How To Qualify For A Business Loan

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As a business owner, you put a lot into your company – be it time, energy or personal savings – and in return, you expect to get a lot out of it. Maybe you've determined that your business is ready for a loan and have a clear plan to grow your business. However, everything's riding on the funding.

The good news is, approval rates for business loans reached new heights in June 2018. According to Biz2Credit, small business loan approval rates rose at regional and community banks with small banks granting 49.4 percent of the funding requests they received in May 2018, the highest rate for small banks since May 2015.

Despite rising approval rates, it's important to understand what lenders are looking for in a borrower and how you can put your best foot forward when applying for a business loan.

Five C's of Credit

The Five C's of Credit – capacity, capital, collateral, conditions, and character – are a traditional framework lenders use to evaluate a borrower's worthiness for a loan. To these five, I would add a sixth C that is especially important for young and small businesses. While lenders often put different values on these characteristics, they act as a great roadmap for understanding how you can improve your chances of qualifying for a business loan.

1. Capacity

Capacity is simply your ability to repay the loan. This factors in whether your business can generate enough cash flow to repay the loan in full. Lenders will look at a business' financial metrics to determine whether this is possible. Everything from debit and liquidity ratios, cash flow statements and credit score, to borrowing and repayment history will be reviewed. Before applying for a business loan, calculate your cash flow ahead of time to understand what your loan capacity is.

2. Capital

Capital refers to the amount of money the borrower, business partners, or management team have invested in the company. Lenders are looking for businesses that are not a 100 percent risk; therefore, if a borrower has invested their own money into the venture, they're more likely to qualify for a loan.

Lenders want to know that you have skin in the game and that your business capital assets are enough to help support the financing of a loan. Answer the question: What will you lose if your business fails? If you're not personally invested already, consider adding some resources into the mix to boost your qualifications.

3. Collateral

Collateral acts as a backup source of security for the lender if the borrower is unable to repay the loan. Assets can include real estate and equipment, working capital, accounts receivable or inventory, and even a borrower's home. Lenders want to know there is a safety net in place to ensure the loan is paid off in full, beyond the borrower's existing capital.

Banks will look into the value of your available collateral, in addition to any debt you may still owe on them, which will be subtracted from that value. Before applying for a loan, be aware of all potential assets that could be used as collateral payment on your loan.

4. Conditions

Economic factors, trends in your industry, and your competitive landscape all contribute to condition. Lenders want to know the purpose of your loan use and what larger circumstances could impact your business and the loan. Banks will evaluate external factors affecting your business, including relationships with customers and suppliers and the state of your industry.

While this characteristic is mostly out of the borrower's control, you can plan ahead. Rather than waiting until you're in dire need of a loan, apply for one when your business and industry are in good shape. This suggests you're aware of the bigger picture and actively working to stay ahead of any possible economic conditions outside of your control.

5. Character

Character is a lender's opinion of a borrower's general trustworthiness, credibility, and personality. Banks are more likely to lend to people who are reliable and responsible because they are seen as less of a financial risk.

- Does your work experience and expertise speak volumes?
- Are the people closely tied to the success of your business reputable?
- Are you regimented with payments and deadlines?

To lenders, your credit history and character go hand in hand. If your credit history proves your dependability, you're in a good position. To help your chances of qualifying for a business loan, start collecting references, credentials, and personal credit history. Borrowers have great control over their character, so make it count!

6. Communication

Lastly, I would add one additional C to the list – communication. You know your business better than anyone. Are you willing and able to communicate openly regarding the condition of your business? You are intimately aware of the business' profitability and cost structure. Your financial statements are one of the primary means by which you communicate your company's performance. Is the quality of your financial reporting sufficient that a lender can understand the company's financial health and render a decision?

Lenders rely on a borrower's openness and the thoroughness of your financial statements when assessing new loan opportunities. Your ability to communicate these things effectively will go a long way toward building credibility.

As your business continues to grow, you need a partner to finance the progress. To learn more about the lines of credit we offer at PlainsCapital Bank, visit our website or call 866.762.8392 to speak with a lender.