The 5 C's of Credit & Some Tips on Applying for a Business Loan

These are the standard things lenders look for in a business loan application. Your loan application must address these five areas, both narratively and with hard data.

1. **Character**

   Lenders are usually looking at a sole proprietorship or partnership for "character." With a co-op or collectively run business, you need to explain the business as an entity, an institution. Bylaws, mission statement, and other operating documents help explain the nature and systems of the business. Customer loyalty, standing in and connections to the community, and relationships with other businesses can also help show a strong character. Any memberships in trade associations, co-op organizations, or local business groups are also good to mention.

   For co-ops, character can be the strongest part of the application. We generally have customer loyalty and relationships that other businesses would kill for. We also tend to develop long-term and mutually beneficial relationships with other small business. This is a time to pull out the testimonials and any positive feedback you've gotten, and show it off. Remember that sustainable business practices are also a key part of character.

   Co-ops also need to make sure to clearly explain their functional structure: who is accountable, and how do things actually work? Remember that you are asking for money from *bankers*, who are not known for their familiarity with democratic management and governance. Spell it out for them so you don't sound like a bunch of flaky hippies, but instead a solid, together group who will pay back a loan.

2. **Capital**

   What money do you have and where does it come from? Do you have owner equity? Any outside equity? Any equity at all? To whom do you owe money? What is the nature, size, and timing of your debts? (This includes long-term financing for asset purchases, small and medium debts, lines of credit, any credit card debt, and patronage owed.) Most lenders look at a ratio of debt to equity to get a sense of the stability of the business.

   For co-ops, the question of internal capital accounts is important to address here. If you owe current and/or retained patronage to workers, be aware that lenders will often require that you to pay debt service before you pay out patronage, so you need to be able to show that you can manage or have a plan for balancing these obligations.

3. **Capacity**

   Lenders want to know the capacity of the business: how well do you do your job? What is your management capacity, production capacity, staffing plan, etc.? The bottom line here is: what's your ability to fulfill your plans with the money they're about to lend you?

For co-ops, capacity can be one of our strengths. We often have amazing capacity within our staffing, people often do multiple job roles and multiple capabilities. Tons of capacity is built into a non-hierarchical structure, but we need to explain this to lenders, who often equate a management structure with adequate capacity. Look at your overall staffing (labor percentage) and at your job roles, and actually write down who does what, to get a sense of who will do what with the loaned money.

4. **Collateral**

The business's assets: land you own, inventory you have, equipment you own, any equipment you plan to buy. Typical bankers will look at ratios that involve assets, and are not very flexible about these ratios.

For co-ops, collateral can be a real sticking point. This is where strong bookkeeping can help you: be sure to have accurate numbers for the value of all fixed assets and inventory, as every little bit helps. And if you don't have collateral, you just don't have collateral, you can't bluff your way through this as the bank will see it immediately. Loan funds can be more flexible; the never lend without collateral, but they can look less at collateral and more at character and capacity. If you are low on collateral, as many co-ops tend to be, character and capacity become more important.

5. **Conditions**

You lender wants to know how well you understand the overall market conditions: the economy at this point in time, geographical conditions, your market, your industry. Here you need to paint a picture of what your world looks like and what your standing is in that world, one that convinces a lender to lend you money. If you're in a struggling industry you can point out how you're different from your industry, your flexibility and ability to diversify; if you're in a growth industry, explain how you'll capture your part of the market. Lenders also want to see how well you track your industry and your own business, how much data and statistics you can present them (a good lender will have their own data on your industry, so you're going to have to deal with the data at some point in the process).

Co-ops often haven't done a lot of this market research, and you may need to begin doing some for your loan application. You can find a lot of industry and trade information online, but you also know a lot of this anecdotally and just need some numbers to back you up. A good resource here is the Robert Morris Associates Book, which shows industry norms and typical balance sheets for a variety of industries.)

This is also where it's important to have kept good records within your own business, so you can show what trends have been happening for you (overall growth? Growth in a certain product line? etc.)

The bottom line (and some more tips):

Lending money to a business is a risk, and lenders tend be risk-averse. You want to dispel this risk aversion with information: acknowledge the risk, then explain it down, show steps you will take to mitigate and offset the risk.

First figure out how much you need rather than asking “how much will you give us?” This puts you in a stronger position, and gives the impression that you know what you’re doing.

Make sure you understand your finances so you can explain them to the lender. Practice with each other. Do research. Look at things from several angles. Find your weak spots and figure out what you’re going to say about them. Know the proper terms for things.

Remember that in asking for a loan, you will be at a disadvantage to begin with – bankers read Balance Sheets and Income Statements all day long. They know what they’re looking at and what they’re looking for. You need to know what they’re looking at and for too. They also have a heads and books full of information to compare you to, so the more you know your context, the better you can anticipate their concerns.

The process of writing the loan application should help you clarify these questions and get practice analyzing your finances, from first determining the amount you want through answering the 5 C’s above.