

HOW BANKS SPOT BAD LOAN APPLICATIONS

Report #51 From George Heaslip

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Only 7.3% of commercial loan applications get approved. Many ask me if commercial loans are tough to get approved based on the sub-prime mess. The answer is yes, unless a proper lender is found and a formal business plan can be presented. These are my specialty areas.

The sub-prime lending mess has spilled over into the commercial sector. Many of the well-known commercial lenders have stopped making loans and have severely reduced the numbers of their business development officers.

Lenders and investors know that approximately half of all small businesses fail within the first four years.

Most banks and non-bank lenders reject loan requests for the following reasons:

- > Over-valued businesses being disqualified by bank underwriters.
- > Poor business value analysis. (My reports show you how to do this).
- > Applicants and spouses poor credit.
- > Lack of management experience by the applicant.
- > Inability to prove that 20% can be put down at closing, sometimes less if seller participation comes into play. Some banks stopped lending and others now require 30% down.
- > Falsified tax returns.

I have worked at banks and an SBA Small Business Development Center. Here's what they look for:

(1) Debt Service Ratio Below 1.25

The real net profit per month, divided by the loan amount, per month, must be 1.25 or higher. If the debt service ratio comes in at 2.0 or higher, this will be difficult for a lender or investor to believe. If the debt service ratio falls below 1.25 as business months move on, the business is generally headed for failure or loan default.

(2) Accounting

The applicant must prove that he or she has an accounting system in place to provide monthly profit and loss statements and balance sheets.

(3) Ignoring the Competition

Consumer loyalty to a single firm continues to decline. The business plan must discuss at least three nearby competitors, and how the applicant will have the competitive edge, even if it means copying their successful ways.

The business plan must show that the buyer has contacted suppliers to find out what regional businesses have succeeded (and why) and which ones have failed (and why).

(4) Sloppy Marketing

Believe it or not, few products or services "sell themselves." A marketing manager with a powerful resume of past successes is a must. Direct in-person contact with current customers, and potential ones, is the best technique. Brochures, faxes and web sites are fine, but should be in a secondary position to personal contact and person-to-person phone calls. Once a customer is landed, the business plan should explain how contact be maintained to monitor customer changing needs. Your author believes that Internet advertising and the quality of your web site is superior to direct mail.

(5) Ignoring Client Needs

Once the applicant attracts customers, the staff will have to work hard to keep them. Customer service should be a key aspect of your business.

Look at a real life example. There is Home Depot and there is Lowes yet many smaller "hardware" stores have thrived, including Ace and Do IT Best. Why haven't the big "box stores" destroyed them? The answer is simple, better customer service.

If the applicant does not follow through with your customers, they'll find someone who will. The business plan must address how customer contact will be maintained, namely a product and/or service feedback system.

(6) Incompetent Employees

The business plan must explain how key employees will be attracted and who their backups are, and should definitely show resumes for persons that will be with the company. Young employees can be a problem, the office or business place is not a party hall. How many of you seen Kitchen Nightmare shows on TV? A good manager will know how to keep the staff working when the pressure is on, and to allow fun times during slack periods.

(7) Lack of Versatility

A good business owner must show that he or she is experienced in hiring, marketing, accounting, and human resources. Poor accounting can lead to tax fraud, penalties and business closure.

(8) Poor Location

Even the best manufacturing plant, hotel, restaurant or retail store will fail if it's in the wrong place. The business plan must fully describe why the site was chosen, provide demographics (available from local chambers of commerce), and explain the ease at which customers can get to your site on a regular basis.

(9) Cash Flow Problems

Loan applicants must provide the lender or investor a three-year cash flow projection, by month for the first year, by quarter for years 2 and 3. Evidence must be shown that a trained bookkeeper or accountant will update these projections monthly.

(10) Open Your Mind

Every business owner will experience setbacks! Don't be surprised if you find that many of your ideas are wrong. Look for business consultants who monitor your monthly statements and provide suggestions for a recovery plan. The minute your debt service ratio falls below 1.25 get professional help immediately. Network with your competitors because sometimes they can help you and sometimes you can help them. Develop a subcontractor relationship where they can handle your overflow or you can handle theirs. This is very important. It is called a business alliance.

(11) Lack of a Formal Business Plan

It must be updated quarterly. Lenders or investors that provide funding will monitor progress per the original business plan. Many business owners fail to modify the plan or stay in contact with the lender or investor as business conditions change. Business owners that throw surprises at the lender or investor are in immediate trouble.

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