SMART SMEs BANK ON KNOWLEDGE

One of the most common misperceptions around commercial debt is that all banks are the same, but as Pindara Magazine discovered, a better understanding of lending criteria can result in real savings for small business owners.

Understanding the risk appetite of banks can result in significant savings by Australia's diverse SME (small medium enterprise) sector, according to a leading financial adviser with more than 30 years banking experience.

There's no one size fits all and the cost of funds for banks varies depending on a range of factors, including internal pricing structures and the risk profile of the lender.

Managing Director of Cooper Financial Connections, Peter Cooper, says the banks have varied ideas on different industries.

"It is important to understand that no one bank has the same approval process. In years past, the manager had the ability to approve various styles of loans from housing loans to bridging loans to commercial loans, to leasing," he says.

"In the current environment, this has changed significantly. My advice to any SME is to gain a better understanding of this shifting lending landscape. To do that, you have to sit down and put pen to paper. I have so many discussions with business owners and the one thing that reoccurs each time is they wish they had a better relationship with their bank."

While communication may seem like the obvious key to garner the best possible result from your bank, Cooper says that unless business owners can write down a plan as to what their requirements are, banks have little hope of understanding them.

"It's important to remember the person you are completing documents with and who may only take notes is not the approver, but rather the conduit between the branch and credit department. They could have 10 appointments per day," he says.

Another thing to keep front of mind is that banks are like any commercial entity in that they are in business to make a profit and to deliver shareholder value.

"On the other hand, the customer wants value for money. It's important for customers to understand what banks are looking for by way of background and information in order to make an informed decision as to loan suitability," says Cooper.

Banks have similar guidelines, but use different language when describing what they want in terms of loan submissions.

"Business owners need to create a word document that covers the history of the business that can be updated over time and be ready to give to their banker when required," he says.

The document should include the following:

1. How long the business has been running.
2. Management experience in running the business.
3. The vision of the business.
4. Is there a business plan/SWOT (strengths, weaknesses, opportunities, threats) analysis/marketing strategy?
5. Who are the major competitors?
6. How are you driving productivity and efficiency of operations?
7. How are you measuring accountability?
8. How are you measuring the actual performance against a plan?
9. What would happen if you were sick, had a disability or died?
10. How often is the accountant involved in the business?
11. How old are your vehicles and equipment?
12. How many employees?
13. Is the income stream seasonal in any way? For those who operate in a business where the revenue is generated in irregularly, it is imperative to let the bank know that thought has gone into cover during flat trading periods. Your overdraft limit must be sufficient to cover these periods to avoid additional interest, fees or issues around lack of cash flow.
14. Are there any debtors? Keep a record of debtors categorised by age (30, 60, 90 + days) and comment on whether or not the debt terms are realistic.
15. Commercial leasing. Banks will always ask for a copy of your rental agreement. You might be in the third year of a five-year lease and the bank will want to know if you have sought clarifications as to an extension of the lease at the end of the five-year period. Banks want to know the cost of alternate premises if the current lease won't be renewed.
16. Some SMEs live in the comfort of operating a business from home and charging themselves rent. But all it takes is for a neighbour to complain to council and all of sudden that paper rent becomes very real that may be significantly higher to what you're charging yourself. Monitor what the costs could be in the event that this becomes a reality. By doing so you are giving the banks a degree of comfort that you have the 'what if' scenario covered.
17. When is GST due? Is the tax paid up to date? Has money been put aside to make these payments?
18. Have any prepayments been made during the accounting period?

Quite often when dealing in small business, business owners sit down with their accountants to tax plan where it is suggested they make prepayments of some expenses during the accounting period in order to take advantage of up-front payment discounts with the added advantage of creating tax efficiencies in that financial year.

Cooper explains it is often overlooked when applying for finance, to advise the bank that some of these expenses are 'one-off' for that accounting period.

"Your submission could be affected and the loan could be subsequently declined because the cash flow doesn't support the loan unless the bank was to add back that prepayment into the calculations," he says.

Another area small business should understand is that credit cards, while not actually utilised, can be viewed as being fully drawn in capacity calculations in order to have a conservative view on the capacity to repay the debt.

"For example," Cooper explains, "if you had $15,000 in limits, the bank views your position as if that total amount was fully drawn and will question whether you can make your minimum repayments on that fully drawn amount together with the rest of your commitments."

The bank will use a 'plug rate' or servicing rate in determining your capacity to repay, particularly in a low interest rate environment. The plug rate is around two percent above the variable. The reason for this is to make sure the bank does not put any unnecessary pressure on the business.

Cooper advises that prior to visiting the bank, that you make contact with your accountant and advise them of your plans so you can authorise them to talk to the bank about your business.

The following documents will also need to be provided:

1. A cash flow diagram to show how the revenue is dispersed across the various entities, which allows the banker to quickly understand the cash flow of the business.
2. Three years financial accounts on the company.
3. Three years financial accounts on the family trust (if applicable).
4. Three years personal tax returns of the directors.
5. Copy of trust deed confirming its ability to borrow (if applicable).

Note: A start-up business would need to provide at least six months financial projections, including a cash flow statement together with a letter from your accountant detailing the assumptions in order for the bank to consider your capacity to repay the debt.

In conclusion, other likely documents that the bank would require include;

- Rental agreement
- Lease arrangement (motor vehicles, equipment etc)
- Letter of offer for business overdraft (if applicable)
- Hire purchase agreements
- A break up of the principal and interest repayment from your accountant is advantageous as it allows the bank to understand the tax-deductible component. pm