

Working With Your Banker

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Banks are in the business of lending money. Loans to small business owners constitute a significant part of most bank investments. Business owners should realize that their banker wants to work with them and will go to great lengths in helping them work through their problems. However, business owners cannot wait until they are "going down for the third time" and expect to receive quick and thorough assistance. A relationship between a business owner and a banker must be established to identify small problems and tackle them before they get out of control.

Establishing and maintaining rapport with your banker

Who should develop such rapport? It can be stated that all businesses, both large and small, should develop a working relationship with their banker because of the invaluable assistance only he or she can offer. Even well-capitalized firms will eventually need such an effective working relationship. We cannot predict when the problems or the opportunities requiring financial assistance will come along, so the best hedge is sound, constant rapport with your banker.

Since it is necessary for a firm to establish and maintain a working relationship with a bank, the next question is, "How do we go about it?" There are a number of steps a business owner should follow in order to do this. The following are offered as suggestions.

- Establish a credit history with the bank. Borrow funds for short periods and repay promptly.
- Establish a checking account and maintain an adequate balance to cover all checks. Do not write checks that may be returned because of insufficient funds. Find out what size of checking balance the bank considers adequate.
- Find out what types of customers the bank is interested in serving. Is your firm too small or too large? Most small businesses need small banks as it is more difficult to get the same level of attention in large banks.
- Get to know the bank and its employees even if you do not need them now. Invite your banker to your business establishment on a regular basis. Introduce him or her to your key employees. This will help your banker gain confidence in both you and your staff. **This step is very important.**

- It is not uncommon to have one or two contacts with your banker per week. Keep your banker current on all phases of your business. Share your plans and dreams with your banker.
- Be honest with your banker as the truth always comes out. Don't try to cover up.
- Don't surprise your banker. If you foresee problems, say so, the banker may have a solution or, if a problem does occur, he or she will be prepared to help.
- Do what you say you will do. This means you should not be overly optimistic about forecasts. If you cannot make projected sales or payments, tell your banker well in advance.
- Provide your banker with adequate records on a regular basis. In the beginning provide balance sheets, income statements and cash flow analyses for the past three years and a summary of the history, management experience and products of your business. Know and understand your accounting records.
- Hire the best CPA and attorney that you can afford and communicate with them. Introduce them to your banker. The four of you can make or break your business.

Changing banks

Another question is, "When should you change banks?" Before changing, have a good reason, such as your needs have grown considerably. A solid relationship is more important than a point or two of interest. If you are uncomfortable with your established relationship, rather than change banks, request a new personal banker be assigned to your account who may be more compatible.

It is also important to establish and maintain a relationship with another bank in the event that problems arise which need immediate attention and your regular banker is not available. As time is generally a critical factor in most financial situations, the second bank will know about your business and be able to respond immediately.

Some common rules to follow:

- Select your bank and banker carefully.
- Be sure that your banker knows your business.
- Stay with the same bank, if possible. Consistency is important to bankers.
- Don't surprise your banker.

Financial situations that are inappropriate for bank borrowing

All business owners have run across bankers that say NO to their request for funds, even though they know their project is worthwhile. The question is, "Why do bankers say no?"

First, the borrower must understand that there are two basic types of banks: retail and commercial. The retail oriented bank does considerable advance work and promotion to attract customers and is involved in installment loans, car financing, passbook accounts, etc. On the other hand, the commercial bank caters to the business firm. The commercial bank operates with purchased funds, such as certificates of deposit, bankers acceptance, etc., while the retail banks use savings accounts, money market certificates, etc., for their sources of funds. For the commercial banks, demand for funds drives the need for funds, which is not as strong for the retail banks. Consequently, the commercial banks have a higher interest rate structure.

Today, neither type of bank wants fixed-rate loans (loans at a given interest rate for a long period of time) because the cost of funds is constantly changing in the money market. Basically, banks decline to make loans because the risk involved is greater than is prudent to the bank. Loans that are inappropriate for banks to make are:

- Loans for venture capital to firms.
- Loans to firms or individuals with no experience in business or inadequate capital structure or no capital of their own involved.
- Loans that have one source of repayment, such as typical retail operation.
- Loans to companies and individuals with questionable business practices such as unauditable accounting records or no accounting records, or secured by a large CD only.
- Loans to firms that do not have a good track record.
- Loans to firms with heavy reliance on personal guarantees. Banks are not liquidators. Banks want loans secured but do not want to be dependent on sale of these assets to be repaid. The goal of a bank is to have adequate margins, but they need to make loans on income-producing activities.
- Loans to provide equity capital to business.
- Loans without adequate information about the business, incomplete accounting records, and no background information about the industry.
- Loan requests that are based on projects which are not supported by past performance of the firm.
- Loans that are secured by securities for which there is not an established market, or loans that have a heavy reliance on second and third securities.

The bank's refusal to make a loan depends on the degree of risk involved as they are concerned about the repayment of the loan's principal and interest. The business owner requesting a loan must be concerned about the type of bank with which he or she is dealing and if the loan request is appropriate for that type of bank.

Common rules of thumb used by bankers

- New ventures must have at least one year's operating capital.
- A large percentage of sales to any one customer causes a banker concern. Banks would rather you sell to many small accounts than a few large ones.
- Do not want to make loans that depend on sale of assets (secured) to get principal back.
- Loan must be on activities that generate funds.
- Poor checking account balance tells how a firm is performing. Small balance indicates problems.

