. They provide a broad overview of your financial health.

3 Profitability ratios

Profitability ratios are used to evaluate the financial viability of your business and to compare your business to others in your industry.

→ Read more

Think about your collateral

The bank will almost always want collateral—something of value that it can hold as security in case you default on your loan.

If that happens, the bank can go to court to obtain the right to sell the collateral. This is always a last resort, because everyone loses in the process. You lose your collateral, and the bank loses the money it lent, since the collateral is often sold at a loss.

The type of collateral you offer depends on the nature of your business, the terms and conditions of the bank, and the leeway you have to negotiate. In the end, it must be something you can live with, both as a business owner and as an individual. This is particularly important when it comes to offering personal guarantees.

A personal guarantee can put your family's assets at risk, including the roof over your heads. That means the loan isn't just a business decision; it's also a personal and family decision.

Types of collateral

- **Accounts receivable**
  If your business defaults, your clients pay your bank what they owe you.
- **Pledges and liens**
  The bank can seize and sell your equipment and other fixed assets.
- **Your inventory**
  Inventory, both finished products and raw materials, can be seized and sold.
- **Your real estate**
  Your bank retains the right to sell your property.
- **Personal guarantees**
  If your business defaults, you agree to repay the loan using your personal assets (for example, drawing on the value of your house).
- **Third-party guarantee**
  Someone else (for instance, a partner, family member or investor) agrees to be responsible for your debts.

2

Choosing a bank and negotiating your loan

- 4 types of business loans
- Beyond the interest rate: Other factors to consider
- The importance of clear objectives
- Common mistakes when borrowing money
- Case study: How I got my first business loan

Various banks offer different loan products. Key differences include interest rates, repayment flexibility, collateral and control, so it's worth looking at all your options.

To help you choose the right bank, ask your network of business contacts about their experience with a given bank, including the quality of service, any problems they encountered, what the bank looked for in a loan proposal and how much the bank was willing to negotiate.

4 types of business loans

Here are the four types of loans generally available from Canadian banks.

1 Personal loan

This is money lent to you, not your business, and secured by your personal assets. A personal loan can be a good option for start-ups or those with few fixed assets (such as land, buildings or equipment).

2 Line of credit

This allows you to borrow as much as you need, when you need it, up to a predetermined limit. A line of credit is often secured by inventory and accounts receivable. Banks can usually require full repayment at any time.

3 Term business loan

This is designed to be fully disbursed and then repaid in regular instalments (usually monthly) over a set period. Term loans are most often used to finance fixed assets, such as equipment, machinery or buildings.

4 Working capital loan

This provides financing for the day-to-day operations of a company, such as marketing campaigns or inventory acquisition.

Beyond the interest rate: Other factors to consider

1

What loan term is the lender willing to offer?

Longer repayment terms mean higher borrowing costs, but you may decide to incur that expense to ensure you don't run into cash flow problems.

2

What is the lender's flexibility on repayments?

Even the best plans can go awry due to unforeseen developments. It's important to ask your banker what would happen if you were unable to make scheduled loan repayments. Would your bank let you temporarily suspend principal repayments, for example?

3

What percentage of your project's cost is your lender willing to finance?

This will determine how big an investment you must make and whether it makes sense to work with a second bank.

4

What guarantees do you need to offer in case of default?

Banks usually need some kind of guarantee (collateral) in case you can't pay back your loan. Different banks will have varying requirements with regards to the assets they accept as security.

The importance of clear objectives

Before you go to see your banker, you should know your objectives and the limits above or below which you're not willing to go.

- The amount of money you need
- The type of loan you're looking for (but remain open to suggestions from your banker)
- The interest rate you're expecting
- The repayment schedule you're looking for (some banks are more flexible, offering deferred initial payments or variable repayments based on seasonal income, for example)
- The collateral you're willing to offer
- The investment you're willing to make
- The date by which you need an answer and the date you expect to receive the funds

Common mistakes when borrowing money

Borrowing late

Don't wait until your firm hits a bump before seeing your banker. A sense of urgency usually indicates poor planning and could raise concerns with the bank.

Solution

Prepare financial projections for the coming year and then discuss your plans with your banker so you can line up the funding before you need it.

[7 deadly sins in borrowing money for your business]

Borrowing too little

It makes good business sense to keep a tight rein on your costs and debt level. However, lowballing the cost of a project can leave your business facing a cash crunch when unexpected expenses crop up.

Solution

Borrow enough money to cover your project and unforeseen contingencies.

Paying your loan back too fast

Many business owners want to pay back their loans as quickly as possible, but doing so could be costly. For instance, you may leave yourself short of cash or unable to invest in profitable growth projects.

Solution

Compare your projected return on an investment to how much interest you're saving by paying down your loan faster than required.

“I needed reassurance that this was a viable opportunity before taking out a loan.”

— Conor Sampson, Owner, CS Design

Case study

How I got my first business loan

When calls began coming in from all over the world, Conor Sampson realized the quirky seesaws his team had designed for Montreal’s festival district could become an international success. The 30 seesaws light up and emit sounds to create a playful symphony as people go up and down.

Sampson faced a decision. Would he take on debt to capitalize on the attention or let the opportunity slip away?

To make sure the idea was viable, Sampson teamed up with one of his employees to study the market and create a business plan. The pair also sat down with an accountant to prepare a five-year cash flow projection.

The process of building the business plan and the interest from potential customers reassured Sampson that debt financing was a risk worth taking.

Their work paid off when they received a BDC business loan for the full amount they’d sought.

