

Why do you need a business plan to get a bank loan?

Description

Why do banks often want a business plan from you, when your are applying for a bank loan or a SBA loan to get financing for your business projects?

Why does a bank need a business plan?

For security, risk assessment and preparation reasons.

Writing a business plan is often necessary to apply for a bank loan, because banks:

- Like to minimize risk
- Want to get their money/investment back (with interest of course)
- Assess if you are worth the risk
- See whether they will make money on your business returns

What do banks look for when you apply for a bank loan?

They look at your financial numbers, assess the risk they run in supplying you with cash and checking the repayment possibility through returning cashflows and profit.

But they look for 2 major things (as any investor will tell you).

The man and the plan (business/team). The entrepreneur, you and your team, is important. They will ask: What is your background, do you have experience, why are you starting out, what will you do, how is your psychology, what type of entrepreneur are you, how are you motivated, do you provide your own cash upfront, how is your business network, how is your credit rating, do you have any prior loans, etc.

The â??manâ?? (and team) is most important for driving the business. Itâ??s the type of entrepreneur (drive) which makes the real difference,

Then of course the market opportunity (which business are you in? Is the industry profitable? Are there any similar companies or business concepts driving the same value numbers? Is there real market demand? Can you prove it already?

Do you already have customers or partners (called market traction). How large is the market? Does it solve customer pain? is of similar importance, as you need both.

Then the financials become relevant. What is the market opportunity size, how much money will you earn (estimate). How much do you expect to get in revenue. Is this really realistic? You need to show it to them and have the numbers ready.

These financial numbers are important

These 10 key financial numbers a bank or loan provider looks before checking your loan application. For starters it about:

1. Revenue
2. Cost
3. Profit
4. Solvability
5. Cashflow (for checking the repayment rate)
6. Balance statement
7. Profit statement for a few years (P&L for a few years, you could do 3 or 5 years estimation)
8. Capital Expense (what are you going to spend the loan on)

Of course, if you are starting out, you are guessing or and estimating how much revenue you will make. After researching the market thoroughly (which will also trigger business ideas and possible improvement of your concept), these numbers will get more real.

So you need to prepare them and know what they are. So you need to have financial plan in excel preferable to show the numbers. It also helps if you have skin in the game, or a bit of your own money already invested. This shows commitment.

When you know what these financial numbers mean, youâ??ll have a better financial understanding of your business situation. This in turn improves your (financial) control of the business, which then enables you to really know whats going on.

Tip â?? keep a monthly financial statement on how you are progressing. Work with an accountant if you have one, and get monthly financial reporting, and have access to the tools yourself. Financial control is essential for your business, and you need to be on top of things.

Check your credit rating if needed

What is a credit report? A credit report is a record of a businessâ??s financial history, including loans, payment behavior, and credit usage. It helps lenders and investors assess the companyâ??s ability to manage debt and meet financial obligations. Including a credit

report in a business plan builds credibility and increases the chances of securing funding.

Calculate how much you can loan

Calculate how much you can loan, need, and need to repay (financial repayment, financial cost of the loan), to get a feel of your financial bandwith, vs how much you need to loan for doing x.

You could try to use this loans payment calculator.

Please be mindful of the difference between invesment (will generate a retun) and using a loan for personal consumption (cars, etc.). Remember loans cost money, but it can greatly enhance your possibilities (if applied properly).

How to create a financial business case or financial business plan?

A good way to start the financial businessplan is having a separate excel sheet of your business model. That means calculations. A lot of them. At first start just with a few numbers, then you can expand. Excel is very helpful this.

Building your business case into revenue, cost, profit, per month / year, working out how much you can earn, is very important. Having these numbers ready at the moment before applying for a bank loan in essential. It is the same if you pitch for an investor. The financials are a part of the core of the company.

A bookkeeping software tip

Also checking in advance for any good bookkeeping software really helps in getting the infrastructure up and running the financials. Need bookkeeping software for small businesses? Try Zero. [link]

What should be in your financials overview (at minimum)

- Expected Revenue + Cost of your business
- Profit & loss (profitability) (the return)
- Balance (status)
- Cashflow / Liquidity statement â?? how much money youâ??ll generate per month (in and out)

Loan and Capital Expenditure (CAPEX).

If you apply for capital / a loan you need to show *how* you will spend the money (investment, staffing, growth, promotion, inventory, store, etc.) and how you will pay for the interest + principal (with cashflow / profit). Also is it a one time investment, or a continuous support for the business (for example to pay for staff, or write downs). or

Approach

Take enough time (at least 3 months, to think /digesting reviewing, asking around) in developing in the financial plan, writing the numbers.

Great tip: ask your peers or a bank consultant and send them the financial businessplan to get their opinion. This really helps. Their questions and feedback will sharpen up your business case. This sparring will help you clarifying your situation. You can also find help at your local chamber of commerce to perhaps review your plan.

and if its really new, just ask (potential) customers if they want to buy your element and then try to deliver it..

If youâ??re not qualified or are not willing to go the banks, there are other ways to get capital for your business.

Ideas â?? Other ways to get capital for investment

There also a number of ways where to get capital, and not from banks.

- Friends & fools / family â?? most used for small businesses
- Government grants & subsidies â?? however sometimes lots of paperwork / specialized
- Own savings â?? if you put in your own savings, you will be more conscious (skin in the game)
- Crowdfunding
- Investors (angel investors)
- Other enterpreneurs â?? mind â?? losing control of business, and gain extra businesspower
- Try to get excess money from job and then save it for the business
- Franchising organizations (sometimes a franchising organization could provide you with some of the capital requirement as a loan)
- Using existing cashflow to fund growth (small investments)
- Try to minimize capital needs (on a shoestring) â?? working with volunteers, free software, and running a business with low startup capital needs â?? but then you grow slower.

How to minimize your capital need

If you canâ??t get the bank loan, try even to minimize your capital needs (operate on a shoestring budget). This is just how to get by. But keep in mind you could grow your business faster with extra capital. You could try these creative ways:

- Work a job and use free cashflow from your job for investing bit by bit
- Work with volunteers/friends who might have the same interest in the area
- Location sharing (share a location with a existing entrepreneur to facilitate any storefront)

- Try asking your potential user group with some research to already assess the market (market research)
- Pre sales (ask customers to pay upfront and then support the service (front end cash loading)
- Ask mentors or other enterpreneurs for their advice (very helpful, because they know its not easy)
- Shop in shop approach, maybe work in another store (if the store owner is willing ofcourse), and then propose your offer within this store

So be smart about your finances and good luck getting the capital for your business!

Please note: this is not financial advice.

Category

1. Finance

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1. Funding
2. Business Plan
3. Small Business
4. Bank Loan
5. Finance
6. Financial Services

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