FINSYNC

WHAT LENDERS ARE LOOKING FOR

Applying for a small business loan? Think like a lender to strengthen your case and give your business the best chance of getting approved.

Securing a Business Loan Isn't Easy

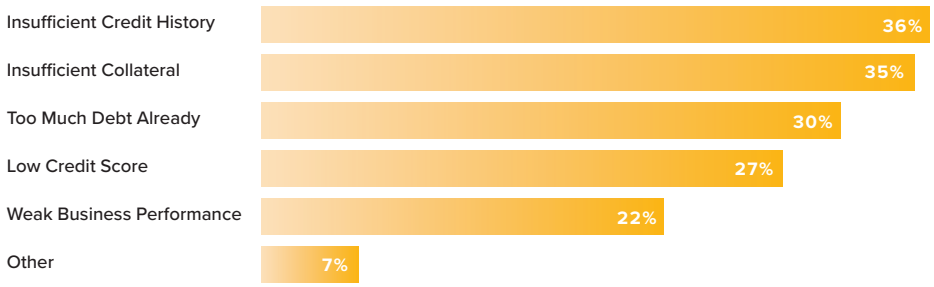
Access to credit is one of the biggest challenges small business owners face. Unfortunately, getting approved for a loan can be difficult.

According to the Federal Reserve's recent Small Business Credit Survey, **54% of small business loan applicants were not approved for the full amount they requested, while 23% of applicants were denied for any funding at all.**

The reasons small businesses were denied funding ranged from poor credit to weak cash flow.

REASONS FOR CREDIT DENIAL

(% of applicants with financing shortfall)



*Source: Federal Reserve Banks 2017 Small Business Credit Survey

Think Like a Lender to Improve Your Chances of Approval

While lenders review a number of factors when considering your loan application, what they're really looking at is your ability to repay the loan. Want to improve your chances of getting approved? Take steps to minimize the risk you represent and maximize the confidence a lender has in your business's ability to repay the loan.

Different types of lenders weigh different factors more heavily. Understanding what your particular lender is looking at most closely will help you know where to focus your efforts to ensure that your application is as strong as possible.

Read along to find out how to best prepare your business for loan approval as you build your cash flow and grow.

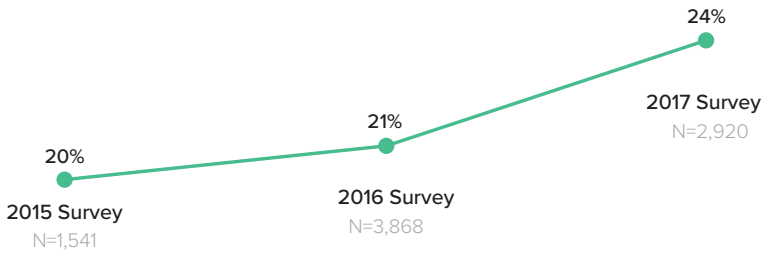
“The 5 C’s” & Beyond

Traditionally, lenders are taught to consider the “5 Cs of Credit”: character, capacity, capital, collateral and conditions. While these factors are most certainly still taken into account when you apply for a loan, technological advances and the introduction of online lenders have started to change the lending landscape.

Cash flow is more important than ever, but a lack of collateral is no longer a roadblock to receiving funding. These days, more small businesses are turning to alternative lenders who generally don’t require collateral. The amount of applicants who applied for a loan, line of credit or cash advance from alternative lenders has grown significantly in the past few years.

BORROWERS WHO APPLIED TO ONLINE LENDERS

(% of loan/line of credit & cash advance applicants)



*Source: **Federal Reserve Banks 2017 Small Business Credit Survey**

The 5 C’s

CHARACTER

Your track record repaying your debts with vendors (credit history) along with your business reputation.

CAPACITY

Your ability to repay the loan (cash flow).

CAPITAL

How much of your own capital you’ve invested in the business.

COLLATERAL

The assets you put up to cover the cost of the loan if you default.

CONDITIONS

Conditions of both the loan and the economy, along with your intended use of the loan.

Know Your Loan Options

Not all loans require a lengthy business history, collateral and good credit to qualify.

EQUIPMENT LOAN

The equipment itself serves as collateral.

INVOICE FINANCING

Borrow money against your unpaid invoices. No collateral required, and poor credit is okay.

SBA MICROLOAN

Loans under $50,000 with low interest rates make this a competitive loan. Startups can qualify, though you will need good credit.

Time in Business

Like many factors that lenders are looking at when you apply for a small business loan, the required time in business depends on from whom you're requesting the loan.

Traditionally, banks require you to be in business for at least two years, though an exception may be made for a (highly competitive) SBA loan, part of which is guaranteed by the government via the Small Business Administration. Some lenders will make an exception for younger companies if your business is getting traction and showing strong revenue growth.

