



## Can a Start-Up Company Obtain a Bank Loan??

As SCORE Counselors, we frequently hear this question. And in the news, there have been many stories about troubled banks and how hard it is to get a bank loan for a start-up business. Are the banks now being more diligent scrutinizing loan applications or has the demand for start-up loans been diminished due to the recession? What is the current environment for start-up small-business loans? Can a start-up company really get a loan now?

In this article, we looked at the availability of start-up loans for the new entrepreneurs. How is the local situation now different from two or three years ago? Is this the right time to start a new business in central Indiana?

The *Indianapolis Business Journal* (11/20/2009) states that SBA-guaranteed lending in the Indianapolis area plunged by an astonishing 64 percent for three of the city's four largest banks during 2009, while overall business lending slipped 17 percent in the Indianapolis area. It is painfully obvious that overall credit conditions are much tighter than they were several years ago and loan policies across the board have become much tighter. Another factor has been a reduced demand for loans as would-be entrepreneurs take a more cautious approach to business start-up, growth, and expansion. However, that does not mean that business loans are not being made. In any event, at this time, almost all approved start-up loans are SBA-guaranteed 7(a) loans. To clarify, lenders generally consider a start-up company as a company with an operating history of less than 3 years.

In the central Indiana area (Marion and surrounding counties), we looked at *total* SBA-backed lending and the amount of SBA-backed lending that actually occurred for *start-up* companies. In FY2009, the volume of SBA-backed funding for start-up companies in central Indiana was about 30% of total SBA-backed lending.\* In Marion County alone, it was about 32%. .....  
Conclusion: *Loans are being made to start-up companies!*

However, not so fast..... Many of these approved loans are Community Express loans which are generally less than \$50,000 and based primarily on the owner's personal credit history. And the current regulatory environment and the instability in the banking industry have put a big chill on small business lending from banks. With more government oversight and regulation, banks are being squeezed to make more loans while at the same time, are instructed not to lower a loan's rating simply because the collateral value has fallen. Such "write-downs" force banks to set aside more in loan loss reserves, leaving less for loans. In order to improve their liquidity, banks are now very reluctant to provide lines of credit to start-up or existing businesses even for long-time customers. Instead banks are converting these lines of credit over to actual loans. Much of the reduced lending can also be traced to lower demand from small businesses as a result of poor sales in the recession. So these businesses have difficulty expanding or hiring new employees without cash ..... a vicious cycle.

### **So what are Start-up business owners who get loans doing better than those who are denied loans? ....**

Every business plan proposal is getting a lot more scrutiny now, so it requires the entrepreneur to be much more diligent in their business plan preparation and to understand the financial implications. The entrepreneur needs to be brutally honest about the start-up company's strengths and weaknesses. The entrepreneur needs to have an extremely good business plan - the lender needs to be convinced that the applicant knows the business, the market, the competition, and the economic conditions to survive and pay back the loan. The lenders are not really impressed by *pretty* business plans that were generated off the internet; rather, they want to see

that the applicants wrote the plan and truly understand the business and the business environment - they are the ones who will need to re-pay the loan!

In general, commercial lending criteria for approving SBA-guaranteed 7(a) loans include most of the following items:

- Ability to Repay the Loan
  - Excellent FICO (Credit) score
  - Must have adequate personal income to meet current obligations plus a potential business shortfall
- Personal Character
  - Must not be under indictment or on parole or probation
  - US citizen or permanent resident visa (Green Card)
- Feasible business plan
  - Product or service of lower risk industries
  - Must have:
    - Complete description of business concept
    - Description of target market and competitive advantages
    - Resumes of principals – must have relevant experience in the industry
    - Two or three-year revenue/cash flow forecast.
- Investment in the business by the Applicant
  - Generally looking for about 20% cash investment by the applicant
  - Requested loan amount should anticipate losses and provide at least 6 months liquidity over and above investment
- Collateral
  - SBA (first lien holder) wants the loan backed by enough collateral
  - Outside sources of collateral are required if business assets do not fully collateralize the loan
  - All owners of 20% or more of the business personally guarantee the loan.

Some of the guerrilla financing tactics (i.e., use of credit cards, etc.) that were previously available to a smaller, emerging business are becoming more scarce, making SBA-guaranteed lending all the more important. Even though the government does not currently provide grants for starting or expanding a small business, the government does offer plenty of free help in planning how to start or expand small businesses and in securing low-interest SBA-backed small business loans.

In summary, even though it is more difficult to obtain a business loan, now may be the ideal time to start a new business. Current interest rates are low and more start-up help is available from many sources. Use the above criteria as a checklist for evaluating your business planning and be sure to contact more than one potential lender. Prepare a solid business plan with SCORE's assistance. For new entrepreneurs, SCORE is the best place to go for start-up and for follow-on business advice.

So there it is.....

To answer the question, ***“Can a start up company obtain a bank loan?”*** -----

The answer is ***“Yes, ..... but prepare well!”***

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- Reference: SBA 7(a) loan data for FY2009

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