



RedSky

BUSINESS DEVELOPMENT
AND CORPORATE FINANCE

How To Get The Bank Onside

By Peter Beresford, Managing Director, RedSky

Issue

The biggest issue facing small and medium-sized businesses today is their access to funding – or lack of it.

Before the credit crunch, it was relatively easy to borrow from banks but that has all changed now – banks are extremely cautious and take a huge amount of convincing that they should lend to your business.

Criteria

Firstly let me tell you what the banks look at when they review your lending request. It can be broken down into several key areas, which are:

The **People**

They look at whether the proprietors are of high integrity, honest etc and what their credit history's like?

Also their ability – how capable are the main people in the business?

Secondly, the **Purpose** of the loan is an important consideration for them and they'll look closely at what the funding's to be used for.

Next, the **Amount** of the loan or overdraft – is it the right amount or possibly too much for what you really need. Conversely, is the amount sufficient or will you soon be back for more?

Serviceability – how their loan will be paid back. I'll come on to this later.

The bank are very interested in **Security** – how they'll get their money back if things don't work out - their get-out of jail ticket .

and last but by no means least...

Their **Profit** – banks aren't charities and will always want to make sure their return is right for the level of risk they're taking

What's changed?

So what's changed over the last couple of years to make it so difficult to raise the funding you need for your business?

The general criteria banks use hasn't really changed, but the emphasis certainly has.

Pre the credit crunch, banks became overly focused on the amount of security being provided. That's all changed, and this is the key message, the emphasis is now heavily weighted towards **Serviceability** of the borrowing.

Your bank manager will want to be able to prove, beyond all reasonable doubt, that your business will be able to service the interest and loan repayments; that they'll get their money back.

How do you do this?

At RedSky, we put ourselves in the shoes of the lender to ensure that serviceability is in place and that there is strong supporting evidence to this effect.

By doing this, we've found that we've had a high rate of success obtaining business finance for our clients..

Method

There are several things banks look at when considering whether serviceability is in place, and it's often a combination of the following:

Firstly, your **Accounts** will show how profitable your business has been in the past – this is a key factor for them. However, there's a big difference between profit and cash and the bank will always focus on the latter.

Looking to the future...your **Forecasts**, particularly your cash flow forecast are very important to your bank manager.

We always spend a great deal of time ensuring that forecasts are as accurate as they can be, supplying robust and very detailed assumptions, with supporting evidence if possible.

Banks also use several **Ratios** for evaluating serviceability, such as...

- Repayment Cover
- Interest Cover, and possibly...
- Rental cover if a rented property is involved

Ratio Definitions

Repayment Cover:

$$\frac{\text{Profit Before Tax (after Drawings/Dir Rem/Dividends) plus Depreciation \& Interest charges}}{\text{All annual loan repayments (capital \& interest)*}}$$

Interest Cover:

$$\frac{\text{Profit Before Tax (after Drawings/Dir Rem/Dividends) plus Depreciation \& Interest charges}}{\text{All annual interest charges*}}$$

*On all borrowing

Rental Cover:

$$\frac{\text{Gross rental income less 10 to 15\%}}{\text{Annual loan rep's (capital \& interest at margin plus 4 to 5%)}}$$

Minimum acceptable ratios vary depending on the business/industry and the lender involved. Typically, a bank would be looking for the following minimum figures:

Repayment Cover - 1.5 times (150%)

Interest Cover - 2.0 times (200%)

Rental Cover - 1.25 times (125%), but varies greatly from lender to lender

Summary

To summarise, cash is king.

Banks still look at lots of things when they're assessing loan application, but they're focusing on serviceability at the moment like never before.

It all boils down to working hard to put together a comprehensive and water-tight proposal with a focus very much on cashflow and serviceability.

If you want to see a copy of this script, please go to our website: www.red-sky.co.uk or give us a ring on 01423 325319 to have a chat.

Coming soon: Alternative sources of finance if the bank says no