

Business Financing Network

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The C's of Credit -- How Loan Decisions are Made

By Alan Kenyon

Understanding the thinking of lenders is a great place to start when you are trying to determine if your business venture can be financed. Lenders primarily must have two questions answered positively

- ▶ Will the loan be repaid?
- ▶ Can my lending institution make a profit on this loan?

Lenders are unlikely to make a loan unless they have a strong, positive sense about those two conditions.

In assessing the risks of a loan request, lenders have traditionally relied on what are often called the six "C's of Credit." They include:

1. Character
2. Cash flow
3. Capacity to earn
4. Conditions in the marketplace
5. Capital
6. Collateral

Let's briefly review each point:

Character: The credit history of the borrower, his reputation and experience in the industry, the soundness of the goals as outlined in the loan request, and the customer's record as an ethical, responsible individual who will repay a loan are some of the factors that serve as indicators of "character."

Cash flow: Since the Great Depression, bankers have shied away from relying on collateral as a guarantee of performance on a loan. Today, lenders look at the earnings stream, be it historical or projected, to determine the viability of loan repayment.

Capacity to earn: Financial Projections are vital in order to convince a lender the company will be able to make the loan payments every month. They must be realistically based on reasonable assumptions.

Conditions in the marketplace: External conditions affect the cash flow of the business. Has the borrower anticipated the kinds of events and situations that could affect profitability? Does the business plan demonstrate that management will know how to overcome such potentially adverse developments?

Capital: How much is the borrower willing to risk on the loan? How much cash is the borrower injecting and what kind of personal collateral is he offering? 100% loans are every entrepreneur's dream, but in reality, they rarely happen. Why should the lender risk money in a venture if the entrepreneur won't put his or her money "on the line?"

Collateral: Even though the borrower may be offering everything he owns as collateral, the lender still does not want to have to recoup his loan by seizing borrower assets if the loan turns bad. The lender does not want to own a fork lift, an empty restaurant, or a delivery van, etc., from a bad business loan.

Remember, 99% of all loans are repaid by cash flow, not collateral. That means that lenders are going to look at anything offered as collateral (other than cash or investments that can be readily liquidated at full value) in a different light than the borrower.

As long as a borrower can meet at least three of the C's, there is a good chance a loan can be secured. The professionals at Business Financing Network can walk you through all the steps necessary for success at gaining funding for your business venture.