The dating rules of banking

By: Veronica Cool   August 2, 2015

Over and over I'm asked about loans, regaled with complaints of relationships gone awry — prompting this particular column.

Banking doesn't need to be so complicated and laborious.

First, banking is just like dating. You may prefer brunettes, slender, dark skin, short hair, etc. Banks, depending on their current portfolio allocations, have similar preferences for manufacturers, hospitality, investment real estate, government contractors, etc. So, "it's not you, it's us" may, in fact, be very apropos. Your business or industry may not fit their current appetite.

Second, bank financing is a small sliver of the capital spectrum. Consider the width of your arms spread wide open; that's the spectrum of capital, including angel investing, friends and family money, hard-money loans, asset-based lending, equity injection, and so forth. Not every deal is eligible for bank financing, so stop jamming a square peg into a round hole.

Lenders consider the following factors when underwriting a credit request: Capacity (or cash flow), Collateral, Character (or credit history), Capital and Conditions – the 5 Cs of Credit.

Cash is king and the borrower's ability to support the debt service is probably the biggest factor when underwriting a request. Cash flow must be documented in tax returns and/or financial statements — not by wishful thinking or forecasting (and don't ever ask the banker, "Which set of books do you want to see? I have the IRS books and the real numbers")

And do remember that banks review data historically, which does not account for growth or increased pipelines. Account Receivables Financing or Purchase-Order Financing are good options in growth situations.

You know that deadbeat cousin or friend with the hare-brained schemes always asking for a loan? Would you lend him your own hard-earned money? Banks think similarly. I clearly remember my senior credit officer asking me, "Veronica, put your hand on the Bible, and now answer me: Would you lend this guy your own money?" Hence the need for tangible collateral, the secondary form of repayment; lenders need an "out" in the event of default. How will the funds be recovered if the business fails? And no, "goodwill" or "business value," is not often tangible. When things get ugly, goodwill won't auction at 100 percent market value to recoup the outstanding debt.

Character encompasses credit history, both personal and business. Before submitting any requests, pull the three credit reports, Experian, Equifax and Transunion by visiting www.annualcreditreport.com. Dispute any derogatory items, duplicate listings or erroneous information; spend the time to clean up any issues. Typically, any individual with 20 percent ownership is reviewed, and a strong credit score (750+) favorably impacts the pricing and terms of the loan, including required collateral.

"Banks only lend money when I don't need it." There's some truth to that … A wise business practice is to seek credit when you're most attractive – a strong balance sheet, good cash flow and a healthy pipeline – and when your capital or net worth of your business is positive, stable or growing.

Post-2008, regulatory constraints have increased, and banks are often audited/monitored to ensure prudent behavior and solid portfolios. Hence the monthly or quarterly covenants and annual renewals tied to most credit facilities.

Underwriters also will consider market and economic conditions as well. A government contractor seeking an increase to her line of credit when the government was sequestered or shut down is not getting approved.

Complying with the 5 Cs is just the beginning. The business also needs an advocate to navigate the internal banking channels. Someone to tell your story and clarify any potential hazards in your package or requests. Someone to negotiate favorable terms and pricing: a business banker or relationship manager. Every bank offers segmented service, from the branch level to corporate banking; each level is established to handle clients of certain revenue sizes and/or complexity. For instance, branches may handle businesses with revenues less than $1 million. Business Banking departments manage companies with revenues of $20 million or less, typically. The ranges differ from bank to bank and being domiciled or managed within the right department provides the borrower with appropriate expertise and sophistication. Most of the issues surface when borrowers are mismanaged; for instance, a fast-growing company remains in the branch system where the products can no longer accommodate their needs.

I recommend businesses date or interview different banks and bankers to find the right match. The industry has changed dramatically, and bankers often move around from institution to institution, so consider following the banker that knows your business well and can advocate for you successfully. Also, when assessing your options do consider credit unions and alternate lenders. Diversify your holdings and note that banks seek to acquire 100 percent of your relationship, including the credit facilities, checking accounts, cash or treasury management services, insurance, merchant processing and much more. A strong business can hold the upper hand when negotiating terms if all of the above services are moved to the new bank.

To recap, assess the 5 Cs of Credit to ensure you are an attractive borrower. Date multiple lenders until you find the ones you wish to marry. Find the right banker and keep her informed, leverage her as your partner in your strategic planning, and discuss challenges and problems ASAP.
Till next time, amigos.

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