

Know the Landscape Before Requesting a Small Business Loan

By Jordan van Rijn, Loan Officer, Accion NewMexico

Many Americans long to see where their talents as inventors or craftsmen or cooks can take them. But businesses often struggle in their early years, and this makes some lenders wary of financing enterprises that don't have an established track record. After repeated rejections from potential funders, many entrepreneurs simply give up.

Organizations like Accion are one option for the aspiring entrepreneur who can't secure a loan through a more traditional financial institution, such as a bank or credit union. But getting a loan requires some groundwork, no matter where she looks.



The Five C's

Traditional lenders evaluate loan requests on the basis of the client's character, capital, collateral, capacity and conditions – the 5 C's of credit.

The lender measures character by observing the client's punctuality, organization and understanding of the size and purpose of the loan. They listen to what references say and what his credit history demonstrates about his commitment to pay off debts. They review the business plan to see how well it reflects the client's experience, strategy and commitment.

Existing capital is a plus for an aspiring entrepreneur and a way for the lender to assess the borrower's personal investment in the business.

Collateral is what a business pledges to secure a loan. These assets are a secondary source of repayment if the borrower defaults on the debt. Real estate, equipment, machinery, vehicles and certificates of deposit are good collateral.

Capacity measures the borrower's ability to assume new debt. Lenders weigh how much credit the client can draw on, how much debt she has and how her debts compare with her income. They make cash flow predictions to assure the business will have cash to pay bills when they're due. Lenders want to know how the client's business will weather economic conditions and what trends are driving its industry. They might be cautious underwriting a new video store, for example, if consumers increasingly prefer direct movie downloads.

Where's the Money?

Entrepreneurs approach banks, credit unions and alternative investors for startup capital. And some entrepreneurs are using the internet to find backers for worthy causes or projects through crowdfunding. Under current economic conditions, banks and credit unions issue loans with interest rates between 5 and 12 percent. A credit union will typically lend to members only. Both banks and credit unions have strict requirements, and few lend money to startups.

Government-backed U.S. Small Business Administration (SBA) loans are funded by banks that participate in SBA lending programs. The SBA provides a loan guarantee of up to 80 percent of the principal, and the interest rate – which is determined by the participating lender – is typically in the range of prime rate plus 3 to 4 percent. Current rates are about 6 to 7 percent. The SBA funds startups, but the application process may not be ideal for entrepreneurs with a short timeline within which to fill their capital needs.

Alternative lenders like Accion, The Loan Fund and WESST offer flexibility, mentorship, quick turnaround and a willingness to support new ventures. Loan terms are often tailored to the use of the loan and the business's cash flow. While small and microloans may be offered, the loan ceiling is often lower than with banks.

High-risk risk businesses that require substantial startup capital sometimes solicit money from private investors, but they usually must surrender a share in ownership, governance and profits.

Getting Ready

Once an entrepreneur has considered her needs and options, she needs to get her 5 C's in order. The New Mexico Small Business Development Center network or SCORE counselors can help her write a business plan, or she can consult online resources, such as those found at financenewmexico.org.

To learn more about Accion, visit accionnm.org.

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