

A Banker's Checklist: Debt Financing

There is no single strategy that will position your entrepreneurial growth company for bank financing. Most banks will evaluate the specific stage and attributes of each company individually as they do their analysis. However, banks differ considerably as to the markets they target, so your first task is to do your homework and make sure you focus on banks that address your firm's industry and stage.

For many entrepreneurs building high-growth companies, particularly those with outside equity backing, so called venture banks are their most likely source of bank financing. Banks, including venture banks, generally use the five "C's" of credit.

Determine your readiness for bank financing against the following checklist.

Capacity. Do you have the ability to repay the loan?

Profits are nice for shareholders, but for banks—cash is king. More to the point, cash from investors and/or cash flow from operations are key for banks. Ultimately, getting your company to positive cash flow will be an important milestone for most lending institutions. Venture banks will consider lending concurrent with or following a first round of venture capital and may allow this static cash to replace positive cash flow – at least in the short term.

Capital. How well and by what means is your business capitalized?

If you are a pre-cash flow company, banks will want to see that you or your venture capital partners have additional capital to invest, if necessary. Banks realize that most high-growth companies will hit inevitable bumps in the road. Thus, having the ability to inject additional equity into the business during these cycles will be an important consideration.

Collateral. Do your assets being financed have value?

In working capital financing, the lender will want to see how well your receivables and inventory are turning over (inventory converting to receivables and receivables converting to cash). In equipment and real estate financing, the lender may want an appraisal to determine value. For venture

banks, intellectual property and/or the enterprise value of the company may be considered in the collateral evaluation.

- ❑ **Character.** What is your character and the character of the management team, and the investors?

Banks will evaluate the trustworthiness of the borrower. Is this the type of management team that will work with the bank to raise important issues early? Will there be open lines of communication? What is the experience and expertise of the team? Have they done this before? Venture banks will also consider their past experiences with the VC firms supporting the company.

- ❑ **Condition.** What are you using the proceeds of the loan for and what is the business environment?

Banks will want to be aware of how their money is being put into use. Is the loan needed to finance trading assets (i.e., A/R and inventory) that are growing to keep pace with revenue? Is the company adding capital assets (i.e., equipment) for future growth? Banks also consider the current business environment. Is this company's market experiencing growth or decline? Is there cyclical nature to their business?

At the end of the day, if you can adequately address the five "C's" of credit, some form of financing, whether from a traditional bank or a venture bank, should be available to you. If you're getting "no's," rely on your entrepreneurial persistence to hang in there until you find the bank that can say "yes."