Why is your time in business so important? It goes back to how much risk you represent to the lender. Consider the following statistics, which lenders are well aware of.

ACCORDING TO THE U.S. SMALL BUSINESS ADMINISTRATION'S OFFICE OF ADVOCACY:

Four out of five small businesses (**roughly 80%**) survive the first year in business.

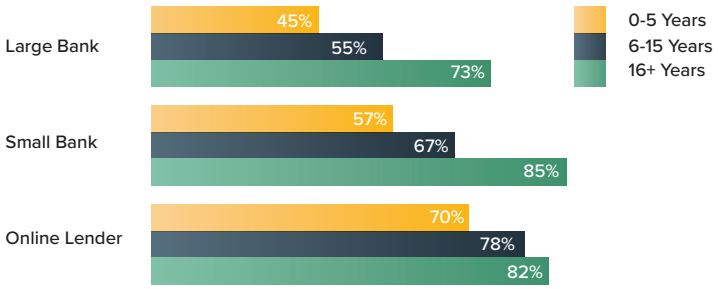
Around half of small businesses survive five years or more, ranging from **45.4% to 51%** depending on the year the business was started.

Only around **one third** of small businesses survive 10 years or longer.

While there's not much you can do to speed up the clock and get more business history under your belt, you can look beyond traditional banks. Alternative lenders tend to have a much less stringent requirement for time in business. Some lenders in FINSYNC's lending network require as little as a month in business. **Younger firms have a more difficult time securing loans than mature firms.**

LOAN/LINE OF CREDIT & CASH ADVANCE APPROVALS BY SOURCE & AGE OF FIRM

(% of loan/line of credit and cash advance applicants)



*Source: Federal Reserve Banks 2017 Small Business Credit Survey

Cash Flow

In the eyes of a lender, cash flow is king as it represents proof of your ability to repay the loan. The strength (or weakness) of your business's cash flow is one of the main factors lenders consider when deciding whether or not to approve your loan.

Ideally, lenders are looking for a history of positive cash flow — when more money is coming in than going out. They want to see that you have enough money to cover all of your monthly expenses, with enough left over to comfortably make a hypothetical loan payment. Dips into the negative are a red flag that indicate risk.

Traditional lenders will consider at least one to two years of your cash flow history, while alternative lenders may look at as little as three months of your bank transactions. It pays to get serious about cash flow management, so now you can build up a history that lenders are comfortable with.

Cash Balances

In addition to positive cash flow, lenders are looking for a history of your ability to maintain a positive bank balance. Ideally, they want to see a balance that's increasing, which indicates that you're growing and getting good at managing cash flow. This is especially important if your business is subject to market swings or other dynamics that can lead to less predictable cash flow.

How Much Are You Asking For?

Asking for either too much or too little can hurt your chances of getting approved for a loan, depending on the type of lender you're working with.

BIG LOANS

Historically, traditional banks lend higher amounts, and have less experience dealing with smaller loans that may not be backed by collateral.

SMALL LOANS

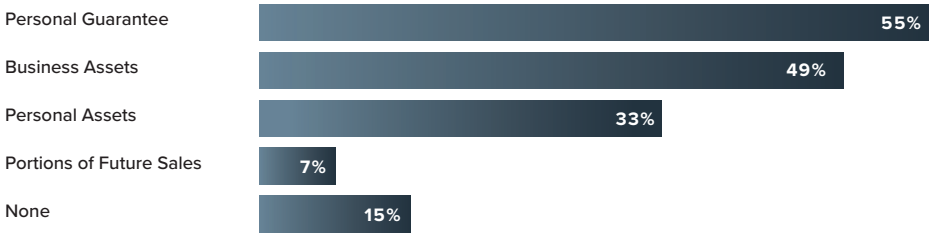
Alternative lenders are more likely than traditional banks to lend smaller amounts, and the application process tends to be faster and easier.

Collateral

Collateral refers to the business or personal assets that you offer a lender in the case that you default on your loan. Collateral can be real estate, savings, equipment, an auto title or other assets. Your lender may also require a personal guarantee.

COLLATERAL USED TO SECURE OUTSTANDING DEBT

(% of employer firms with debt)



*Source: Federal Reserve Banks 2017 Small Business Credit Survey

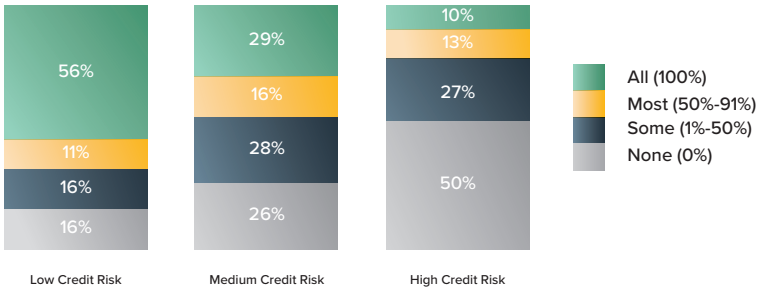
Depending on your operating history and cash flow, a lender may require an assessment of collateral prior to loan approval. This is especially true if you're offering assets that appreciate, such as real estate. Assets that depreciate quickly, like equipment and inventory, won't do much to strengthen your loan application. With this type of collateral, the lender will focus more on the cash flow of your business. These days, not all lenders require collateral. Most alternative lenders offer unsecured loans that do not require collateral.

