Key factors when applying for business finance

By Darlene Menzies

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Many factors go into the decision-making pot when funders decide to approve or decline a loan, and not all of these are within your control.

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This article looks at some of the key factors that will impact on your loan, and what you can do to improve the odds of a successful application.

Risk and payment reputation

One of the biggest decisions funders need to make when reviewing loan applications, is to decide on the probability of the loan being repaid. It is important to remember that funders or credit committees do not know you personally, and so they have to rely upon historical data to build a risk profile of you and your business. Only a couple of credit bureaux provide business credit records, and since these reports are not yet standardised, the personal credit check of directors carries more weight.

Your personal credit record gives funders a good indication of how financially responsible you are.

In particular, they will examine the accounts listed on your record, and how well you have done in making regular payments. Judgements and blacklisting are showstoppers as this displays a serious breach of credit contracts.

What you can fix

If the credit record holds inaccurate information, contact the credit bureaux and provide updated information. Know your credit score and problem areas and put plans in place to address these to increase the score (the credit record provides this information so it is easy to fix).

You are entitled to one free credit report per year, so make sure you access this and check that the information is correct. If you don’t have any accounts and therefore funders cannot assess your risk profile, then apply for a credit card and use it sparingly (make sure to pay the minimum repayment on the due date) as this starts to build a history of responsible credit use.

What you cannot fix

1. The minimum score a funder decides they will accept.

2. Judgements - these remain on your credit record for a fixed period of time as determined by the laws of the country, and few funders will consider funding an owner with a judgement on their credit record.

Amount and affordability

The amount of money you need and whether or not you can afford the repayments is a big determining factor in the approval process. As with most important decisions, the amount you need will be weighed against the financial history of the business, its asset base, and profitability, and whether the lender considers you can afford the cost of the finance.

This is where management accounts play an important role. They show the lender how you manage your business, whether you have a sustainable business, how much you have invested in the business and, in particular, how you manage the profits.

Your balance sheet shows the assets the company owns and this is important for funders as it is sometimes possible for assets to be used as security for a loan. The type of asset, its current book value and whether the funder believes it has a high resale value will determine whether the asset can be used as surety for a loan.

What you can fix

Do your homework and make sure that your accounts are always up to date. Make sure you have a valid tax clearance certificate, as funders want to know they are investing in a legally compliant company.

Cash flow statements are particularly useful for showing that the company will be able to afford loan repayments. If you do the right research, you’ll be able to get a good indication of the cost of borrowing and can then adjust the amount requested to fit what the cash flow shows you can afford.

Also bear in mind that interest rates are closely linked to your risk profile, so improving your risk profile can result in a better interest rate. It is important here to mention the difference between fixed and variable interest rates. Many lenders will consider a fixed repayment amount that will not adjust should the prime rate change, so find out if this option is available should it be important for your business.

What you cannot fix

The cost of business loans varies considerably as it is dependent upon the type of finance you apply for, as well as a number of economic variables; such as the current prime interest rate, inflation projections and the overall economic forecast for the country, and you have no control over these factors.

Security/collateral

Funders seek always to minimise their risk and maximise their return on the money they lend, and one of the ways they do this is to demand collateral against the loan. This means that should you default on the repayments, they have the right to use the collateral to recover the cost of the loan.

In general, the amount of collateral required against a loan depends on the type of loan and your risk profile. If you do have collateral, for example, you own a property that is paid off, then you are in a good position to use this as collateral and raise the much-needed finance.

Offering collateral against a loan means that you determine what asset the funder will seize in the event of non-payment of the loan. However, be aware that if you are also asked to sign personal surety for the business loan, this means that the funder can decide to recover the outstanding monies from you in your personal capacity.

What you can control

The type of finance you apply for dictates whether collateral is required. Research funders carefully as some Government financing agencies are less stringent in their demands for collateral than the private lenders. Get to know the different types of finance products available for small businesses and see which ones would work for your business and your risk profile.

ABOUT THE AUTHOR

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