→ Read the full story

3 Advice for start-ups

- The differences between bankers and entrepreneurs
- How to establish your credibility
- What to include in your business plan

If you're an entrepreneur working on a start-up venture, securing a bank loan may be a new learning experience.

In this chapter, we look at how bankers think, the importance of establishing your credibility and what to include in your business plan to help improve your odds of getting the money you need.

The differences between bankers and entrepreneurs

Entrepreneurs:

- Fuelled by passion and vision
- Often intuitive
- Able to visualize and judge a project based on a few details
- Risk takers
- Tend to be emotionally engaged in their dream

Bankers:

- Methodical and risk averse
- Deal in facts and figures
- Emotionally distant from your business
- Believe a business must have a sound financial footing
- Do not draw conclusions quickly, especially without all the facts

How to establish your credibility

If your start-up doesn't have substantial revenue or isn't generating positive cash flow yet, it's particularly important to demonstrate that you are a credible and worthwhile risk.

1. **Use facts and figures**
   Support every conclusion and claim with research from third-party sources, particularly if you mention trends or evaluate your market potential.

2. **Focus on one project**
   Bankers prefer one clear and complete idea over many excellent but vague possibilities.

3. **Be clear**
   Your banker probably isn't an expert in your field, so avoid industry jargon, acronyms and technical details.

4. **Show you've done your homework**
   Show that you've looked at your project from every angle and prepared contingency plans.

5. **Indicate how you'll pay back your debt**
   Show how the project will be profitable for both you and the bank. Your forecasts must be reasonable and backed up by solid data. Be careful about making claims that you'll be the next Google or Amazon.

6. **Stick to business**
   Focus on proving your case. It's good to be passionate about your business, but it's your facts and figures that will get you the loan.

What to include in your business plan

1. **Executive summary**
   Briefly describe your company, its industry and its competitive advantage; the business need or project that requires financing; and the amount of money needed.
2. **Description of the company**
   Describe the history, current operations and strategy of your business.
3. **Management team experience**
   Show the skills, experience and qualifications of all management team members to prove they have what it takes to make your project work.
4. **Key financial data**
   Provide financial statements, as well as forecasts for the next two to three years, to show your track record and capacity to repay the loan.
5. **Marketing plan**
   Provide a marketing plan to show that there is a proven market for your product or service, you know who your competitors are, and you understand your client profile and your key competitive advantage.
6. **Production plan**
   Show that you have the operational capacity to handle your projected sales.
7. **Human resources management**
   Demonstrate that your business can recruit, develop and retain the right people to carry out your business project.

Download BDC's free business plan template.

4

Once you have your loan

- Maintain a strong relationship with your banker
- What to do if trouble strikes

It's important to maintain a strong relationship with your banker once you've received your loan.

Your banker not only needs to stay up to date on developments in your company; he or she can also be an excellent source of advice and contacts.

What's more, your banker may be able to extend additional financing for your future projects.

Maintain a strong relationship with your banker

Your banker is an advocate for your business to his or her colleagues and superiors, who may have final authorization power over your account. You need to cultivate a trusted relationship with your banker so he or she will go to bat for you.

3 ways to build a strong relationship with your banker

1. **Be punctual**
   Provide financial statements and other required reports on time. A lack of up-to-date financial information could be interpreted as a sign of trouble.

2. **Stay in touch**
   Regularly touch base with your banker to keep him or her updated on your plans, and any challenges or opportunities you face. Throughout your relationship, your guiding principle should be "no surprises!"

3. **Invite your banker for a visit**
   At least once a year, invite your banker to see your operations first hand, meet your team and foster a clear understanding of the dynamics of your business.

What to do if trouble strikes

Financial difficulties can come from a variety of sources—the loss of a key customer, a major change in your market, fraud, fire or a natural disaster. Or perhaps your company's performance has been deteriorating steadily for several years.

Financial trouble can cause anguish and stress for you, your managers and your employees. However, this is a time to deal with your difficulties transparently and honestly.

Resist the temptation to deny or downplay the situation. Communicate with your bankers, investors and other creditors, and come up with a plan to get back on track.

Know how to spot trouble ahead of time

Look at your problem the way lenders do. Entrepreneurs are often so involved in day-to-day operations that they don't recognize early warning signals that may be visible to a banker. Since bankers must be vigilant to preserve the security of their loans, they will often be the first to see danger ahead.

Common signs of financial challenges

- Arrears on source deductions or property taxes—payroll deductions that should be remitted to the appropriate government departments are used as cash for general operating expenses
- Maxed-out lines of credit, frequent bank overdrafts or inability to make monthly payments on term debt
- Lack of up-to-date financial information or deteriorating trends in financial ratios
- Conflicts within management
- Continuing operating issues
- New and significant competition
- Loss of a major customer or a high concentration of sales among a few customers
- Continued failure to meet sales or profit margin objectives

The fuel your company needs to grow

Getting a loan for your business may seem daunting. However, if you clearly understand your business, its needs and what a banker wants to see in a loan proposal, you will be on a solid footing to negotiate with confidence.

A positive answer is never guaranteed, but the right preparation will help you impress your banker and improve your odds.

Even if the answer is negative, you can still gain from the experience by getting feedback from the banker on your loan proposal. That should help you make improvements and improve your chances next time.

Remember, bankers want to meet you, understand your business and see you succeed. Your job is to make it easy for them to lend you money.

BDC is here to help.

We provide business loans to finance your growth and get your projects underway, and advice to help you run a better, more profitable business.

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