

# Knowing banker's mind can help obtain financing

## *Untisting cash needs and where it comes fivrn improves banking relationship*

**W**hile visiting Las Vegas, I was approached by a man outside a casino who asked me for money for a hot meal. I said, "How do I know you won't go inside and gamble it away?" He said, "That won't happen. Gambling money I have!"

This fellow understood the importance of adequate financing; so does the management of every successful business, regardless of size. Adequate financing doesn't necessarily mean having a hidden pot of cash available for a rainy day. It means knowing when you'll need the cash, about how much will be needed and where it's going to come from.

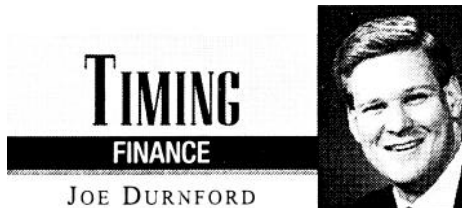
Using funds provided by others has given rise to a whole new language. For example, you can buy it with "paper," do it with "mirrors," leverage the buyout or "bridge" financings.

One source of funding is, of course, the local bank. You use its money and no matter how well you do, the bankers have no ownership. The only things they are entitled to is the money they loaned you and the agreed interest.

Trying to line up the money with your banker, however, will be disappointing if you don't understand the lender's thinking. It can produce many unpleasant surprises and perhaps even some anguish following the closing if certain basic principles are not carefully considered.

Timing is key. Line up the money when you need funds least. Loan amounts, rate, terms and conditions are based on risk. The better your financial position and the near-term outlook, the lower the risk, and therefore, better financing.

Next comes negotiating the terms. Getting the amount you want and living happily ever after means writing in provisions that will come to your rescue if things don't go as well as planned and avoiding provisions that benefit the lender in case things go much better than planned. For example, most loan agreements do not allow the borrower to take on any more debt without the prior wit-



ten consent of the lender. Most lenders also require their prior approval for the borrower to buy another company. If there is any chance that during the term of the loan, your business will enter into other debt agreements or that an acquisition is possible, get some protection in the loan agreement. How? Get the right of prepayment without penalty.

If there is a good reason to take on more debt or the company has the opportunity to make an acquisition, some other lender will be happy to take on all the debt.

Lenders to middle and smaller companies often ask for personal guarantees. Owners flinch at the thought, but need to understand that banks do not necessarily view personal guarantees as collateral. It's really just a very effective way of getting the owner's attention. It's sort of the bank's way of reaching out and touching you.

Fortunately, in today's competitive lending environment, personal guarantees are negotiable. For example, we recently negotiated a \$7 million line of credit for one of our clients. Initially, all of the lenders asked for the personal guarantee of the owner of the business. Ultimately, the lender that was selected was willing to waive the requirement for a personal guarantee.

Another common debt covenant is that the company must limit the amount of annual equipment purchases it can make. If so, come to an agreement on the annual limitation and then make the test a cumulative one. This technique may eliminate the need for a debt covenant waiver or, worse, premature purchases, just to stay within the limitations.

Lenders frequently ask for limitations of officer compensation. Some would say that the lender wants to insure that the borrower does not begin to prematurely enjoy too high a standard of living. Occasionally, I think that the lending officer's standard of living becomes the measure. If so, tie compensation to performance. The greater the earnings and equity, the more flexibility owners should have in determining their own compensation.

The final step is understanding the banker's mentality. Lenders want a high degree of comfort that their loans will be repaid out of operations, not by auctioning the underlying collateral. Therefore, business owners need to focus more on the viability of their operations than on the adequacy of the collateral.

Owners sometimes focus on the interest rate, comparing a prime rate to a fixed rate to a rate with a floor or a ceiling. But basic financing means understanding that the rate is not meaningful if you don't get enough money or don't obtain it for a long enough period of time. The amount of the loan and the terms are much more important than the rate. Also, in comparing rates remember that a lender's effective rate may be much higher than the stated rate if there are fees, long float times, compensating balances or warrants.

It is important for potential borrowers to know that there are numerous financing sources competing to make loans. The key to obtaining the financing you need is to present the right information, to the right group of potential lenders and then negotiate for the terms best suited to your business needs.

Most business owners negotiate relatively few loan agreements; your accountant and lawyer see a great deal of them, so don't negotiate an agreement without first seeking their guidance.

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