BASIC LENDING GUIDELINES FOR SMALL BUSINESS

THE 5 C's OF CREDIT

The "5 C's of Credit" are the 5 key elements a borrower should have to obtain a loan. Regardless of where you seek funding - from a bank, a local development corporation or a relative - a prospective lender will review your creditworthiness.

A complete and thoroughly documented loan request (including a business plan) will help the lender understand you and your business. The "Five C's" are the basic components of credit analysis. They are described here to help you understand what the lender will be looking for. Each lender and each loan will have slightly different requirements, but the 5 C's are a good starting point…

1. **Capacity**
2. **Capital**
3. **Collateral**
4. **Conditions**
5. **Character**

Capacity to repay is the most critical of the five factors; it is the primary source of repayment - cash. What is your company's borrowing history and track record of repayment? How much debt can your company handle? Will you be able to honor the obligation and repay the debt? There are numerous financial benchmarks such as a debt service ratio that a lender will use before advancing funds. Useful documents: financial statements and cash-flow projections (b-business), personal financial statement (p-personal), tax returns (business & personal).

Capital is the money you personally have invested in the business and is an indication of how much you have at risk should the business fail. Interested lenders and investors will expect you to have contributed from your own assets and to have undertaken personal financial risk to establish the business before asking them to commit any funding. Capital injection by owner is often 30%. So, for example, if project costs are $10,000, then the owner must have $3,000 to contribute in cash or equivalent contribution. Useful documents: sources and uses of capital (b).

Collateral, or guarantees, are additional forms of security you can provide the lender. Giving a lender collateral means that you pledge an asset you own, such as your home, commercial real estate or equipment to the lender with the agreement that it will be the repayment source in case you can't repay the loan. A guarantee, on the other hand, is just that - someone else signs a guarantee document promising to repay the loan if you can't. Some lenders may require such a guarantee in addition to collateral as security for a loan. Useful documents: balance sheet (b), personal financial statement (p).

Conditions describe the intended purpose of the loan. Will the money be used for working capital, additional equipment or inventory? The lender will also consider local economic conditions and the overall climate, both within your industry and in other industries that could affect your business. If your business is sensitive to economic downturns, a lender wants to know that you are good at managing productivity and expenses. If you are out of work and on the verge of losing your home to foreclosure, now is not the time to borrow more money. Useful document: business plan (b).

Character speaks to integrity. The lender will form an opinion as to whether or not you are sufficiently trustworthy to repay the loan or generate a return on funds invested in your company. Your educational background, credit history, work and industry experience will be considered. The quality of your references and the background and experience of your employees will also be reviewed. A FICO score ("credit score") below 650 and/or bankruptcy are most often deal killers. If you have a bankruptcy on your credit history, wait until it is expunged and then wait some more. Useful documents: credit report (b-business), résumé (p-personal).

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