U.S. Small Business Administration

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Op-Ed

Five Critical Steps to Securing Small Business Capital

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Cash flow is the life blood of all small businesses. Cash flow allows a business to make payroll, pay suppliers, and keep its doors open. We have been told that there is a credit crunch and that small business lenders are no longer extending lines of credit to their customers. As this state's strongest advocate for the small business community, I believe it is critical to understand the true facts about small business' access to capital in the current economic climate. Recently, the SBA assembled a blue ribbon panel of experienced commercial lenders to brief us on the current credit market, and to find ways to help our small business community survive these turbulent economic times.

All of the lenders agree that capital is still readily available to credit worthy small businesses. The lenders noted that they are performing more due diligence on loan applications today then they did six months or a year ago. We were told that in the current economic environment small business borrowers are more wary to take on new debt and have seen their revenues and liquidity drop severely over the last few months. Business owners that are too highly leveraged may have difficulty taking on new debt, even if that debt is critical to the survival of the business.

The panel of lenders provided us with five critical steps that small business owners can take to help secure capital.

1. **Borrowers must be credit worthy**. Small business owners must avoid depleting their current liquidity or cash position. They must immediately deal with negative financial issues including poor or inaccurate credit reports, and must resolve all business and personal tax issues. A negative credit report and/or credit score can be a "deal buster". Back taxes, liens, garnishments, multiple bounced checks all show increased risk for a lender. Borrowers should deal with recent bankruptcies by providing an explanation of why it occurred. Address all of these issues prior to applying for the business loan.

2. **Immediately develop a stronger business plan**. The panel of lenders stressed that a business plan must be well thought out, and realistic. The business plan should outline the money, management, and marketing of a business. One lender stated "I need to understand that you understand what you are getting into." Borrowers must explain how the money will be used, and how will it be repaid. Repayment ability is the critical factor. Without repayment ability, no lender will make the business loan. Few, if any, lenders provide 100 percent financing.

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3. **Plan for the worst case scenario**. All lenders require borrowers to provide a minimum of 12 months of financial projections. These projections should be broken down into a month by month format. The business owner must understand how these assumptions were developed, and establish their validity. All lenders agree that the projections must be presented with a best case, mid-case, and worst case scenario. How will the business survive if revenues nose dive by 10 percent, 20 percent, or 30 percent over the next 6 to 12 months? There are no crystal balls to answer this question. This "hands-on" forecasting will help the borrower become more strategic in their thinking, and help the lender feel more comfortable with repayment ability.

4. **Two Years Business History is necessary**. The lenders made it absolutely clear that they were looking for established, financially strong, quality businesses to lend to. Working capital loans are becoming harder to approve, and lines of credit were being tightened or not extended. Loans to start-up businesses are more difficult to approve in the current economic climate. Lenders may require an additional cash equity injection by the owner, or even a seller carry back, to reduce the size of the loan. A proven franchise concept may help mitigate any risk.

5. **Time to become a hands-on owner**. This is not a time for business as usual.

   - Collect accounts receivables in a timely manner – don't allow your customers to drag out the payment terms. If necessary, get in your car and visit the customers that have not paid timely and have large amounts of outstanding money owed to you.
   - Don't keep all your cash liquidity tied up in inventory. Review your business operations to see what work can be handled in-house and not contracted out.
   - Review each business expense item and eliminate discretionary expenses that could help generate additional cash flow.
   - Eliminating unprofitable account relationships could also help the bottom line. Increase your efforts to market your business.
   - Cutting new marketing expenditures may be a mistake. Many business owners make the mistake of cutting marketing expenses when business slows. That might be the wrong decision to make.

Access to capital is critical to the survival of many small firms across Maryland. This is especially true given the upcoming holiday shopping season. Though small business loans are still being made to credit worthy borrowers, many business owners do not comprehend what lenders require in a loan application. Their chances of securing a loan are better if they follow our Five Critical Steps to Securing Small Business Capital. The SBA has taken a statewide leadership role in advocating for the small business community during these uncertain economic times. The SBA remains committed to helping our small businesses weather the economic storm and prepare for brighter days ahead. Small business owners that have questions about obtaining a loan, or need assistance with other business issues, should contact the SBA Baltimore District Office at (410) 962-6195.