

10 Questions to Answer Before Applying for a Bank Loan

Most small-business owners need a bank loan at one time or another, and applying for one involves much more than filling out paperwork. Among other things, you need to consider the state of your personal and business finances, how you're going to repay the loan, and how much money you actually need.

Here are some of the key questions you should ask and seek answer before applying loan:

1. Is it likely I will qualify for the loan?

You're only going to hurt your credit if you apply for a loan you won't get. Better do some homework. We suggest ask atleast one lending institutions about their specific requirements before applying. Many will let you know the minimum credit score they require, the cash flow you need to show, and other qualifying factors.

Credit Score by CIBIL and other Credit Information Companies plays an important role

Now in India, referring to CIBIL and other Credit Information Companies by the banks has become a commonplace. Most people know their personal credit score, but very few know their business score, As with personal credit, you can find your business credit score through CIBIL, Experian, HighMark or Equifax. If the score isn't as high as you think it should be, it might be because there are outstanding unpaid loans against your business.

How to protect CIBIL score: Everytime Bank asks for CIBIL report, the score will come down by 5-10 points. It is desirable to take own report directly from CIBIL and enclose to Bank with a request to take CIBIL report only after they have accepted to finance in principle.

2. How much do I really need?

Before you approach the bank, make sure you have made assessment on how much loan you actually need. The best way to determine this is to create a monthly cash-flow projection. Does your customer pay you in 60 days, but you have to pay your vendors in 15 days? If so, you might need extra money to tide you over. It will reflect poorly on you if you go to the bank asking for an amount and while working out the specifics, it may go up by huge margin.

If the loan is for buying assets /create new manufacturing facility, better to be prepared on requirement before going to bank. Prepare a detailed project report by taking help of consultants which include detailed financial plan. Include in the plan a breakeven analysis, which estimates the amount of revenue the business must generate to cover

expenses before even a rupee of profit is made. The analysis can help you determine the funding you need to survive until you reach—and exceed—the break-even point.

3. What type of loan facility I should ask?

The type of facility must be linked to nature of use (working capital, asset creation, new project, export, etc). Borrowing should be purpose specific and aligned to cash flow cycle. Short term funds should not be used to create capital assets. It is an extremely important measure to avoid such temptation to (mis)use short term funds to any long term use.

4. How much collateral they ask? can I borrow based on the asset only?

It is common perception among the small business owners that Bank will give loan only based on collateral. Of course collateral plays a key determinant to open the relationship. How much you can borrow depends upon how is the cash flow. You should stay away from any temptation to borrow without clear cut revenue model before you.

Secondly there are some loan products wherein bank finances solely against assets intended to purchase (for ex truck finance). Under CGTSME scheme of Govt of India, Bank will extend loan without collateral security upto Rs 1 crore.

5. Should you loose heart if you don't get loan from any Bank?

NO, absolutely no

There are many other opportunities to raise the required loan. There are many NBFCs who lend without collateral provided customer is having good profile (Ex Equitas, Visthara,etc) . Also there are few venture funding sources for those which envisages new product development (Ex SIDBI). Also you may explore venture capital /Private Equity/Crowd funding route.

For small businessman it is always desirable to be member of any local cooperative bank as it will help them to borrow in emergencies,

The good profile mainly consists of having good CIBIL score, filing IT returns on time with proper disclosure of profit, ensuring no cheque returns etc.

REMEMBER- Going forward, it is his individual or his company's **credentials** that holds the key to get desired funding support.

6. Do I have adequate cash flow to repay the loan?

Your banker will probably ask you to provide financial projections for the business. Make sure to include your debt repayment plan in those projections. Bankers are interested in businesses that have minimum headroom to service the debt.

7. Will the money sufficient help my business grow or compete the project undertaken?

It is commonplace in India wherein the borrowers agree to lower amount of loan under pressure from the bank, although he is aware that the loan agreed is not sufficient to complete the project or meet the working capital expenses. In the end it leads to distress.

It is strongly recommend to not to start any project or growth plan without tying up the full funds required. Remember Banks' will not show any mercy in distress and will initiate recovery proceedings.

Equally it is important to avoid excess borrowing for any reason as It will be an inducement to disaster.

8. Are my personal finances in order?

Bankers may want to look at your total picture of your finances, including personal information like outstanding home loans, Car loan, personal credit card debt and mortgage payments. Until your business reaches a substantial size, the bank is going to rely heavily on your personal financial statement and personal credit score to determine the creditworthiness of your business. If you have a lot of personal debt and very little collateral that is considered credit negative and you may have to look at alternatives.

9. Do I have all the documentation I need to apply for the loan?

It is observed that more than 75% of loan applications are not fructifying not because of business you are in but for poor paper work. We suggest to keep ready tax returns for the last three years of business and personal, financial statements and financial projections for the next 24 months.

10. If I die, how will the loan be repaid?

It's something most people don't like to think about, but in the event of your death, an unpaid business loan can affect your family. Most business owners give their house as collateral and the business fails, they could lose their house. If you leave a large life insurance policy, for example, the bank may come after that. Otherwise be mindful of risk and have a contingent plan.
