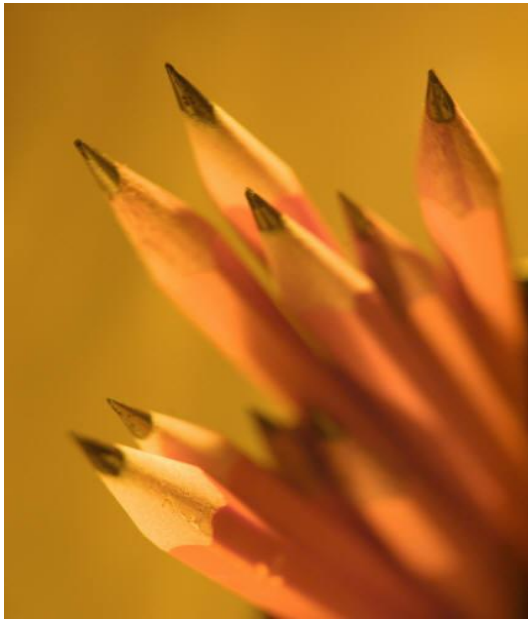

Taking Care of Business

Bank Financing Beyond the Basics

By: Aaron Dyer

You've read the previous article on types of financing and perhaps you think, "Ok, now I'm prepared. Off to the bank!" You'll start along on your merry way, whistling a happy tune to the beat of your entrepreneurial heart, but pause for a moment. Do you need long term or short term financing? A term loan or a Line of Credit (LOC)? Are you going to be getting a secured or an unsecured loan? At this point, as your heart rate is slowing from your jaunty step that has now slowed to a pitiful plod, you might want to head back to the computer and do a little homework.



Taking steps to determine the type of financing you will be requiring is an in-depth and time-consuming process, but the end results will be worth it.

Short Term vs. Long Term Financing - The "term" of the loan refers to the length of time you have

to repay the debt. Debt financing can be either long-term or short-term. Long-term debt financing is commonly used to purchase, improve, or expand fixed assets such as your plant, facilities, major equipment, and real estate. If you are acquiring an asset with the loan proceeds, you (and your lender) will ordinarily want to match the length of the loan with the useful life of the asset. The LOC will give you the opportunity to recycle the funds as you will have the ability to get the money, pay it back, and then borrow from that same line further down the road. Typically, LOC's will be used to carry accounts receivable or for seasonal businesses.

Secured or Unsecured Debt -

These lines of credit can be secured or unsecured, terms you will want to find out which applies to your particular case. A secured LOC occurs when you have collateral in the form of your inventory or accounts receivable. Lenders typically advance 50% of the cost of inventory that makes it a popular choice for seasonal businesses. In cases of accounts receivable, lenders can advance 75% of the accounts receivable that are not delinquent in any way. Small businesses often use this LOC in cases where payment from a client may not arrive for 30-60 days, but an immediate infusion of funds is necessary. Businesses also use their LOC's to take advantage of supplier discounts that may be offered. The balance of the LOC is paid down each year until a zero

balance is attained. Long term loans are usually secured by the asset being purchased.

Unsecured loans place more risk on the lenders side as if the borrower defaults. Unlike a secured loan, the promise is not supported by granting the creditor an interest in any specific property. The lender is relying upon the creditworthiness and reputation of the borrower to repay the obligation. An example of an unsecured loan is a revolving consumer credit card. Sometimes, working capital lines of credit are also unsecured. Most often, until a small business has an established credit history, it cannot usually get unsecured loans because of the business's risk.

Other key issues with Bank loans:

- **Interest Rates** - Usually, LOC's interest rates can greatly vary or "float" based on current rates. These rates are determined by the lender and are most often tied to a published interest rate, like the Prime rate. Your payments on a LOC will most likely be "interest only", with requirements from the bank that the loan be paid down to a zero balance for at least 30 days. For long term loans, the interest rate normally remains constant for the term of the loan. Each payment of principal reduces the balance of principal remaining and the subsequent interest is

calculated on this reducing balance.

- **Loan fees.** The lender may charge up-front loan or processing fees. Check these fees carefully, and try to get an estimate as soon as possible to help you evaluate the loan package.
- **Prepayment.** Ideally, you want to be free to pay off the loan at any time before its due date. Make sure that your loan agreement or promissory note gives you this flexibility and try to avoid a prepayment penalty for paying off the loan early.
- **Defaults.** The lender may define a variety of events that will constitute a default on the loan, including failure to make any payment on time, bankruptcy, insolvency and breaches of any obligations in the loan documents.
- **Grace period.** Try to get a grace period for any payments. For example, the monthly payments may come due on the first day of each month, but they won't be deemed late until the fifth day of the month.
- **Late charge.** If the loan includes a fee for late payment, try to make sure that it is a reasonable charge.

- **Co-signers and guarantors.** A lender may ask for a co-signer or guarantor as a way to further ensure that the loan will be repaid. A co-signer or guarantor runs the risk that their personal assets will be liable to repay the loan.

Have any ideas about what type of loan you're going to be asking your lender for yet? Determine how long you will need to repay the loan and outline what it will be used to cover. Know what kind of terms you need in order to be able to meet deadlines and guarantee that your credit will stay in good standing. Loan payments are usually broken up into

more manageable installments that can be paid monthly. Calculate the cost of the money you deem necessary for your business by obtaining estimates and quotes. If you are looking for a longer-term loan, which will be the case if you are going to buy or refinance commercial real estate, improve current real estate holdings, or make a large equipment purchase, the same research must be conducted. Don't let yourself be unprepared or ill informed about the market prices of certain services or products, but exhaust all avenues in order to cover all cost case scenarios.

About the Author:

Aaron Dyer is President of Dyer Consulting Group, a small business consulting firm that advises business owners on ways to grow their revenues and increase profitability through better strategic planning and financial management. For more information, and also to sign up for Aaron's future articles, visit www.DyerConsultingGroup.com

