



excessive funds being withdrawn by owners seeking to support extravagant lifestyles. Therefore, "personal judgment" might also be included under this category.

## Capacity to Repay

This is the least understood area of business financing. Most lenders are able to discern between a legitimate borrowing request and an act of desperation. Simply asking a bank for money because things haven't been so good lately isn't sufficient. The reason should be specific. For example, a "down economy" is not a reason - it's a symptom. The specific reason must address why some customers have left, are buying less, or have switched to your competitors. Once the specific reason is addressed, the lender will need to understand your plan to compensate for each issue. That plan should directly influence the company's ability to repay the loan.

### **Example:**

A small job-shop has seen sales decline by 30 percent in the last 18 months. They analyze sales by customer and learn that four companies have not placed an order in 11 months, eight companies are buying half of what they used to and three customers have gone out of business. The sales people explain two specific problems as follows:

- "Our product # 134 XE is priced too high. Several of our customers are buying the same gauge overseas at 60% of our price."
- "ABC, Inc. has brought their "widget" production in-house as of June, so that was \$12,000 a month we've lost in widget product sales."

The company owner comes into the bank, explains the situation and the reasons behind the decline in revenue. He then proceeds to show the lender how they will compensate for each of the reasons behind the decline:

- Product #134 XE - "While many of our customers have gone elsewhere for this product, they are still buying the "custom" base assembly from us. Therefore, we have re-structured our product-price strategy to package the XE with the Base Assembly as a single unit and our combined price will include a volume discount enabling each customer to save 26% on every unit above quantity #50. We estimate that this strategy will assist us in recovering 60% of our lost customers and motivate 20% of our faithful clients to increase their purchases from us and decrease purchases from our competitors."
- "ABC, Inc is now producing seven times the number of widgets that we are. We've decided to shut down our "widget department" and outsource our future needs through ABC. This will save us three full time positions and provide needed space to support the anticipated growth in our XE and Assembly product. Our annual overhead savings will exceed \$20,000."



Accredited by the Institute for  
Independent Business



Tom Long

[telong@solidoakconsulting.com](mailto:telong@solidoakconsulting.com)

If you're not working with  
BizMACH, you're not using  
the BEST

**BEST - Business  
Evaluation and  
Salability Tool**

*Coming in the Next Issue*

How Debt Affects the  
Company's Value

As a result of these changes, the sales department has projected a first year revenue increase of \$230,000. Operating expenses will be reduced by over \$80,000.

The company owner requests that the bank consider the following:

- Increase the company line of credit from \$200,000 to \$300,000 to accommodate the projected sales increase of \$230,000 annually
- \$50,000 for two pieces of equipment to replace outdated Base Assembly machines
- Re-structure an existing note with two years remaining and accept interest only for the next six months while they implement these changes
- \$80,000 for three new trucks to replace existing vehicles

The owner then turns the page and shows the banker how the proposed changes will affect projected cash flow. He estimates that 80% of the new debt expense will be covered through the overhead savings from outsourcing the widgets. Outsourcing service contracts will save enough to cover 120% of the proposed debt increase. If all of the changes are made and the company achieves 70% of projected results, they'll have sufficient cash flow to cover the proposed debt five times!

---

The above example represents the type of presentation every banker looks for but few ever see. Here is a company owner who understands what's wrong and what affect it is having on profitability. He has analyzed the issues separately and identified detailed strategies to address each one. Finally, he has outlined the repayment capability of this plan by individual strategy and again as a discounted projection of the entire plan coming together. This plan is effective when action is taken early enough. Otherwise, the cash problems create a new debt need that exceeds the company's ability to catch up as discussed below.

### **Collateral to Support the Request**

What most people don't understand is that the reason one borrows should point to the collateral. For example, a line of credit to support growth will be secured by the accounts receivable that are created when sales are made. Purchase order financing is secured by the inventory being ordered and a mortgage is supported by the building and land. Leasing or equipment financing is supported by the machine or equipment. So what happens when a company asks for \$100,000 because it can't cover operating expenses this month or its vendors will require C.O.D. terms? This is one of the most common financing requests and the one that gets declined most often.

When the request doesn't match up to collateral, the loan request is already in trouble but not finished. As mentioned above, waiting too long before approaching the bank allows the growing "cash flow imbalance" to grow beyond the company's

ability to recover. The first sign of trouble is when the "payables" start to grow from 30 to 45 to 60+ days. This means that vendor payments are being held back because the company can't spare the cash. This happens when sales are declining, margins are compressed due to price reductions, customers are paying later and/or expenses have not been adjusted to compensate for revenue or margin issues.

If the damage isn't too great - which is typically a function of how soon one realizes the problem, this situation is often workable. Unfortunately, since the need doesn't point to the applicable collateral, the banker will examine both business and personal assets to determine if there is some insurance against loss. After all, the banker is being asked to assist in fixing a "mismanagement" problem.

Strict bank lenders will test the collateral value against the debt to insure they can get out in a worst-case scenario, but most will still need a definitive plan based on cash flow. Collateral lenders, on the other hand, will advance less against the value of the collateral and may not require a formally documented repayment plan. By advancing less against the value, they remain safe. By not requiring a lot of documentation, they can move quickly and often close a loan in days versus weeks. They also charge premium rates and fees for this convenience.

**BizMACH Affiliates are highly trained business consultants who have relationships with over 100 national lenders.**

**Let your local BizMACH Representative help you get your company back on the road to growth and profitability.**

phone: 800-249-2024

web: <http://www.bizmach.com>

JEMM Corp. dba BizMACH | 841 Worcester Rd. #155 | Natick | MA | 01760