Credit

Lenders want to see a positive payment history with vendors, as it leads them to believe they can expect the same from you. Likewise, they'll view a negative history as a risk that you won't be able to make your loan payments. Many vendors don't report to the business credit report bureaus — be mindful of the ones that do. **Applicants with good credit are more likely to secure financing.**

FINANCING RECEIVED BY CREDIT RISK OF FIRM

(% of applicants)



'Low credit risk' is an 80-100 business credit score or 720+ personal credit score. 'Medium credit risk' is a 50-79 business credit score or a 620-719 personal credit score. 'High credit risk' is a 1-49 business credit score or a <620 personal credit score.

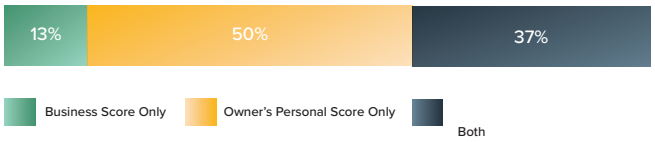
*Source: Federal Reserve Banks 2017 Small Business Credit Survey

Both your personal and business credit can affect your chances of getting approved for a loan, along with your interest rate should you get approved. Lenders often view the credit scores of majority stakeholders as a reflection of the company's ability to repay the loan. The newer your business (and shorter your history), the more closely your personal credit will be considered — especially if you have not yet established business credit.

If you're applying for a loan from a commercial bank, or an SBA loan, your business credit will also be taken into account. Always check both your personal and business credit reports before you apply for a loan, and fix any potential errors that may be dragging your score down. If either credit score is low (below 600 for personal credit), it's a good idea to take steps to improve it before applying for a loan.

USE OF PERSONAL & BUSINESS CREDIT SCORES

(% of employer firms)



*Source: Federal Reserve Banks 2017 Small Business Credit Survey

If you're worried about your credit for any reason, and you don't have the luxury of time to improve your score, you still have options. Alternative lenders are generally more lenient when it comes to credit scores, and often weigh cash flow more heavily when making their lending decision.

87%

OF LOAN APPLICANTS RELY ON PERSONAL CREDIT SCORES TO OBTAIN FINANCING.

*Source: Federal Reserve Banks 2017 Small Business Credit Survey

Business Profile & Reputation

In addition to considering the length of time you've been in business and your credit history with vendors, lenders will also consider the industry you operate in, makeup of customers and online reputation.

Businesses operating in industries that are subject to market swings and scrutiny are considered higher risk than those with more predictable patterns and favorable coverage. A growing, diverse customer base with repeat customers represents less risk than a business with nascent revenue and no repeat customers.

Your business profile also includes your reputation. **Online reviews from customers and employees can strengthen your application,** especially when you plan to use the funds to serve more customers and keep your team happy and growing.

Your Future

The "5 Cs" is a traditional assessment of credit based on where your business has been, but thankfully a growing number of lenders are using new technology to analyze where your business is going. This is good news, as it can help more businesses qualify for financing.

While traditional lenders tend to make decisions based solely on your past cash flow, **more lenders are starting to take future cash flow projections into account.** Future projections are an opportunity to show these lenders where you expect to be with the help of their funds, which may tip the scales in your favor.

To be clear, we're not saying that lenders are turning into venture investors. An operating history with positive cash flow will always be the most important factor for lenders. However, this new model allows you to combine a positive history with plausible projections to build credibility in the eyes of lenders so you can obtain the capital you're looking for.

About FINSYNC

The old way businesses processed payments was decentralized, expensive and insecure. Accounting and cash flow forecasting required data input – often from many systems, and applying for a loan was a cumbersome exercise for both the borrower and lender.

FINSYNC set out to solve these problems and help more businesses succeed with a new class of financial software: Cash Flow Management.

FINSYNC's all-in-one platform helps businesses centralize control of payments, manage cash flow and grow. In a single platform, businesses can collect income, pay bills, process payroll, automate accounting, forecast cash flow and access fast, flexible and affordable financing through FINSYNC's Lending Network.

Businesses using FINSYNC benefit from improved operational efficiency, lower operating costs, better analytics and quicker access to lower-cost capital.

Banks, credit unions and lenders join the FINSYNC Lending Network to receive loan applications electronically and benefit from advanced analytics and automation.