Preparation and presentation of a loan request

Banks are in the business of making loans and they have a need to make loans to firms. Therefore, the firm must sell them on their needs or they must have a strategy or plan; the firm must have something to sell. One key to a successful loan request is to get acquainted with a banker before a loan is requested. Another is to follow these steps in the preparation and presentation of a loan request:

- **Plan.** What is the objective? How will the objective be accomplished using the proceeds of the loan.
- **Prepare.** Banks will tell you what must be included, usually the past financial history of both the company and the principal owners and managers.
- **Package.** A well-prepared written document is needed.
- **Present.** An oral presentation should cover the highlights; this is "selling".

Any loan request should answer the following questions. Why does the firm need the funds? How much does the firm need? How and when will the funds be repaid? Can the firm afford the cost of the funds?

In preparing the loan request the firm must understand what the bank needs and uses in loan analysis, such as the five C's of credit:

Character: The trust and confidence of the firm's management and ownership.

Capacity: The business and management capacity of the firm — can it take on added responsibility?

Capital: Amount of funds the owners have invested in business — is it a sufficient amount?

Collateral: What is the secondary repayment plan of the firm? However, all the collateral in the world will not make a bad loan a good one.

Conditions: The state of the economy, rate of inflation, tax policy and changes and state of the industry.

Analyzing a loan request

In the analysis of a loan request, the bank needs the following information:

- History and nature of the company.
 - when it was formed and why
 - type of organizational structure
- Management personnel.
 - background, personal biographies
 - type of individuals
 - style of living, where they reside, personal balance sheets
- Nature of company's operations.
 - product line
 - marketing operations
 - labor force
 - competitors
- Condition of company's premises.
 - buildings
 - equipment
- Trade experience in the context of the proposed request.
- Conditions within the industry — both the economy and degree of technology indicate the state in the technology cycle the industry falls into.
- Government regulations and anticipated "red tape."
- Opinions of what others think of the idea or plan.
- Accounting records. Banks prefer accounting records for the past five years or, if firm has been in business less than five years, accounting records from its beginning, including balance sheets, profit and loss statements and cash flow projection vs. actual income and expenses.
- Any outstanding lawsuits.
- Full description of the firm's inventory and estimates of any items judged obsolete.
- Any liabilities.
- All leases or contracts.

- A list of accounts receivable, by age, and chances for collection.
- A break-even chart.
- Ratios, such as, current ratio, quick or acid test ratio, debt to capital, fixed assets to capital, inventory to working capital, etc. These ratios should be compared to ratios of the industry and any significant deviations should be explained.

In the actual presentation the firm must show that the bank needs to make a loan. The loan request must be neatly prepared, typewritten, with a cover letter. The loan request package must be complete and provide all necessary information; otherwise, the bank will request the additional information, delaying action on the loan.

Outline of a loan request package

Cover letter Title

cover sheet

Table of contents

- Summary
 - Nature of business
 - Amount and purpose of loan
 - Repayment terms
 - Equity share of borrower (debt/equity ratio after loan)
 - Security or collateral (listed with market value estimates and quotes on cost of equipment to be purchased with the loan proceeds; best if appraisal by an outsider can be provided.)
- Personal information (on all corporate officers, directors, and any individuals owning 20 percent or more of the business.)
 - Education, work history, and business experience
 - Credit references
 - Income tax statements (last three years)
 - Financial statement (not over 60 days old)
 - Background and type of personnel; where they live
- Firm's operations
 - Nature of the firm's operations
 - Product line
 - Equipment type and condition
 - Labor force
 - Buildings — type and condition

- Marketing
 - Experience in market
 - Organization and salesforce
 - Sales history and forecast
 - Economic conditions in the industry
 - Major competition and share of market
- Full description of the firm's inventory
- Government regulations and anticipated regulations
- Description of outstanding lawsuits or legal claims and liabilities
- Aging of accounts receivable
- Firm's accountant and its attorney.
- Firm information (whichever is applicable below, 1, 2 or 3)
 1. New business
 - Goals and objectives of firm — strategy
 - Life and casualty insurance coverage
 - Lease agreement
 - Partnership, corporation, or franchise papers, if applicable
 2. Business acquisitions (buyout) Information on acquisition
 - Business history (include seller's name, reasons for sale)
 - Current balance sheet (not over 60 days old)
 - Profit and loss statements (preferably more than 60 days old)
 - Business's federal income tax returns (last three to five years) and those of principal owners, if possible
 - Cash flow statements for last year
 - Copy of sales agreement with breakdown of inventory, fixtures, equipment, licenses, goodwill, and other costs
 - Description and dates of permits already acquired
 - Lease agreement
 3. Existing business expansion
 - Goals and objectives of firm — the strategy business history
 - Current balance sheet (not more than 60 days old)
 - Current profit and loss statements (not more than 60 days old)
 - Cash flow statements for last year
 - Federal income tax returns for past three to five years
 - Lease agreement and permit data

- Life and casualty insurance
- Partnership, corporation, or franchise papers, if applicable
- Projections
 - Profit and loss projection (monthly, for one year) with explanations
 - Cash flow projection (monthly, for one year) with explanations
 - Projected balance sheet (one year after loan) with explanations
- Ratio analysis
- Break-even analysis
- Repayment plan: Complete description of how funds will be repaid by firm and alternatives if funds are unavailable.

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