Chartered Accountants of Ontario

Obtaining a business loan

At some point, most businesses need to borrow funds – to upgrade equipment and technology, acquire a competitor, expand into new markets, or simply to have a line of credit that helps them smooth out cash flow cycles. As with any business activity, preparation is the key to success.

"There are a variety of lenders willing to extend funding to businesses, but not all specialize in the same kind of lending," says Chartered Accountant Anna Maria Cicirello, a Senior Manager with KPMG LLP in Toronto. "Having a clear understanding of what the funds will be used for, and how long those funds will be needed, helps in identifying a lender that best matches the funding needs of the business."

That's important because, while approaching multiple lenders might seem like a way to shop around for the best lending terms, doing so can actually decrease the likelihood of obtaining a loan, Cicirello says. Each potential lender will check the business's credit rating, and every check will reduce its credit score. One or two checks normally won't significantly affect the credit rating of a business, but successive checks over a short period of time could disqualify the business from obtaining a loan.

Other advice Cicirello offers businesses searching for a loan:

- **Prepare the right support information for your loan** - If it is to fund the start up of a business, lenders will want to see the business plan; if it is to acquire equipment or property, lenders will want details of that investment; if it is to fund an existing business, such as a line of credit, lenders will want to see the business's financial statements. Being prepared with the right information not only saves time, but also demonstrates to the lender that the borrower is organized, has a clear purpose for the funds, and a plan for repaying them.

- **Make sure senior officers' personal information is in order -** In addition to researching the business's credit rating, lenders may also make enquiries about the personal credit ratings of the company's management, in particular the CEO and CFO. Defaults on personal loans or liens on personal real estate or automobiles could disqualify the business's application.

- **Review the fine print carefully -** Many business loans come with covenants or requirements that the business must maintain during the course of the loan, such as debt-to-equity ratios. Since lenders may call in their loans if any of these ratios are not maintained, it is important that the terms are well-defined and understood if the business is to remain onside. For example, what is considered debt? Is it short-term and long-term? Does it include accounts payable or bank indebtedness?

- **Understand all of the loan covenants -** Banks, traditional financial institutions and private lendors may impose additional requirements, such as requesting that the business maintain a certain amount of cash or prohibiting the business from selling certain assets. Not only should these requirements be clearly defined and spelled out in the loan agreement, the business must also be sure that they won't restrict its ability to operate effectively.

- **Understand the full cost of the loan -** In addition to covenants and amounts to be repaid on the principal and interest, many lenders will also require the loan to be insured. In addition, the business may be required to carry a certain level of insurance as well as key person insurance on the company's senior officers. All of these costs need to be factored into the cash flow for repayment.

- **Consider alternate sources of financing -** Depending on the industry, location, or other characteristics, the business may be eligible for funding that the government makes available to encourage activity in these areas. Usually, these funds are offered on more favourable terms than those of traditional lenders.

- **Consult a professional -** From researching lenders and products, to helping prepare supporting financial documentation, to reviewing the loan agreement, the professional advice of a Chartered Accountant can be invaluable, particularly when loan amounts are large, loan agreements are complex, and specific lending requirements and covenants are involved.